

**Organization of Companies Dealings on their Market-Traded-Shares
(Treasury Stocks)**

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Introduction:

This manual tackles a highly specific and extra-ordinary issue in the filed of companies finance, it is an issue with various interpretations and indications having direct impact on shareholders of companies listed at the stock exchange.

Therefore, the CMA was of the opinion to organize the matter of companies' shares repurchase process, for its importance to all issuing companies, all companies with securities listed in the stock exchange, all their shareholders and all dealers in the capital market. The manual includes a definition of treasury stocks, the means for repurchase by companies of their shares, the reasons for repurchase process and the means for handling this process.

Due to the diverse financial effects and treatments of treasury stocks, the manual explains the effects arising out of treasury stock transactions, which include accounting treatment, accounting disclosure, the elements required to be disclosed upon application of companies' shares repurchase program, and the relevant tax treatment. The most significant accounting errors which may be committed by shares-issuing companies upon undertaking accounting treatments of treasury shares transactions were also discussed in the manual, which further tackled the regulatory approaches on trading by companies of their shares and the improper practices made prior to organization of treasury stock transactions, for listed companies to avoid these errors in future and any related penalties enforceable by the Law.

The manual allows share-investors to have a clear picture of all scientific, practical, philosophic, technical and professional aspects, to clarify related facts, rights and obligations of treasury stocks.

The CMA confirms that this manual is designed for issuing companies, investors from companies' board members and market dealers, and that this manual may participate in improvement of the quality of their financing and investment decisions.

First: Definition of Treasury Stocks

Treasury stock transactions mean a process of repurchase or buyback by a company of its shares. Shares repurchased by a company are called "treasury stocks".

There are several cases where joint stock companies seek to recover part of their capital shares by means of repurchase, whether this repurchase is made in cash or in-kind by the company. This would lead to reduction of the company's assets or increase of its obligations, and would consequently result in reduction of its ownership rights proportionally.

It is worth noting that ownership by a company of its shares does not mean that these shares have been cancelled or finally recovered. However, there are a number of areas to use treasury stocks; as they may be kept for resale at a later time or for distribution to staff or to shareholders, or for any other corporate purposes, to be explained in this manual.

Issuing company's repurchase of its shares may result in reduction of their ownership rights, as shares' price would be paid to a shareholder or more in return for waving its/their shares. Therefore, repurchase of treasury stocks may be viewed as reduction of shareholders' rights, not acquisition of new asset by the company, as it is not reasonable that a company owns itself and includes its shares in its assets. Nevertheless, sale of these shares provides the company with liquid cash as similar as its sale of any other owned assets.

In light of the financial and accounting treatments given for purchase and/or sale of treasury stocks in the accounts of shareholders rights, it is worth noting that sale of treasury stocks against a price less than the relevant purchase costs reduces ownership rights, while sale of treasury stocks against a price higher than purchase costs increases ownership rights, which increase does not create any dividend payment, but is considered as a component of paid capital.

Dear investor, it is noted that if financial resources available to a company exceeds its requirements, it would be preferable to distribute cash surplus to its shareholders, which distribution may be made by repurchase of a part of the shares comprising the capital of the company itself. As this policy has no near or far effect on the revenue of the company, it would be expected that reduction of the number of existing shares would lead to a raise in shares' profitability, in light of the presumption of stability of the revenue achieved after their repurchase.

Second: Methods of Regulatory Treatment for Treasury Stocks

Treasury stocks were regulated by several international legislations, whether applying the Latin or the Anglo-Saxon system, which regulation was effected through promulgation of a number of provisions or rules preventing use of treasury stocks as means for manipulation of share prices or for protection of shareholders and companies' creditors. In this respect, there are two methods for giving regulatory treatment for treasury stocks, which are summarized as follows:

a) The Method of Setting Detailed Procedures and Judgments:

This method tackles all detailed steps that should be undertaken by issuing companies for repurchase and/or dispose of treasury stocks, and further includes the rules for disclosure of same, such as the legislations in a Latin form, on top of which is the French Legislation.

b) The Method of Setting General Rules

In this method, the regulatory authority sets a number of general principles and rules, which do not discuss any executive details or procedures, while permitting companies to apply whatever found appropriate in light of the said general principles and rules issued with respect to treasury stock transactions. Based on this method, companies are allowed to repurchase its shares, without prejudice to a number of controls or procedures, which do not permit companies to use their shares' repurchase programs as means for manipulation of prices of their issued shares.

Studies indicate that regulatory authorities in several countries tend to combine between the two methods. The regulatory authorities' role in the companies' dealings on their shares lies in confirming the companies' due compliance with the said controls. Accordingly, these authorities do not definitively prevent companies from repurchasing their shares, while not absolutely permit repurchase of their shares.

Third: The Means for Repurchase by Companies of their Shares (Execution Mechanisms):

The means of repurchase by companies of their shares are numerous, the important of which are as follows:

- Repurchase from the open market.
- Repurchase by means of limited auctions.
- Repurchase by means of fixed price purchase offer to responsive shareholders.
- Repurchase from outside the market (through conclusion of agreements) or (entering into private transactions).
- Repurchase from all shareholders at equal percentage rates.

