DITRECTORATE OF DISTANCE EDUCATION
NALSAR University of Law, Hyderabad

Post-Graduate Diploma in
Financial Services & legislations

MODULE V

EQUITY AND DEBT RESTRUCTURING

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EQUITY RESTRUCTURING

- Between company and shareholders –
  - Alters the fair value.
  - Rights Offering
  - Stock Split
  - Stock Dividend (Bonus Shares)
- Adequate returns to shareholders
- Boosts investor confidence

- A tool for
  - Write off losses
  - Increase liquidity of stock.
- Trend to use free cash
  - Buy back of shares
  - Pay Dividend
- Objective assessment of future cash requirements
  - For investments
  - For M&A’s
- Prudence plays an important role.

ISSUES OF PUBLIC SECTOR IN INDIA

- Use of free cash
  - Go by the Govt. diktats
  - Dividend / Bonus Shares
  - Share buy back
  - Stock splits
- Rule book/guidelines
  - Not having futuristic view

- Dividend Policy
  - Companies are now mandated to have a Dividend policy.
  - To be approved by the BoD.
  - Posted in the website.
- Annual Budget plans are reviewed and the Dividend is recommended.
- Safe to have a policy of maximum dividend payable.

- Before approving the Dividend – BoD to –
  - Consider future expansion needs
  - Capex
  - Profit earned
  - Free Cash Flow
- Bonus Shares
  - Reward for Shareholder
  - Impact on the share price
  - permanent to service by payment of dividend
  - Leads to reduction in future Dividend
- Bonus Debentures could be alternative

BUY BACK OF SHARES

- Drain on cash of the company
- Reward to Shareholders
- Promoters equity holdings increases (consolidation of promoter holdings)
- Boosts investor confidence.
- Resurrects the share price in the markets.

STOCK SPLIT

- Increases liquidity in market.
- Encourages investors to enter the market.
- Price of stock falls and is affordable to small investors.
- Prospects are greater for growth in price of shares in future.

BUY BACK OF SHARES PREFERRED ROUTE

- Shareholders are rewarded as the price offered is normally higher than price in market.
- Improves shareholders value – Higher Earnings per share.
- Provides safeguard against hostile takeovers – increases promoters control
- Enhances the intrinsic value of shares.

- Financed by / through internal accruals
- Promoters can use the route to manipulate price of shares or enhance the holdings.

LEGAL PROOVISION – Sec 68 – 70 Companies Act

- Buyback can be made from –
  - Free reserves
  - Share premium Account
  - Proceeds of any previous issue of security.
  - Authorized by articles.
  - Special Resolution of members
  - Upto 10% of paid-up capital and free reserves – no shareholder approval needed.
  - Approval of BoD is sufficient – at meeting of BoD.
  - Debt to net-worth - maximum 2:1
  - Fully paid shares only can be bought back.

- Notice / explanatory statement to shareholders contain
  - Rationale
  - Necessity
  - Class of shares
  - quantum
  - Amount to be invested
  - Time limit for completion
- Share Buy Back can be
  - From existing shareholders on proportionate basis.
  - From open market
  - From employees given under ESOP scheme

- Declaration of solvency by directors (2) filed with ROC (SEBI) – only for listed companies.
- Solvency certificate not needed for other companies.
- Extinguish shares – Bought back
- No further issue of shares bought back for 6 months – except bonus shares.
- Data to be maintained in a separate register.
- Filing with ROC and SEBI
- Creation of capital redemption reserve equal to the nominal value of the shares bought back.
- Capital Redemption reserve to be used only for issuing bonus shares.
- Purchase of shares through subsidiary or another group investment company not permitted

DEBT RESTRUCTURING

- Is done to avoid risk of default on payment of loans.
- To pay off high cost borrowing with low cost borrowing
  - reduction in interest rate
  - Swap of debt for equity
- Companies on brink of bankruptcy restructure debts.
- Creditors accept to avoid bankruptcy of the company
  - Priority of payments to certain creditors over other creditors

RESTRUCTURING DEBT – HOW DONE?

- Reduction of interest rates
- Extending due dates of payments
- Write off of interest of bond holders
- Call option - to recall bonds with higher interest.
- Creditors accept something as against nothing.
- It enables companies to save itself from closure / winding up.

CORPORATE DEBT RESTRUCTURING

- Provides a lifeline to companies to survive.
- Its done when a business is viable but is not profitable due to
  - Change in policy of Govt.
  - Enhancement of interest rates
  - Change in value of currency
- CDR enables companies to maintain viability

- CDR scheme – introduced by RBI in 2001
- Voluntary process
- If 75% of creditors agree, the rest have to fall in line
- Available only if multiple lenders / creditors.
- Non statutory process
- Is possible in cases referred to
  - BIFR, DRT, suits filed for recovery
- CDR is done when a company is unable to pay the sum in full.
- Creditors forego certain amount in exchange for equity

CDR SCHEME

- Plan for restructuring to be drawn
- CDR cell scrutinizes the plan
- If found feasible, it is referred to lenders
- Empowered groups approve the scheme of CDR.
- Implementation of the scheme if agreed to by all.