Capital Reduction

A way to reduce its paid-up capital by either one of two methods, as follows:

1) Reducing par value
2) Reducing the number of shares

Benefits of capital reduction

- To support future dividend payments if the company is experiencing accumulated loss. Capital reduction will compensate for a deficit in retained earnings allowing the firm to pay dividends without waiting for current operating results.
- To support capital increases by new investors
- To encourage efficiency of capital usage, which consequently improves financial ratios (e.g., ROE, ROA, total asset turnover) and increases the company’s attractiveness among investors.

Shareholders

- To have more opportunities to receive dividend payments if the company is experiencing a deficit in retained earnings.

Capital reduction to support future dividend payments

If a company has a deficit in retained earnings, laws prohibit it from paying dividends. The company may reduce its capital and use the funds obtained to offset the deficit in retained earnings. The company will consequently be able to pay dividends because (a) its retained earnings become positive and (b) the company’s statutory reserves are allocated and reserved in accordance with regulatory requirements.

Issues for consideration

- The capital reduction of retained earnings and reserves set in accordance with the company’s statement of financial position carries tax payment duties for shareholders who receive it accordingly.

- The company must inform its creditors in writing about the upcoming capital reduction. Creditors have the right to object to the reduction within two months from the notification date.

TIPS

If creditors object to the capital reduction, the company may negotiate and repay them in order to proceed with the plan.

“The company reduced capital by reducing the number of shares on August 3, 2010 in order to wipe out the deficit in retained earnings that was incurred during normal business undertakings. The company did not need capital reduction, but with the deficit in retained earnings, the company was not able to pay dividends despite the fact that the company had net profit earnings.

Thus, reducing capital to offset the deficit in retained earnings was a proper option that did not affect the company’s financial status. It positively impacted shareholders by giving them the chance to receive dividends or even capital gains from share price movement”.

Mr. Polpat Karnasuta,
President,
Navarat Patanakarn Pcl., (NWR)

CIMB Securities (Thailand) Co., Ltd.

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Reducing capital to support a capital increase by new investors

A company may foresee a business opportunity that it is unable to take advantage of because it has been experiencing accumulated losses. If the firm wants to raise funds, it can reduce its capital so that its capital level truly reflects the past loss. Thus, new investors will be able to inject funds at a price that properly reflects the firm’s value.

Reducing capital to encourage using capital more efficiently and thus improve financial ratios, e.g., ROE, ROA, or total asset turnover

If the company has a large amount of excess cash and does not need to use aforementioned funds in the near future, the firm may reduce capital to return the excess funds to shareholders. Examples are as follows:

<table>
<thead>
<tr>
<th>Statement of financial position – Before capital reduction</th>
<th>Statement of financial position – After capital reduction of THB800 million</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash 800</td>
<td>Liabilities 200</td>
</tr>
<tr>
<td>Other assets 400</td>
<td>Paid-up capital 1,000</td>
</tr>
<tr>
<td>Retained earnings 0</td>
<td>Retained earnings 0</td>
</tr>
<tr>
<td>Shareholders’ equity 1,000</td>
<td>Shareholders’ equity 200</td>
</tr>
<tr>
<td>Liabilities and shareholders’ equity 1,200</td>
<td>Total assets 400</td>
</tr>
</tbody>
</table>

Example: If net profit = THB20 million per annum, Return on Equity (ROE) and Debt/Equity (D/E) ratios can be shown as follows:

<table>
<thead>
<tr>
<th>Ratio</th>
<th>Before capital reduction</th>
<th>After capital reduction</th>
</tr>
</thead>
<tbody>
<tr>
<td>Return on Equity</td>
<td>2.0%</td>
<td>10.0%</td>
</tr>
<tr>
<td>Debt/Equity</td>
<td>0.2 times</td>
<td>1.0 time</td>
</tr>
</tbody>
</table>

Reducing capital to offset a deficit in retained earnings

Reducing capital to return excess funds to shareholders

Reducing capital by reducing par value

Reducing capital by reducing number of shares

Registering changed registered capital with the Ministry of Commerce

Reporting to SET about registering capital reduction

Commencing stock trading with the new registered capital

Remark * The record date is when the company determines the list of shareholders eligible to receive particular rights. The share register book closing date must be the following business day.