Tope Adebayo LLP
Legal Practitioners and Arbitrators

SHARE BUYBACK SCHEME AN UNEXPLORED CORPORATE MANAGEMENT TOOL

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INTRODUCTION

A share buyback occurs when a company repurchases its shares from its shareholders. It is a situation where a company is investing in itself. In the past, this had given room to unscrupulous managers and promoters of companies to perpetrate fraud by creating an artificial buoyancy of the shares of companies and encourage dangerous speculative trading of shares by buying back shares through loans and luring the unsuspecting general public into dealing in those shares under the erroneous financial health of the companies created by them.

Yet, share buyback could also serve as a legitimate corporate management tool to deliver more value to a company's shareholders and stakeholders in the capital market. In fact, it could be positively employed by a company to achieve including but not limited to:

1. returning surplus cash to shareholders;
2. increasing the underlying share value;
3. supporting the share prices during temporary weakness;
4. achieving or maintaining a target capital structure;
5. preventing or inhibiting unwelcome take-over bids.

For these and other positive uses, a share buyback mechanism can be deployed, the Companies and Allied Matters Act (CAMA) Cap C20 LFN, 2004 and the Securities and Exchange Commission (SEC) Rules allow companies albeit with restrictions to buy back their shares.

As the economy continues to recover from the global financial recession, share buy-back has become a veritable option to companies who are flushed with cash but experiencing depressed share prices, in ensuring long time investors confidence. The anticipated move by companies to embark on this scheme in order to add more values and increase the demand for their shares necessitates the need to examine the scope of the restrictions placed on companies as regards the manner in which the buyback will be carried out, the procedures, time frame and proportion. By the same token, this write-up also examines and articulates the general requirements and procedure in CAMA for the reduction and cancellation of share capital, a consequent action upon the repurchase of shares, as a company cannot act as its own shareholder.

This will be done by outlining the requirements of CAMA as they relate to share buyback with emphasis on public companies, bearing in mind that buybacks are normally employed by publicly quoted companies whose shares are freely traded on the market and subject to the provisions of the SEC Rules . Although, this piece focuses on the public companies, discussion of this scheme shall also entail its applicability by private companies, the restriction on the share transfer , the fact that their shares are not traded on the market thereby making it difficult if not impossible to determine the value of their shares through the company performance or the market and the different legal consequences vis a vis public companies.

RATIONALE FOR SHARE BUY-BACK

The natural starting point in discussing the rationale for share buy-back and the need to regulate same are the provisions of Sections 158 to 165 of CAMA which regulate the transactions of companies, both public and private, in respect of its own shares. As earlier observed, CAMA forbids a company from acquiring; either by itself or financially assisting others; its own shares save for the legitimate exceptional situations provided for in CAMA in line with international best practices of safeguarding the general public including the minority shareholders of the company from the fraudulent practices which the controller of the affairs of the company might want to perpetrate with the buyback mechanism .

However, modern business expediency dictates that absolute prohibition of share buy-back by companies will do more harm than good hence government intervention through regulations. Sections 158, 160(2) and (3) to 164 of CAMA provide for the exceptional legitimate circumstances in which a buyback by a company will be permissible for the following purposes:

1. Redemption of redeemable preference shares;
2. Settling or compromising a debt or claim asserted by or against the company; or
3. Eliminating fractional shares; or
4. Satisfying the claim of a dissenting shareholder; or
5. Complying with a court order; etc

It must be noted, however, that where the company buying back its shares is not a publicly quoted company and has not altered its Articles of Association to cancel or reduce its shares, such a company can still make the repurchased shares available for re-issue . Meanwhile where the company is not authorized by its Article to buy-back its shares, it must alter its article in line with Section 48 and proceed with the purchase in accordance with the provisions of CAMA. Section 48 of CAMA articulates the conditions that must be followed by other companies who are desirous of buying back their shares and reducing/or cancelling the repurchased shares. These conditions do not apply to a publicly quoted company save as they are made applicable to them by the SEC Rules.

BUY-BACK SCHEME BY PUBLICLY QUOTED COMPANIES: THE PROCEDURE

The Securities and Exchange Commission (SEC), in line with its powers to regulate the capital market as conferred on it by the Investments and Securities Act 2007 (ISA), makes rules and regulations for the effective and efficient discharge of the functions so reposed in it. One of those rules is Rule 109B (as amended) that deals with share buyback by public companies or publicly quoted companies. The general conditions for the buyback scheme is encapsulated in Rule 109B(2) which provides that

"Every company acquiring its own shares shall file an application with the Commission for the approval of such acquisition accompanied with detailed information about the transaction including the company's latest audited financial statements."

This further confirms the Commission's power of supervision and control over the approval of buyback schemes that are carried out by publicly quoted companies.

For a buyback to be done by a publicly quoted company, it is required to satisfy the following conditions:

- The company's Articles of Association must authorize the buyback. Therefore, where the Articles do not, the company has to alter its Articles as discussed above under CAMA.

