Securities and Exchange Commission of Pakistan

Public Consultation

On

Draft Guidelines

for

Stock Split by Unlisted Companies

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Guidelines for Stock Split by Unlisted Companies

1. Introduction, Purpose and Scope:

Introduction:

In terms of clause (c) of sub-section (1) of section 85 of the Companies Act, 2017 (the Act), stock-split primarily refers to the process of sub-dividing shares of a company into shares of smaller amount than is fixed by the memorandum. In simple terms, a stock split is a corporate decision whereby a company decides to divide its existing shares into multiple new shares, based on a predetermined ratio, while the overall value of the company's capital remains unchanged.

For instance, in a **2 for 1 stock split**, each existing member holding one share will receive an additional share, thereby doubling the number of shares held, while price per share is reduced to half. Although, the number of outstanding shares increases, the total value of the investors' holding remains the same, as the reduction in share price is compensated by the increase in number of shares.

Companies typically opt for stock splits to make their shares more accessible and affordable to a broader range of investors, particularly small investors. By splitting high-priced shares into a larger number of shares with a lower price, a company enhances the liquidity and marketability of its stock. Consequently, stock splits can lead to increased investor participation and attract a more diverse investors, thereby potentially improving the stability and volume of its stock. Additionally, stock splits can signal positive growth expectations and improve market perception, which can foster investor confidence.

Purpose and Scope:

The scope of these guidelines applies specifically to unlisted companies considering or planning a stock split. It outlines the essential steps that the unlisted companies should consider when preparing for and deciding on a stock split. The purpose of these guidelines is to offer a comprehensive framework to unlisted companies contemplating a stock split, ensuring a structured and well-informed approach.

2. Legal Framework for Stock Split in Pakistan:

Clause (c) of sub-section (1) of section 85 of the Act primarily addresses the legal requirements for executing a stock split by unlisted companies. Section 85(1)(c) of the Act[1] provides that *"a company having share capital may, if so authorized by its articles, alter the conditions of its memorandum through a special resolution, so as to sub-divide its shares, or any of them, into shares of smaller amount than is fixed by the memorandum"*.

[1] https://www.secp.gov.pk/document/the-companies-act-2017-updated-18-aug-2022/?wpdmdl=45422&refresh=67a989d2dbfca1739164114

Additionally, the Central Depository Company of Pakistan Limited Regulations also allow for share splits under Chapter 8D "Consolidation or Sub-division of Securities"[2]. Clearly, the legal framework for stock splits in Pakistan is well-established and straightforward.

Accordingly, it is essential that, prior to proceeding with a stock split, the company's constitutional document i.e. its Articles of Association contains the relevant provisions regarding stock splits, thus these provisions should be reviewed before initiating the process.

3. Procedure for Executing Stock Split by Unlisted Companies:

Unlisted company should follow the following procedural and regulatory requirements:

1. **Preparation Stage:**
   - The management of the company shall conduct a detailed analysis and evaluation before considering a stock split transaction based on factors including but not limited to the company's strategy, share price based on breakup value or other valuation method and market conditions etc.
   - May also consult with the experts and advisors in the field, if necessary.

2. **Board of Directors' Approval:**
   - Seek approval from the Board of Directors to proceed with the stock split transaction either through a board meeting or by passing resolution through circulation in terms of section 179 of the Act.
   - The Board to deliberate, deicide and recommend on the stock split transaction, including but not limited to the rationale, ratio for stock split (e.g. 2 for 1) and terms and conditions such as the execution date etc. While determining the ratio it must be ensured that post stock split no fractional shares are created.

3. **Shareholders' Approval through Special Resolution:**
   - If approved and recommended by the Board of Directors of the company, the company must seek approval of its shareholders through a special resolution for the transaction and changes in memorandum and articles of association of the company as required under section 85 of the Act.
   - Approval may be sought either by holding a meeting of the shareholders or by passing resolution through circulation in terms of section 149 of the Act (if requirements are fulfilled). This approval includes approval of the stock split ratio, terms and conditions and necessary amendments to the memorandum and articles of association of the company.

