-THE LAW ON-

SHARE BUY BACK BY AN UNLISTED LIMITED LIABILITY COMPANY

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Introduction

Share buyback is when a company buys its own shares from shareholders or investors. This has several advantages to a Company that is a going concern.

a. It is a way of increasing the value of shares by increasing the Earning Per Share.
b. It is a way to attract short term investors as the company's financial statements look more attractive due to the boost of financial ratios.
c. It reduces the cost of capital.

For companies seeking to purchase their own shares the main question may be what is the legal framework on share buy backs in Kenya.

What is an unlisted Company?

An unlisted company is one that is not listed in any securities exchange market, in the case of Kenya the Nairobi Securities Exchange (NSE) while a listed company is one that is listed at NSE.

Can a Company buy back its own shares?

The General Rule under the Companies Act, 2015 is that a limited liability company shall not acquire its own shares, whether by purchase or otherwise if the remaining shares will only be redeemable or treasury shares as stipulated by section 447 of the Companies Act, 2015. This is because the shares are looked upon by Creditors as their security in the event of default. Purchase of shares would mean that should some amount remain unpaid by the Company to the Shareholders who have sold their shares, there would be a conflict as to who would take precedence at the point of liquidating the Company. However, the risk notwithstanding, a limited company may purchase its own shares if it meets the stipulated qualifications under the Act

What are the restrictions on share buyback?

Part XVI of the Companies Act contains provisions on acquisition by a limited company of its own shares. Restrictions and requirements under this part include:

i. General Restrictions

In addition to the restriction under section 447 as stated above, section 448 stipulates that a Company may only purchase its own shares if they are fully paid. Contravention of section 447 and 448 of the Act renders the share buyback void and unenforceable. Further, the Company must be a limited liability company and not an unlimited company.

ii. Financing of a share buy back

The Act stipulates several restrictions on the financing of a share buyback. Section 449 of the Act provides that a company cannot purchase its shares on credit and may only buy back its shares out of the distributable profits of the company or the proceeds of a fresh issue of shares made for the purpose of financing the purchase. Additionally, if the shares are bought at a profit to the exiting shareholder, the profit may only be paid out of proceeds of a fresh issue of shares made for the purpose of financing the purchase. Companies are however permitted to pay for the buy backs from capital but upon compliance with very stringent requirements under the Act.

iii. Filing of returns upon share buyback.

Section 464 of the Act requires that within 14 days after a company purchases shares, it shall lodge with the Registrar for registration a prescribed return.

How can a company purchase its own shares and what happens to the purchased shares?

Share buyback may be effected under a share buyback contract approved by the Directors through a special resolution. When a company purchases its own shares, it cancels the shares on their return and the company's issued share capital is diminished by the nominal value of the shares cancelled.

Section 526 stipulates that a company may only convert purchased shares into treasury shares if the shares are qualifying shares included in the official list in accordance with the provisions of the Capital Markets Act (Cap. 485A).

A resolution on reduction in share capital through a share buyback must be accompanied by a Solvency Statement by the directors of the Company as stipulated in section 419 and 420 of the Companies Act, 2015. A Solvency Statement should contain a statement that the Directors of the Company have formed the opinion that on the specific date no ground exists on which the company could be found to be unable to pay its debts and that the company is in a position to pay its debts as they fall due during the year immediately following that date. The Company must notify the purchase and cancellation of shares to the Registrar of Companies within 14 days with respect to a purchase and within 28 days with respect to an immediate cancellation.

The Company is required to lodge an application for share buyback with the Registrar accompanied by the following documents:

i. CR 37 - Return of purchase of own shares;
ii. CR 38 - Notice of cancellation of shares on purchase of own shares by a company;
iii. CR19 - Notice of Special Resolution;
iv. Minutes and resolutions approving the share buyback;
v. Last filed annual return of the Company; and
vi. A solvency statements.

The application is approved by the registrar and records of the company changed to reflect the buy back and cancelation of shares.

Are there further restrictions for Listed Companies?

In addition to the requirements stated above a listed company may purchase its own shares through a market purchase, at the Nairobi Securities Exchange, subject to approval of the shareholders through a prescribed resolution. If the buyback is by way of a market purchase, the purchased shares are required to be held and dealt with as treasury shares under part XXI of the Companies Act, 2015.

The approval of the Capital Markets Authority is required in accordance with the Listing and Disclosure Draft Regulations. CMA has formulated draft Regulations on share buybacks for listed companies but these are yet to come into force. In the event of an intended off-market purchase, the share buyback contract shall be submitted to CMA for approval. Even though the regulations are yet to come into force, they portray CMA's understanding of the Companies Act specifically provisions on share buyback.

Conclusion and M&K Advisory

In this article, we have provided an overview of the concept of share buy backs. We have also outlined, in brief, the applicable law on share buybacks in Kenya.

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