Herein below are some of exemplary means for repurchase by companies of their shares, as applied by a number of countries subject of this study:

In France: Repurchase program is applied either by means of repurchase offer, through the securities exchange or the open market.

In Egypt: The Egyptian legislator did not define the means for execution of repurchase program. Accordingly, repurchase may be effected either by a repurchase offer, a repurchase through the stock exchange or through the open market, according to the purpose of repurchase and the percentage of shares required to be repurchased.

In America: It is not necessary to make a repurchase offer. However, repurchase program may be effected by means of repurchase from the open market, i.e., the securities exchange.

In England: If the quantity of shares repurchased exceeds 15% of the capital, a repurchase offer is required to be submitted, while if the quantity is less than this rate, a repurchase offer may be effected through the stock exchange.

In Germany: Either through a repurchase offer or through the stock exchange.

In Japan: A repurchase program is required to be effected through the stock exchange.

Fourth: The Reasons for Resorting by the Company to Treasury Stocks

The issuing company may seek to repurchase its shares for one or more of the following reasons:

- 1- Using the cash surplus available to the company, in case no opportunities to invest this surplus are available.
- 2- Using repurchase in replacement of dividends payment, if expected by the management that repurchase may have positive effect on the company's share price in the securities market.
- 3- Using repurchase to market the shares, to procure additional requests for purchase of the company's shares or to support the current market price of the company's traded shares. Companies further resort to this mechanism, in case of reduction of their shares' price for reasons irrelevant to the company's performance.
- 4- Using repurchase to regulate ownership rights and control shareholders' structure, as means for limiting dominations by some shareholders.
- 5- To confront adverse purchase offers of the company's shares. Company's repurchase of its shares may reduce the number of its freely traded shares and increase their trading prices.
- 6- To obtain tax privileges, in case cash payments are subject to tax. Repurchase, in case thereof, may result in increase of trading prices of shares and accordingly achievement by shareholders of capital profits which may be tax-exempted.
- 7- To increase the share profitability or the earning-per-share through reduction of the number of existing shares, and consequently reduction of the multiple earning per share. This, accordingly, makes the share price attractive to investors and increases dividend payment.

- 8- Repurchase by the company of its shares may participate in enrichment of shareholders, by increasing their dividend payments through distribution of earnings/ profits realized to a smaller number of existing shares.
- 9- This mechanism may be used for repurchase of shares owned by shareholders desiring to leave out the company, or the shares owned by those aggrieved by optional de-listing made pursuant to listing and the de-listing rules applied by the Egyptian Stock Exchange.
- 10- Repurchase is further applied in case of new secondary placements where Treasury stocks are used for controlling the price of securities issued by the company and to create a sort of balance between requests and offers, as the case may be in secondary placements and upon formation of a fund or an account. This is to keep the market price of shares stable during certain period of time after placement is made.
- 11- Repurchase is also applied in case of dividends payment made in the form of bonus shares, by using the treasury stocks available to the company upon payment.
- 12- If there is a need to increase dividends paid for existing shares, this could be done by adding treasury stock dividends to the existing shares.
- 13- Repurchase is used as a mechanism to determine the legal quorum in general assembly meetings.
- 14- Repurchase is further used in option contracts and futures in which the company acts as a party.

Fifth: Means for Disposition of Treasury Stocks

There are several means for disposition of treasury stocks, which are summarized as follows:

- 1- Reduction of the company's paid capital, and consequently reduction of company's investments volume. The company seeks to create a balance between the property available for investment and the actual need for financing the investments planned by the company or returning funds to shareholders in case investment opportunities are unavailable.
- 2- Resale of treasury stocks in the open market to provide liquidity to the company.
- 3- Use of these treasury stocks in an incentive plan, by allowing company managers to acquire these shares according to a system approved by the general assembly of the company.
- 4- Redistribution to shareholders of these treasury stocks either free of charge or against reduced price, as means for profit distribution/payment to shareholders.
- 5- Use of treasury stocks in swap transactions whereby the company repurchases its shares when desires to acquire other companies by means of swapping the company's shares with the shares owned by shareholders of the other targeted companies.

Sixth: Financial Impacts of Repurchase by Companies of their Shares

Repurchase by the company of its shares may result in various financial effects, as explained in the following schedule:

Item	Effect
Earning Per Share	The earnings of each share, out of the net distributable profits, may increase due to reduction in number of existing shares, on the assumption that dividends would remain stable after repurchase by the company of its shares.
Dividend Payments	The earnings of each share out of cash payments may increase due to decrease in number of existing shares for which dividends, decided to be settled out of distributable profits, shall be paid.
Number of Existing Shares	The number of issued shares - the number of treasury stocks = the number of existing shares.
Shareholders Rights	Total rights of shareholders would be reduced by the value of acquisition of treasury stocks repurchased. Repurchase value is deducted from the total rights of shareholders in the budget.
Book Value of Shares	The book value of the share would increase, if share's repurchase costs are less than the book value, while the book value reduces, if the share's repurchase costs are higher than that book value.
Market Value of Shares	Market value of shares would increase as a result of reduction of the number of shares offered for trading and due to the increase in share's earning or the raise of cash payments.
Multiple Earning Per Share	It would be reduced as a result of the increase in earning per share, which makes the share price more attractive. It is calculated by dividing market price of the share by the earnings per share.

