UNFAIR BUYBACKS

Buybacks

Under a *buyback* scheme, the company repurchases outstanding shares of the company in order to bring down the number of the company's shares in the market. The company extinguishes such repurchased shares.

A *buyback* is done by the company for several reasons:

- to improve the company's performance ratios such as EPS, return on equity
- to distribute to shareholders surplus cash held by the company which is not required for the business
- as a protective measure from hostile takeovers
- to increase the promoters' holding in the company
- to delist the company

Buyback schemes against minority investors

- Earlier, companies (usually MNCs) which desired to delist used the buyback process as a tool to bring down the public shareholding below 10% which would allow the companies to delist its shares. But now as per SEBI's new Takeover Code "if after buy back the promoters' stake increases to more than 90% then it has to compulsorily first bring down its stake in the company to 75% within one year".

- In India, Sec 77A of the Companies Act, 1956 is the route / law to be followed for buyback, but many companies have wrongly used section 391 of the Companies Act, 1956, which is generally followed for mergers and acquisitions. This section (391) is followed to carry out restructuring of capital, after approval by shareholders and creditors and appropriate court sanction.

- Section 391 of the Companies Act, 1956, lets the company avoid many of the checks and balances that exist under the normal buyback route under Sec 77A. Under Section 391 there is the provision of **negative consent**, whereby if the shareholder does not explicitly reject the scheme, it would be assumed that he/ she has accepted the scheme. This clause is considered investor unfriendly and a bad corporate practice.

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Sect 77A	Sect 391
Buyback cannot exceed 25% of the net worth	No such restrictions
Payment to be effected only in cash	Companies can use other means
Post buyback debt to equity ratio should not exceed 2:1	No such restrictions

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SEBI's amendments to SEBI Regulations 1988 buyback, as on 25 June 2013

To align with changing market realities and to enhance the efficiency of the buyback process, the following amendments were made:

- Minimum buyback has been increased to 50% from existing 25%.
- Maximum buy back period has been reduced to 6 months from 12 months.
- The company has to create an escrow account towards security for performance- with an amount equivalent to at least 25% of the amount required for buyback.
- The company shall not raise further capital for a period of one year as against existing six months under the previous regime.
- The company shall not make any buyback offer within a period of one year from the date of closure of the preceding offer.
- The promoters of the company shall not execute any transaction, either on-market or off-market, during the buy-back period.

The companies can buy back 15% or more of networth (paid up capital and free reserves) only by way of tender offer.

CASE STUDIES

Sterlite Industries Ltd (2002)

Sterlite Industries Ltd (SIL) at its board meeting held in December 2001 approved the *scheme of purchase* and consequent cancellation of equity shares of the company. They used the provisions of Section 391 to pursue this. Sterlite planned to purchase a maximum of 50% of outstanding equity shares i.e. 2.8 mn equity shares of face value Rs 5 at a consideration of Rs. 150 per share. The consideration was to be discharged in the form of Rs. 100 in cash and Rs. 50 by way of 10% secured non-convertible debentures, redeemable 35% each in the 4th year and 5th year and 30% in 6th year. SIL mailed cheques representing 2/3rd value of the investors' shares holding (the cash component). This confused many investors who thought it was mandatory to accept the cheques. Where investors had not replied back/not returned cheques, it was deemed that they have accepted the scheme and were ready to surrender their shares in the company.

Status: In June 2002, SEBI moved the Bombay High Court requesting a stay on the buyback since they viewed the scheme unfair to investors. However in July 2002, the High Court rejected SEBI's contention. Under the buyback scheme, 20,068,004 shares, i.e. 35.8% of the share capital, were repurchased by the company and extinguished. The Promoter's stake in the company increased from 43.1% to 67.3%.

Godrej Industries Ltd (2002)

Godrej Industries also used section 391 of the Companies Act, 1956 for buyback scheme. GIL sought a negative consent from investors for its buyback offer. GIL planned to purchase a maximum 40% of equity shares i.e. 24,684,087 equity shares of face value Rs 6 at a consideration of Rs. 18 per share. GIL ultimately purchased 13,068,276 equity shares (21.2% of total share capital) and cancelled them. The Promoter's stake increased from 71.4% to 88.6%.

UNFAIR DELISTING

Delisting

Delisting means a permanent removal of shares of a listed company from public trading on the stock exchange. Shares are acquired by the promoter of the company and then taken off the exchange. Delisting does not reduce capital of the company and can be voluntary or forced.

Delisting may be viewed as unfair when shareholders feel that the exit price offered is lower and not reflective of the company’s true worth. When the markets are down the exit price is generally much lower than the company’s book value. Minority shareholders often conclude that they do not have much of a choice and end up surrendering their shares at the exit price offered- they fear their shares may turn illiquid once the shares eventually do get delisted.

CASE STUDY

Fresenius Kabi Oncology Ltd (Fresenius): Delisting

In order to meet SEBI’s minimum public shareholder limits Fresenius went for Offer for Sale (OFS) and the promoters divested 9% from their holding of 90%. The promoters’ stake came down to 81%. The promoters then proposed to delist the shares of the company. It is observed that after increasing public shareholding through OFS route the company suddenly changed track and chose to get delisted.

If the company were to get delisted pre OFS then the promoters would have had to buy back at least 5% (half of the public shareholding of 10%) After OFS the company had to buy back at least 9.5% out of the 19% public shareholding.

SEBI received complaints from investors alleging that the entities which recently purchased shares in the OFS may have participated in the OFS with intent to subsequently tender their shares at an artificially higher price in the bid for the delisting offer. The shares sold recently in the OFS were 9% and a 9.5% buy back was required to delist the shares of the company. The logic of such moves is not clear.

Status: SEBI in its order dated 22 July 2013, allowed the promoters to proceed with the delisting, subject to the condition that, the pre OFS promoter shareholding [i.e., 90% and not 81%] be considered for computing the percentages for buyback under regulation 17 of the SEBI (Delisting of Equity Shares) Regulations, 2009 (Delisting Regulations) to determine whether the delisting is successful. This meant that promoter had to take their holding to a minimum of 95% in order to delist its shares from stock market. However in the present case, the promoters had to increase their holding to just the minimum of 90.5% to get delisted.

However, Securities Appellate Tribunal (SAT) in its order dated 10 September 2013 allowed the promoters of Fresenius to go ahead with the delisting offer without the condition imposed by SEBI. SAT was of the view that the law must operate uniformly to maintain its sanctity and there can be no question of SEBI specifying a different criterion. The allegations made by the investors that the investors who purchased shares in OFS were acting on behalf of the promoters could not be proved.

IiAS Comments

Though the above practise is not likely to be categorized as a fraud, the manner in which the buyback was conducted appears to be against the interest of investors/minority investors as it leaves them with limited choice.

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