Buyback offers roiling shares

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Mumbai: There is something curious about buybacks.

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A number of cash-rich companies that have announced them are seeing a downturn in stock prices.

Company managements announce buybacks -- the reverse of an issue of shares -- to instill confidence in its shareholders.

The repurchase, they claim, is an indication of the fair value of a share and by announcing to buy them back at a higher price than the prevailing market price, a company rewards its investors.

But a DNA Money analysis of the buyback offers currently open, shows that the opposite has happened.

Of the 23 buyback offers currently open, 22 companies are trading below the maximum buyback price. And two-thirds of these stocks are trading lower than the price on the day which the offer commenced.

Gujarat Fluorochemicals and Reliance Infrastructure lead the reverse-gear list: their share prices are at a 65% discount to what they were on the day of the buyback announcement.

One senior investor, who has been in the market for decades but does not wish to be named, said the buyback scheme is inherently flawed and misleads small investors.
He said under the present buyback scheme companies need to announce a maximum price for buying shares from the open market and not floor.

"Therefore, it is in the interest of the promoters to bring the share prices down. At the end of the day, the buyback will indirectly increase their holding in the company and this is done by using the company's reserves. Therefore, it is in their interest to push it down."

Recent data by Delhi-based broker SMC Global on the subject tallies with the argument.

Reliance Infrastructure has purchased its entire buyback quota of87.6 lakh shares at an average price of Rs 920, 42% lower than the maximum buyback price of Rs 1,600.
It used up only Rs 806 crore, as against the Rs 2,000 crore earmarked for the purpose.

DLF repurchased nearly 40% of its buyback quota using just 4% of the money earmarked. SMC data say DLF bought back over 21.4 lakh shares spending just Rs 51 crore. Its average price of acquisition works out to just Rs 238, or 60% lesser than the maximum buyback price of Rs 600.

All the current buybacks are happening at a discount to the maximum offer price.
While average discount stands at 36%, the range of discount varies from 0.46% (India Infoline) to 67% (R Systems International).

Mehul Savla, chief executive officer of **Ripple Equity**, a merchant banking firm, said after a buyback announcement, there is some movement in the share price initially.

"Then people don't know what amount will be utilised and whether the company will actually buy back. There are a lot of uncertainties," said Savla.
This is the reason why the open market purchase route is more popular.

"The tender offer process of buying back shares is not popular, because the stock market buy backs gives companies the flexibility. The buyback can be done more opportunistically when the stock is under pressure," Savla said.

"It is a corporate finance tool to improve the profitability ratios such as earnings per share, return on equity and also a way to provide some support to the stock price, as well an exit to public shareholders."

Experts said the catch in buybacks is that there is no legal provision saying what a company has to do after making a buy-back announcement.

A company can make an announcement and not buy back. If it has declared a maximum price of Rs 600, it may buy back some shares at Rs 200. There is no compulsion. Also, thecost associated with announcing a buyback is minimal, though it is a time-consuming process which may take 6 months from conception to the day the offer is made.

The proposal has to go through board an EGM, Sebi and stock exchanges for approvals.

"Sebi may be considering amendments to the buy back regulations making it mandatory for the company to spend the money on buy-backs," said an investment banker who wished to remain anonymous.

Though buybacks are not very lucrative, merchant bankers may be willing to take up buyback offers during market meltdowns like the current one, as they are jobless, anyway. Buybacks also may help the merchant banker to maintain relationships with clients.

"The markets have become smarter and do not react to a high buy-back price. However, there may be a risk of some small investors making purchases in anticipation of selling at higher price," said Savla.