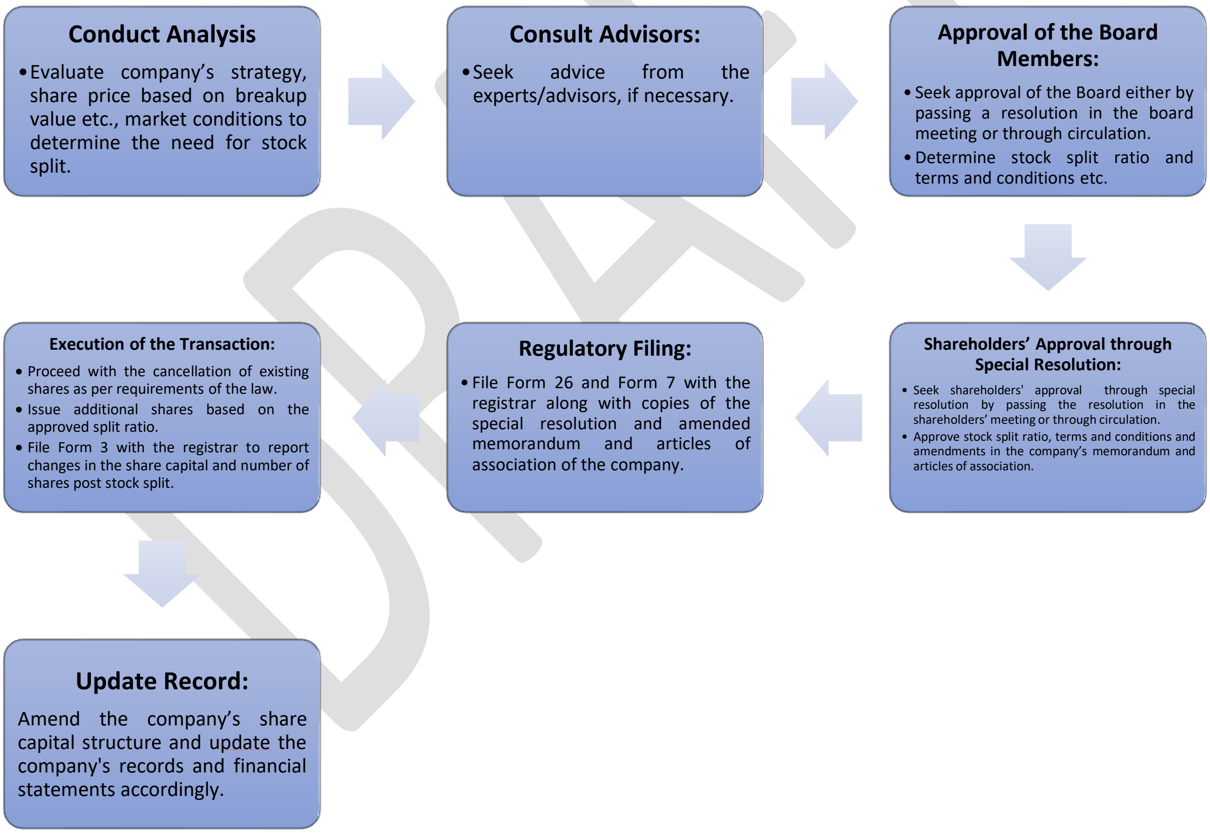
4. **Regulatory Filing with the Registrar Concerned:**
   - File Form 26 (Special Resolution) and Form 7 (Notice of Alteration in Share Capital) as per the Companies Regulations, 2024 along with the copy of special resolution and the amended copy of memorandum and articles of association of the company with the registrar concerned.

[2] https://www.cdcpakistan.com/assets/uploads/2023/12/CDCPL-REGULATIONS-MASTER-COPY-December-2023.pdf

5. **Execution of the Transaction:**

- The company shall proceed with the cancellation of shares in physical form and coordinate with the Central Depository Company (CDC) if the shares are in book entry form, in accordance with the applicable laws.
- The company shall issue additional shares based on the approved split ratio.
- In case shares of the company are maintained in book entry form, coordinate with CDC to facilitate the issuance of new shares to shareholders based on the approved split ratio and update shareholders' accounts with the new shares resulting from the stock split.
- File Form 3 (Return of allotments of shares & change of more than twenty five percent in shareholding or membership or voting rights) with the registrar as provided in the Regulations to report changes in the share capital and number of shares post stock split.
- Amend the company's share capital structure to reflect the revised number of shares resulting from the stock split and update the company's records and financial statements accordingly.

Process Flow:



4. <u>Costs Associated with Stock Split:</u>

The costs of executing a stock split for unlisted companies may include the following:

1. Administrative and legal costs associated with obtaining legal advice, if any, preparing necessary documentation, and updating company records etc.
2. Regulatory fee for filing documents with the registrar. Administrative and regulatory fee may vary depending upon the size of the company.
3. Costs associated with updating company's records such as shareholder registers and issuing additional share certificates (if applicable) or CDC in case shares are maintained in book-entry form.
4. Stamp duty fee on new shares, if applicable.

5. Accounting Treatment of Stock Split:

In a stock split transaction, the company's equity remains unchanged and the number of shares is simply increased while the par value per share decreases. Therefore, no major accounting changes are required. The par value is adjusted accordingly by balancing an increase in the number of shares. The company will then adjust the share capital account to reflect the split.

Additionally, the company should provide adequate disclosures regarding the stock split in its financial statements, detailing the impact on the number of shares and share capital.

6. Disclaimer:

These are general guidelines to facilitate the unlisted companies and do not set aside, replace or substitute any existing regulatory requirements applicable to unlisted companies under the prevalent laws and regulations.

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