Seventh: Negative Aspects and Risks Related to Repurchase by the Company of its Shares

There are several risks and errors that may be caused by the company's management, in case of dealing by the company on its shares, which risks and errors may be caused by the non-similarity of the information available during transactions between share dealers in the market and the company's management when dealing on shares. The following is a description of some risks which should be avoided by the company's management when dealing on its shares.

1- Abuse of Insider Information:

The company's management and staff enjoy distinguished position more than the other remaining traders in the stock exchange, as the company's management always has information unavailable to the public. This may allow management to abuse the insider information available thereto, while unavailable to other third parties, which represents one of the crimes of the stock exchange for abuse of insider information. The company's management is considered to have access to insider information unavailable to the public. Therefore, in violation of corporate governance rules, the management may abuse the mechanism of repurchase of the company's shares based on any positive or negative insider information unavailable to the public, to achieve unusual earnings on the account of other investors in the spot or the derivative markets, such as the option contracts and futures markets.

2- Listing Unrealistic Price

In light of the illegal or manipulation-related practices, the company's management may desire to apply a –mechanism for the repurchase of shares to achieve unrealistic high price of shares either due to the unfavorable work results of the company or to create essential event having actual and remarkable effects on the company. This could be made by the company's announcement for repurchase of treasury stocks on the basis of a share price less than the actual or fair price of the share. This would convince the market that there is information available to the company and unavailable to investors, which increases the volume of requests/offers and consequently raises the share price. In case thereof, the company is charged of perpetration of a crime.. a crime of manipulation of prices by listing unrealistic price.

Dealing by the company on its share with the intention of setting trading prices in motion would open the gate widely for participation by companies in the trading market for the purpose of speculating on their shares, manipulating their prices and abusing insider information unavailable to the public either to achieve earnings/profits or to avoid losses, taking into consideration that companies always have insider information regarding work results which are unavailable to the remaining dealers. This, consequently, would lead to deviation by some companies from their original functions and main roles of direct investment and due provision of their products and services to consumers, while resorting to speculation on their shares at the stock exchange in a manner causing harm to all parties dealing with the company, including its shareholders and creditors.

3- Giving Incorrect Indications to the Market

The company may apply its share repurchase mechanism to give misleading indications to the market or to have the market reoriented to increase requests or offers. This allows the company, besides its main job, to perform another function, which is to be a market maker with respect to its shares. Moreover, in the absence of realistic controls governing this mechanism and given the fact that these companies are not qualified to act as market makers, which fact is confirmed by non-authorization by regulatory authorities for issuing companies to practice this activity, these companies, being incompliant with disclosure rules, would make them raise their share price to reach unfair prices for a period of time and may further succeed in maintaining their high trading price for a while. Nevertheless, these prices would return to their realistic level, which causes abnormal loss to companies' investors in addition to reduction of their ownership rights as a result of sale of treasury stocks against unfair prices.

Therefore, we hereby confirm that improvement of share price by creation of devised requests really manipulates and counterfeits the price determination mechanism, while share price eventually returns to its realistic level, which causes abnormal loss to shareholders.

4- Collision by Repurchase from Certain Shareholders

In some cases where a company may face losses or future problems, the executive management of the company agrees with a number of large shareholders or board members therein for repurchase of a part of their shares against certain price. In this context, the company makes an announcement for repurchase of treasury stocks and the elected shareholders sell the shares to the company against the agreed upon price, which process allows those shareholders to achieve benefits in unfair manner on the account of other investing shareholders of the company who may not have future information regarding the company, which would lead, if publicized, to reduction of the trading price to be less than the price of repurchase of treasury stocks.

5- Prejudicing Creditors' Rights

The legislator granted company's creditors, whose rights were created prior to publicizing a capital decrease resolution, as well as the legal representative of bonds bearers group, the right to object the resolution for reduction of the company's capital, in view of the fact that the rule of fixed capital represents the prime guarantee and security for creditors. Therefore, repurchase by the company of its shares for the purpose of reduction of its capital must be made after notifying creditors, as it would be possible that objecting creditors may resort to Courts in case of non-acceptance of the company's resolution to repurchase its shares to reduce capital, and the Court may cancel this resolution.

Some companies, whose management is incompliant with the corporate governance principles, may issue a resolution for repurchase of treasury shares and neglect reimbursement of creditors' funds in spite of existence of cash surplus, to cause harm or to passively affect creditors' rights. The company, in case thereof, repurchases

treasury stocks using its cash surplus or tends to liquidate its assets and uses the liquid cash for such repurchase, which may lead to illegal liquidation of the company, recovery by shareholders of their funds and loss of creditors' rights, which is unfair to creditor. Creditors' loans granted to the company are approved in view of certain securities and guarantees, the most important of which is the value of paid capital which is considered a fund not subject to distribution. At this point, it emerges the risk of giving the company an absolute freedom to repurchase treasury stocks without controls by a regulatory authority.