- The aggregate number of shares to be repurchased by the company must not exceed 15% of the company's existing issued and paid up equity capital in any given financial year.

- Filings from the directors before and after the buyback scheme in relation to their compensation packages.

- The company shall make an undertaking that the repurchased shares shall not have any voting rights attached to them. This is also the case even when the shares are repurchased through a nominee or trustee of the company.
- The buyback of the shares shall be done through a special resolution in line with the CAMA provisions on special resolution.

- The Notice of the General Meeting in which the buyback scheme will be authorized shall be published in at least two (2) national daily newspapers and evidence of the publication shall be filed with the Commission.

- The company shall make a public announcement in at least two national daily newspapers, at least 5 days before it commences the buyback scheme and the announcement shall disclose relevant information to the public as to the proposed size, nature, duration and the impact of the scheme on the financial position of the company. Same announcement must also be made after the conclusion of the buyback scheme.

- The buyback must be a direct purchase made only by the company and the beneficiary shall be the company.

- The purchased shares shall be cancelled by the company in line with the procedures laid out in CAMA.
- Redeemable shares shall not be purchased at a price greater than the lowest price at which they are redeemable or shall be redeemable at the next date thereafter at which they are due or liable to be redeemed .

FUNDING BUYBACK

The Rule requires that the source of funding the buyback of shares must be disclosed. It further provides that shares shall only be bought back out of:

- The company's share premium account; or

- The accumulated profit of the company which would have been otherwise available for dividends which shall be reflected in the company's last audited account.

The share buyback shall either be through:
- Open market: this involves the company repurchasing its shares on the floor of the exchange at the prevailing or current price. The company is however precluded from using more than two stock broking firms for the scheme. The stock broking firm must not be a subsidiary of the company.

- Tender offer which is an arrangement where the management will offer to repurchase a part of the company's shares which is not more than 15% of the company's existing issued and paid up equity capital in any given financial year and within a specified period which is not more than 12 months from the date of shareholders resolution . This mode gives the Board of Directors a qualified discretion to fix the price at which the company can repurchase its shares which will not be more than 5% above the average market price of the shares over the last 5 days.

JUSTIFICATION FOR REGULATION

Rule 109B in its entirety is geared towards safeguarding the interest of the company and protecting the general public from the sharp practices of some company directors and controllers. More importantly, it is to ensure that the company remains solvent after a buyback scheme and minimize to a great extent the incidence of fraud through the scheme that could jeopardize the financial health of the company. Therefore, in ensuring the buoyancy of the company after a buyback scheme, the Rule provides that the shareholders fund of the company shall not fall below any legally prescribed minimum for the line of business which the company is involved in.

The significance of this is to protect and ensure that some key sectors and industries in the nation's economy like banks and other financial institutions, insurance companies, pension fund administrators who are legally required to maintain a particular minimum capital balance under their relevant laws do not breach such laws. In the same vein, the Rule provides stringent provisions to ensure that the company remains a healthy going concern after a buyback scheme.

These provisions require the disclosure of most recent financial information and publicity of the shares bought back before and after the buyback scheme from the company, its directors, auditors and financial advisers. Companies are further required to place adverts in national daily newspapers that must disclose relevant information to the public as to the size, nature, duration and potential impact on the company's financial standing of the buyback scheme. It is a further requirement of the Rule that notices and filings are done both at the CAC and with SEC. In line with the Rules' objective of ensuring the solvency of the company after a buyback scheme, it prohibits arrangements that may suggest a conflict of interests by prohibiting a buyback facilitated by a stock broking firm which is a subsidiary of the company involved in the buyback scheme.

The company's Board of Directors must file a declaration of solvency that they believe that the company will be solvent in the foreseeable future . Thus, the buyback shall not be made if the company is illiquid i.e. a company defaulting in payments of its obligations including dividend payment. In this wise, a letter on the going concern status of the company by Auditors shall be filed with the Commission to convince the Commission that the company shall remain in liquid .

In the same vein, the residual debt-equity ratio of the company after the buyback scheme shall not exceed 2:1. The equity for this purpose is the shareholders' fund to protect the company from volatile earnings as a result of high interest rate to service the debt which may impact negatively on the financial health of the company. Furthermore, "the Company and its financial adviser shall file a monthly report not later than 5 days after the end of each month, indicating the number of shares bought, the total amount paid, the minimum and maximum price, and the number of shares cancelled" .

These rules are provided to ensure that the company remains solvent after the buy back.
The rules provide for a maximum period of 12 months for the completion of the buyback scheme from the day of the shareholders' resolution and further provide that any two buyback schemes must be separated by a period of 365 days after the end of the preceding buy back even where they are of different classes.

