



SEBI's Rejection of L&T's Buyback Proposal

Why in news?

\n\n

The Securities and Exchange Board of India (SEBI) recently rejected Larsen and Toubro's (L&T's) proposal to buy back part of its shares.

\n\n

What is the buyback mechanism?

\n\n

\n

- Buyback of shares refers to the repurchasing of shares of stock from the market by the company that issued them.

\n

\n\n

\n

- A company prefers buyback usually when it has a significant cash reserve and feels that the shares are not fairly valued at the current market price.

\n

- The bought back shares will have increased Earnings Per Share (EPS) by default.

\n

- It's because a buyback is usually done at a price higher than the then prevailing market price and so shareholders get an attractive exit option.

\n

- A company can use a maximum of 25% of the 'aggregate' of its free reserves and paid-up capital for a buyback.

\n

\n\n

What is the L&T case?

\n\n

\n

- Larsen and Toubro, an engineering group, had sought the permission of SEBI to purchase 6.1 crore shares from its shareholders.
- The stated intent of the company was to improve shareholder return by purchasing the shares above the traded price.
- The buyback proposal has, however, been rejected by the SEBI.
- It stated that the company's consolidated debt-to-equity ratio after the buyback would be above the limit stipulated in the regulations.

\n

\n\n

What is the dispute here?

\n\n

\n

- L&T has stated that it considered the post-issue debt-to-equity ratio of the standalone entity before moving the proposal forward.
- With the parent entity holding negligible debt on its books, the ratio after the issue was well within permissible limits.
- The 'aggregate' secured and unsecured debts owed by the company after the buyback and the paid-up capital and free reserves should be used for arriving at the debt equity ratio.
- This is as per the requirements specified in SEBI's buyback of securities regulation, 2018 as well as the Companies Act, 2013.
- SEBI, thus, considered the debt of the L&T's consolidated entity, including the share of the subsidiaries.
- It, hence, concluded that the company has failed the post-issue debt-equity ratio test.
- The word 'aggregate' is open to several interpretations here and so the company cannot refute the regulator's objection.

\n

\n\n

Is the rejection justifiable?

\n\n

\n

- The regulator cannot be faulted for taking a more holistic view of the group finances after the recent experience in the [IL&FS issue](#).

\n

- In the IL&FS issue, most creditors and credit rating agencies had erred, considering only the standalone numbers.

\n

- So a better scrutiny of numbers by the regulator is certainly welcome.

\n

- It is a signal that the SEBI is vigilant about protecting investors' interests and improving corporate governance.

\n

- However, Larsen and Toubro was also not wrong in interpreting the buyback rules as referring to the debt and equity of the parent alone.

\n

- Investors who would have already purchased shares of the company in anticipation of the buyback stand to lose now.

\n

- Also, the company will have to look at alternative routes to reward its shareholders, which might not be as tax-efficient as share buyback.

\n

\n\n

What is the need now?

\n\n

\n

- Rules and regulations need to be spelled out in an unambiguous manner so that companies and investors are clear about it.

\n

- SEBI needs to spell its stance clearly on the numbers to be considered in a buyback.

\n

- It would also help if the regulator took a closer look at the composition of the group debt.

\n

- SEBI can see if the numbers were elevated due to the nature of business of a group company.

\n

\n\n

\n\n

Source: Business Line

\n



IAS PARLIAMENT
Information is Empowering
A Shankar IAS Academy Initiative