6- Using Treasury Shares as Mechanism for Obstructing Completion of Adverse Purchase Offers

In cases of adverse purchase offers, a number of legislations may prevent the management of the company targeted by a purchase offer to severally or jointly interfere, either directly or indirectly, in its share trading transactions. This control is intended to prevent the company's board of directors from undertaking any illegitimate practices to prevent a purchase offer which may achieve certain interest for the company and its shareholders. It is possible that the company's board of directors would undertake shares repurchase transactions through other companies to create fictitious request for these shares, which may lead to raising shares' price, and consequently obliging any bidder to withdraw its offer. However, in other certain cases, the board of directors of the targeted company would apply a repurchase-program; if the company's ordinary general assembly meeting approved the repurchase program and granted this right to the board of directors or permitted the board to interfere in order to undertake a defensive procedure against an adverse repurchase offer. Meanwhile, the idea of repurchase by the company of its shares as a defensive procedure undertaken against adverse purchase offers emerges from the fact that repurchase by the company of its shares from the market would lead to an increase in the shares profitability raise, which consequently results in increase of the share's value and renders the process of acquisition very expensive to the bidder who would have no option but to withdraw and fail its offer in favor of the management and against the interest of shareholders and the company itself.

7- Use of Treasury Stocks to Affect on Voting Rates in General Assembly Meetings

In the Egyptian Legislation, investors whose shareholding would reach $1/3^{\text{rd}}$ upon conclusion of certain transaction regarding a company's shares, whether it actually owns lesser rate in the said company's shares or desires to reach this limit of shareholding only one time, shall be required to submit a mandatory purchase offer, as stated in the Egyptian Law, if found that this investor participated in a treasury stock resolution. Thereafter, upon calculation of its $1/3^{\text{rd}}$ rate, this rate shall be counted on the basis of its shares to be owned in proportion to the total existing shares, after exclusion of treasury stocks, since treasury stocks, in case thereof, is viewed as shares excluded from the company's capital and have no voting rights. It is known that purchase offers for the purpose of acquisition focuses only on the shares representing a part of the capital and granting their shareholder a voting right in general assembly meetings.

Eighth: Disclosure Items and the Conditions for Applying Companies' Repurchase Programs under Several Legislations

In our review of various international practices, disclosure items required to be available in the company's repurchase program and the terms for due application of this program can be described as follows:

1- Disclosure of Repurchase Targets: The company shall be required to determine the target intended to be achieved upon repurchase of its shares within the framework of its repurchase program. No matter if more than one target is intended by the company for its repurchase program, since the target for repurchase would be rewarding and encouraging staff as well as controlling the market price of its shares at the same time.

2- Preceding and Succeeding Disclosures of Repurchase Program: The issuing company should disclose all its transactions made in application of its repurchase program, as follows:

- **Preceding Disclosure:** The company is required to disclose the details of its repurchase program to the regulatory authority and to obtain the authority's approval prior to application of the program. Disclosure is to be made in the form of data sheet to be submitted by the company. This data sheet shall include, at minimum, the target of repurchase, the means for financing the repurchase transactions, the means for using the shares repurchased, the maximum repurchase limit and the period required for application of repurchase transactions.

- **Succeeding Disclosure:** The company shall notify the regulatory authority at the end of every week and every month of the quantities already repurchased in the repurchase transactions, the average price during this period of repurchase, any essential events occurred during repurchase and any amendments made to the information contained in the data sheet approved by the authority during the period of applying the repurchase program.

3- Disclosure of Price

Several countries set a ceiling for company's shares repurchase price, to avoid any manipulations by listing unrealistic market price for its shares.

4- Disclosure of the Quantity That Could Be Repurchased

Most of the countries tend to set a maximum limit for the quantity of treasury stocks that could be repurchased, in order to prevent the company from using treasury stocks in a manner causing harm to the interest of shareholders in the general assembly, due to the fact that treasury stocks have no voting rights, as treasury stocks rate, on one hand, may be used as means for non-completion of the quorum required for attending general assembly meetings, which could prevent the general assembly from playing its role of controlling and supervising the company's board of directors, and on the other hand, treasury stocks may be used as means for amendment of the attendance quorum, based the fact that treasury stocks are excluded from the shares having voting rights.

5- Certain Conditions Regarding the Quantities Repurchased During Relevant Session

Some countries tend to set a maximum limit for daily repurchase of treasury stocks up to certain rate of total traded shares of the company, in an attempt to allow most of the market price of shares to reflect, to some extent, the offers and requests of market dealers, other than the issuing company.

6- Certain Conditions Regarding Resale of Purchased Shares

Some Countries impose certain controls on resale by issuing companies of treasury stocks in the market during the period of application of their repurchase program and until completing repurchase of all quantities required or expiry of the period scheduled for repurchase, whichever is earlier.