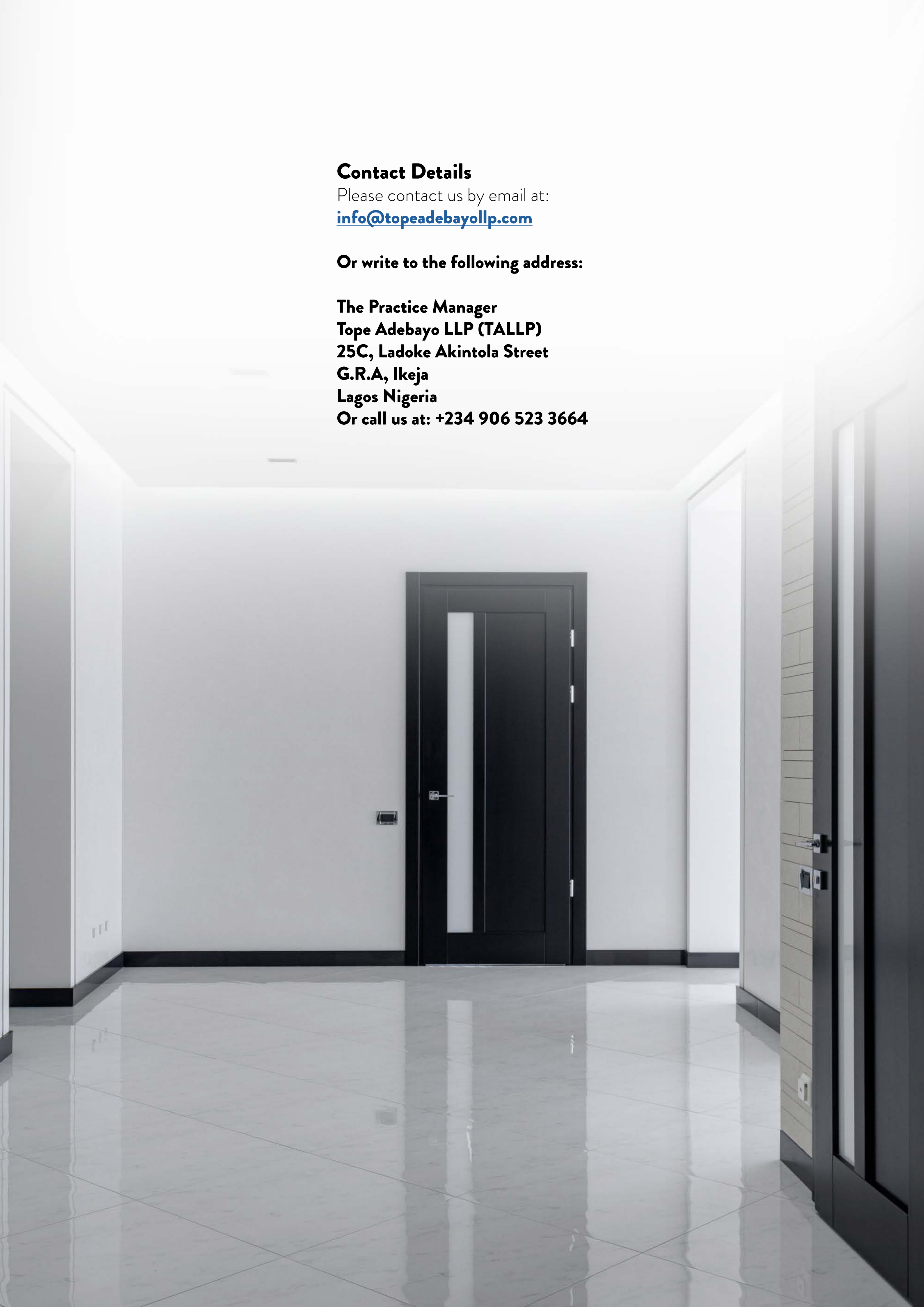
The shares bought back shall be cancelled in accordance with the procedures laid out in CAMA . Therefore, there is a need for the company to reduce its share capital to dispense with the acquired shares as a company cannot be its own shareholder.

CONCLUSION

It is clear from the above that SEC rules do not apply to companies not quoted on the Nigerian Capital market and that the provisions of CAMA cover those companies when it comes to share buyback scheme. Although, the new rules on share buyback may prove very useful to protect the general public and investors in the capital market, it has also imposed a higher cost on the companies as the buyback scheme transaction is now more expensive.

The effect of SEC rule on buyback is that publicly quoted companies can only cancel the bought back shares and cannot add them to their treasury as practiced in other jurisdictions.

It is instructive to note that just like every scheme in the capital market; the share buyback scheme has its advantages and disadvantages. But, in general, a share back scheme announcement by a company management is a veritable way of asserting the financial soundness of the company and boosting investors' confidence in both the company and the economy. In fact, it is arguably the most effective way of communicating to the investing public that a company's share price is undervalued and that the company has enormous potential for growth with great and bright prospects.



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