7- Certain Conditions for Acting by the Company as Insider Dealer:

Some legislative acts impose a ban period on the company as similar as any insider dealer, such that the company may not deal on its shares except after publicizing an essential event having effect on the share price.

8- Certain Conditions Regarding the Periods of Time for Repurchasing and for Maintaining Treasury Stocks:

Several countries schedule a period of time for repurchase by the company of its shares as well as a period of time to maintain treasury stocks, as follows:

a) The Period of Time Scheduled for Repurchase:

In some countries, the period of time scheduled for the company's repurchase would be extended to three years, according to the repurchase program applied by the company.

b) The Period of Time Scheduled for Keeping Treasury Stocks:

In some countries, the period of time to maintain treasury stocks is definitive. It may be one year, as in Egypt. In some other countries, the period could be 24 months. Meanwhile, in several other countries, the company may keep and maintain these treasury stocks for any period of time found appropriate in light of the purpose for repurchase.

9- Certain Conditions Regarding the Authority to Approve Repurchase by the Company of its Shares.

This authority varies from one country to another, as explained in the following part:

In Egypt: Listing rules, with respect to listed companies, provide that the authority having competence to approve repurchase by the company of its shares is the company's board of directors. However, if the purpose for repurchase is to reduce the company's capital, the extra-ordinary general assembly, according to the Law, is to be the competent authority. As for the de-listed companies operating in the field of securities, the CMA's Executive Rules for Corporate Governance provided that the authority approving repurchase of treasury stocks is the extra-ordinary general assembly whose resolution is to be issued with a 75% consent rate.

In France: The authority competent for approving repurchase is general assembly of shareholders. However, the type of the general assembly whose approval is required varies according to the reason for repurchase by the company of its shares. If the reason for repurchase is to reduce the company's capital, the extra-ordinary general assembly is to be the authority assigned to issue approvals. This assembly does not convene except by a quorum of 1/3rd. If the quorum has not been achieved in the first invitation to convene, the assembly may validly convene by a quorum of 1/4th. The assembly's resolution approving the repurchase program shall be valid and effective, if approved by 1/3rd of the votes present or represented by proxy. However, if the reason for repurchase is to control the company's share price in the stock exchange, the approval is to be obtained from the ordinary general assembly meeting.

In America: The authority approving repurchase by the company of its shares is the company's board of directors which is required to issue a resolution permitting the company to apply its repurchase program for the company to be authorized to repurchase its shares.

In England: The authority approving repurchase, in all cases, is to be the general assembly. However, such approval must be issued by the extra-ordinary general assembly; if the repurchase program is applied over the counter (outside the market). Meanwhile, if the repurchase program is applied through the stock exchange, an approval of the company's ordinary general assembly shall be required.

In Germany: The company can not repurchase its shares, except after an approval is issued by the board of directors which shall advise the general assembly of the purpose for repurchase, the price and quantity of repurchased shares.

In Spain and Italy: A general assembly's resolution must be obtained, permitting the company to repurchase its shares.

Ninth: Treasury Stocks' relationship with Financial Derivatives

Many legislations permit the company to apply a repurchase program to assist the company to execute transactions related to financial derivatives, in particular the "warrants". The company issues a warrant, by which the warrant bearer submits, to the company after certain period of time or on a date scheduled by the issuing company, a request for purchase of the company's shares against certain price, naturally less than the market price. In case thereof, the company applies a repurchase program regarding treasury shares in order to be able to fulfill its obligations relating

to the options issued. It is worthy to note that the Egyptian Law has not yet regulated option contracts and their trading transactions.

Due to the risks related to dealing by the company on purchase options, the French legislator required that the data sheet, submitted by the company to the regulatory authority to obtain the latter's approval, must contain an accurate and definite description of the company's targets intended to be achieved by application of the repurchase program used for execution of option contracts. Legislator further required that an insider control by the company on options must also be made. It is further required by French legislator that the general assembly's resolution approving repurchase by the company of its shares must expressly refer to application of purchase options. Moreover, the period for applying an option must not be less than three months, whether or not the option is listed in the stock exchange, and the option price should be in cash.

Tenth: Accounting Treatment of Treasury Stocks

To complete the image, the manual in the following section describes the accounting treatment of treasury stocks when repurchased and after sale thereof, as follows:

a) Upon Repurchase by the Company of its Shares

When the company repurchases its shares, regardless to the execution mechanism applied, repurchase transactions is recorded and established by making the treasury stocks account debited with the treasury stocks repurchase costs (i.e., the repurchase price, the repurchase commissions and any other costs, such as the costs of announcing for the company's desire to repurchase treasury stocks), as well as by making the cash account or the creditors account credited with the assumed costs, whether paid in cash or undertaken to be settled by the company at a later time. This mechanism could be explained by the following example:

If the number of issued shares of the company was million at nominal value of LE 10 per share, while the reserves, on 31/12/2006, reached two million Egyptian Pound as statutory reserve, LE 1.5 million as general reserve and LE 2.5 million as brought forward profits, and on 25/3/2007 the company repurchased one hundred thousand of its shares in cash against a price of LE 20 per share and further assumed a commission of LE 1000 the company would accounting-wise record and establish the shares acquisition transaction as follows:

2,001,000: debited from the treasury stocks account	2,001,000: credited to the cash account
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The treasury stock repurchase costs= 100 shares x LE 20 = EL 2,001,000.

The company's issued and fully paid capital= one million shares x LE 10 = LE ten million. The treasury stocks are to be deducted from the shareholders rights in the financial status list. If the company prepared a financial status list on 31/3/2007 an the turnover for the three months ending on 31/3/2007 resulted in a net profit of LE 350,000 the shareholders rights in the financial status list in LE would be as follows:

The Financial Status List of.....Company
On 31/12/2007

Assets	Shareholders Rights and Liabilities
	1,000,000: Issued and fully paid capital
	2,000,000: Statutory Reserve
	1,500,000: General Reserve
	2,500,000: Brought forward profits
	350,000: Net profits for the three month period

	16,350,000: Shareholders rights
	(2,001,000): Treasury Stocks (100 thousand stocks)

	14,349,000 Shareholders Rights (The number of existing shares 900,000 shares)

The following schedule, using the data of the above example, describes the effect of repurchase by the company of treasury stocks on the book value of the share and on the share's profitability:

Item	Prior to Purchase of Treasury Stocks	After Purchase of Treasury Stocks
Shareholders Rights (1)	LE 16,350,000	LE 14,349,000
Number Existing Shares (2)	LE 1,000,000	9,000,000 shares
Book Value of the Share (1/2)	LE 16.35	LE 15.94
Net Profits for the Period (3)	350	350
Share profitability (3/2)	LE 0,035	LE 0,0389

In analyzing the above table, it is noted that purchase of treasury stocks resulted in an increase in share profitability, due to reduction of the number of shares by which the net profit for the concerned period was divided. The number of existing shares became 900,000 shares instead of one million after exclusion of the 100,000 shares in the form of treasury stocks, which resulted in an EPR raise from LE 0.035 to LE 0.0389.

It is also noticed that the book value of the share was reduced from LE 16.35 to LE 15.94, due to the fact that the purchase price of treasury stock reached LE 20, which price is higher than the book value of the existing share after purchase of the treasury stock, which consequently led to increase of the amount deducted from shareholders rights. It is generally noticed that the book value of the existing share increases if the purchase costs of the treasury stock is less than the book value of the existing share, while the book value of the existing share reduces if the purchase costs of treasury stocks is higher than the book value of the exiting share.

b) Upon Sale by the Company of its Shares

When the company resells its treasury stocks or any part thereof during the period in which resale is permitted (i.e., within one year from the date of acquisition), or when treasury stocks are granted, during this period, to the staff within the framework of their incentives plan, the company reduces the treasury stocks account by the costs of the part sold or granted to the staff, by making the treasury stock account credited with this amount, by making the treasury stock or the bank account indebted with net sale value of the treasury stocks sold, or by making the staff incentive plan costs account indebted with the fair value of these treasury stocks on the date of granting same to the staff and additionally with the commissions paid for transfer of ownership of these treasury stocks to the staff. The difference between the costs of treasury stocks disposed thereof (by selling or granting same to the staff) and their net sale value or their fair value with the transfer of ownership commission is treated, by decrease or increase, through the brought forward profit account or through the reserves account. The company may not add the resulting difference to the income statement, since the company may not achieve profits or bear losses as a result of dealing on its own shares.

Description of the Means for Treating Treasury Stocks Sale Process in Cash:

In view of the above example, and assuming that the company has resold 50,000 treasury stocks previously repurchased against sale price of LE 24 per share and obtained cash sale proceeds after deduction of a brokerage commission of 0.0005, it is deduced that:

- The sale price prior to deduction of the commission= 5000 treasury stocks x LE 24 = LE 1,200,000
- Value of the commission paid= LE 1,200,000 x 0, 0005= LE 600
- Sale price after deduction of the commission= 1,200,000 x 0, 0005 – LE 600 = LE 1,199,400

Whereas, the cost of repurchase of 50,000 treasury stocks is calculated as following:

The cost of one treasury stocks= 200,100 / 100,000= LE 20.1

Therefore, the cost of the 50,000 treasury stocks sold= 50,000 x LE 20.1 = LE 1,005,000.

There is a positive difference between sale and purchase prices:

1,199,400 – 1,000,500 = LE 198,900.

Accordingly, the company shall record this result as follows:

1,199,400: from the cash account	
	To certain persons
	1,000,500: treasury stocks account
	198,900: general reserve account (profits brought forward)

On the other side, if the sale price is reduced and the sale is made against LE 18 per treasury stock, and if the company obtains the sale price in cash, after deduction of the brokerage commission of LE 500, the company shall obtain LE 899,500.

Accordingly, the sale price after deduction of the commission= 50,000 treasury stocks x LE 18 – LE 500 = LE 899,500.

In case thereof the difference between sale and purchase prices is negative, i.e., 899,500 – 1000,500 = LE 101,000.

Accordingly, the company shall record this result as follows:

From certain persons	
899,500: cash account	
101,000: general reserve account (profits brought forward)	1,000,500: to the treasury stocks account.

Description of the Means for Treating Treasury Stocks Granted within an Incentives Plan

If the company grants the staff these treasury shares within the framework of an incentives plan for the company's staff, and if the fair value of treasury stock on the plan's date reaches LE 24 per stock in addition to LE 600 as brokerage commission for transfer of treasury stocks ownership within this incentives plan, the following record shall be made:

1,200,600 from the incentives plan account	
	To certain persons
	1,000,500: treasury stocks account
	600: cash account
	199500: general reserve account (profits brought forward)

In case of granting these treasury stocks to the staff according to an incentive plan and the fair value of these stocks is LE 18 per stock, and if a brokerage commission of LE 500 for transfer of stocks' ownership is born by the company and paid in cash, the company shall record this transaction as follows:

From certain persons	
900,500: incentive plan account	
100,000: general reserve account (brought forward profits)	
	1,000,500: to the treasury stock account.

Eleventh: Accounting Disclosure and Treasury Stocks

It was stated in Egyptian Accounting Standard No. (25), Paragraphs "33" and "34" that:

"If an institution repurchases property right instruments belonging thereto (treasury stocks), these instruments shall be demonstrated as deducted from the total property rights, and no related profit or loss contained in the profits and losses arising out of purchase, sale, issuance or cancellation of the property ownership rights of this company shall be acknowledged .

The institution or any other institution in relevant group may repurchase these treasury stocks, keep same and their value directly paid or collected shall be acknowledged in the property rights "Paragraph (33)

"Treasury stocks maintained by the institution shall be disclosed and stated separately either in the main body of the balance sheet or in the clarifications attached to the financial statements, pursuant to Egyptian Accounting Standard No. (1) " Demonstration of Financial Statements", and if the institution repurchases property rights instruments belonging thereto from related parties, the institution shall disclose their data, pursuant to Egyptian Accounting Standard No. (15) (Disclosure of Related Parties)

Twelfth: Accounting Errors Expected to Occur upon Treating Treasury Stocks

- 1- Treating the differences arising out of disposition of treasury stocks, through the income statement.
- 2- Deduction of the entire costs for acquisition of treasury stocks from the capital when reduced, in execution of relevant established rules, in which case the capital shall be reduced by the nominal value of treasury stocks only.

Thirteenth: Tax Treatment of Treasury Stocks

It is required to add or exclude the differences arising out of disposal of treasury stocks (added to or excluded from property rights) in the tax bracket of the company. However, tax practices applied indicate that the Tax Authority adds any differences entailed by virtue of property rights to the tax bracket of the company.

Fourteenth: Demonstration of a number of Business Problems Discovered by the CMA

Please find herein below a number of treasury stocks business problems discovered by the CMA:

- 1- A company inquiring about the means for disposition of the value of cash coupons that will not be distributed/paid for treasury stocks intended to be purchased up to 3/4/2007, which is the maturity date of the coupon valued at LE 35, in execution of a company's ordinary general assembly's resolution issued on 15/3/2007. The CMA replied that the company may keep these cash payments as brought forward profits to be stated in the subsequent periodic financial statements of the company and to be added to the distributable profits when the ordinary general assembly of the company resolves in future to make cash payments regarding existing shares, just as brought forward profits.
- 2- A company requesting the CMA's approval to exempt the company from reducing its capital by the value of treasury stocks purchased more than one year ago, in order to transact through the transfer of ownership market at the stock exchange, as the company's stocks are not listed in the stock exchange. The CMA replied that the company is required to reduce its capital by the value of the treasury stocks purchased more than one year ago, pursuant to Article (3) of Ministerial Decree No. 75/1998 regarding execution of a number of provisions of Law No. 3/1998 amending a number of provisions of the Joint Stock, Limited by Shares and Limited Liability Companies Law No. 159/1981. This Article stipulates that "The company shall dispose of its treasury stocks prior to expiry of a period not exceeding one calendar year from the date of acquisition of these treasury stocks. Otherwise, the company shall invite the extraordinary assembly thereof within thirty days from the date of expiry of this said period to reduce the company's capital by the nominal value of these treasury stocks, according to the procedures established by the company for due invitation of the assembly and for reduction of the capital".
- 3- A company increased its capital through private offering, and requested to have the CMA's opinion regarding its desire to allocate LE 80 million to execute a "Green Shoe" to keep and maintain the stability of its shares in the Stock Exchange, through the private offering, by opening a private account by a limited number of selling shareholders. The CMA, in reply, was of the opinion that if the private offering prospectus provides for this procedure, the procedure may be undertaken in the manner suggested for this purpose. Since the private offering prospectus did not include the possibility to undertake this procedure, therefore, this request can not be approved by the CMA. Nevertheless, the company may interfere at any time, using treasury stocks, to keep and maintain the stability of the share price in the market, while the selling shareholders' interference, for a temporary period of (45) days, to keep and maintain the stability of the share price without an express provision in the offering prospectus is unacceptable.

It is worthy to note that the above question was raised after publication of the offering prospectus. Therefore, the CMA's opinion focused on the prospectus and the data included therein.

Fifteenth: Improper Practices Using the Company's Repurchase Transactions

Please find herein below a number of improper practices made by a number of issuing companies prior to promulgation of disclosure and trading controls related to treasury stocks.

- 1- A company announces that it shall repurchase 15 million of its shares from the open market to keep same as treasury stocks, which results in a raise in the market price of the shares due to the investors' enthusiasm for purchasing these shares. It is found thereafter that the company repurchases an approximate number of 100,000 shares only, without revealing the reason for its failure to repurchase the retire quantity subject of the announcement. The company's objective was to raise the trading level of its shares and to increase the share price during a period of time in which the stock exchange index was going down from one session to another.
- 2- A company repurchases treasury stocks, based on unpublicized insider information, on dates either preceding the announcement about the company's turnover or preceding the announcement about payment of the cash coupons, without application of the principles of equity to the company and the remaining dealers in the market.
- 3- A company with an objective to produce commodities, however, it tends to have its funds involved in financial investments, part of which is directed to repurchase treasury stocks. The company achieves abnormal profits, as it repurchases its share at a price less than the issuance price and then it destroys the shares, achieving profits from sources outside its scope of activity, and further tends to increase the rights of founding shareholders on the account of subscribing shareholders.
- 4- A company desires to have a number of resolutions passed by the general assembly, and in order to guarantee that no objections are raised by the minority who may own at least 5% of the company's shares and to avoid their requests for cease of assembly's resolutions, the company announces that treasury stocks shall be repurchased to prevent the minority from acquisition of the 5% of the company's shares and accordingly to be unable to cease the assembly's resolution.
- 5- A company notifies the CMA regarding repurchase of treasury stocks and announces in the market for this repurchase. However, the company fails to repurchase in spite of the fact that the market price of the share was at the minimum limit of price notified by the company to the CMA. When an explanation is requested from the company, the latter replies that it stated only that repurchase would be made if the share price is less than minimum limit of repurchase which was notified to the CMA, although a financial obligation is signed by the company in this respect by the listing committed at the stock exchange.
- 6- A company whose shares repurchased, in the form of global depository receipts, are kept for more than one year, however, it does not desire to reduce its capital, claiming that the deposit certificate representing its shares were not treasury stocks when repurchased by the company. The company was notified by the CMA regarding the necessity to reduce the company's capital by the value of treasury stocks which remained in its possession for more than one year.

- 7- A company announces for repurchase of treasury stocks, while a number of its board of directors announces, at the same time, for their desire to sell their shares in the market at the same time specified by the company for repurchase of treasury stocks. The CMA notified them that this action is not permitted in spite of disclosure of their intention, in light of the dissimilarity between the information in the market and that available at the company and its board of directors.
- 8- A company always announces, when tends to repurchase treasury stocks, that repurchase is to be made for the purpose of reduction of the capital during the year, if so desired by the company's management or if required to execute a shares-swap-program. This is deemed incomplete disclosure to the market, as the main purpose for which the company shall repurchase its treasury stocks is not clear from this announcement. This is due to the fact that the repurchase resolution is not issued by a board of directors or a general assembly, but it would emerge from the chairman of the board or the managing director who owns most of the company's shares and has private information not available to the remaining shareholders or to board members, which is deemed a case of manipulation.
- 9- A company announces, when tends to repurchase treasury stocks, that repurchase is to be made for the purpose of reduction of the capital during the year, if so desired by the company's management. However, this announcement is made by the company only through the stock exchange, without publishing same in two daily wide-spread newspapers. The company further fails to notify all shareholders through their registered addresses, pursuant to the Law, given the fact that capital reduction procedures undertaken through repurchase by the company of its shares differs from repurchasing for other purposes. The company's action represents either a case of ignorance or a case of manipulation.
- 10- A company desires to repurchase about 97% of its shares to be treasury stocks, in spite of cessation of its activity. This repurchase action is suggested by the board of directors of the company and approved by relevant extra-ordinary general assembly, which witnessed an attendance and consent rates of 100%. The company notified the CMA of the above, and the CMA was required to adjourn its approval until verifying the status of the company's creditors, the impact of repurchase transaction and payment of cash flows by the company on the creditors' rights, given the fact that the repurchase resolution is deemed as liquidation of the company.
- 11- A company not listed in the stock exchange, and its shares are traded in the orders market. This company periodically (approximately every week) repurchases treasury stocks from the market to keep its share price at certain level in the orders market, as there is no closing quotation for shares in this market. The company further has treasury stocks maintained for more than one year, while no capital reduction is made by the company for being not subject to the CMAs' control as it trades over the counter ,i.e., outside the organized market which is characterized by transparency and disclosure.
- 12- A company announced that there were negotiations with an Arab investor for purchase of a share in a company mostly owned by a governmental authority, which led to a raise in the first company's share price. The company used this chance to dispose of treasury stocks previously repurchased against high prices and the CMA cancelled related transactions as a result of manipulation and listing unrealistic prices by the company's management.