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NRUPS NEWSLETTER



Why is buyback of shares done?

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TOPIC: BUYBACK OF SHARES

News Flash

1) Editorial.....	03
2) Buyback of Shares: A Concept.....	04
3) Why Buyback of Shares?.....	06
4) Impact of Buyback on various Shareholder's Segment.....	07
5) Case Study: Buyback of Equity Shares.....	08
6) Conclusion.....	12
Sources & Reference About NRUPS	



Infosys announces Rs 13,000 crore share buyback at Rs 1,150 per share

(Source: www.economictimes.indiatimes.com)

Marathon Nextgen Realty rises 3% post buyback plan approval

(Source: www.moneycontrol.com)

The Indian government has reportedly listed 26 PSU companies to consider buying back parts of stakes and paying dividends to help New Delhi meet its target of raising Rs 400bn (\$7.7bn) by selling shares this financial year.

(Source: www.indiainfoline.com)

In financial year 2016-17 alone, there were more than 40 listed companies announcing share buybacks to the tune of 30,000 crores, making it the highest ever in terms of value in a single financial year in the history of the Indian equity markets.

(Source: www.financialexpress.com)

Editorial

Dear Friends,

Hello Everybody!

Share buyback as a concept is very old but its actual usage has been on increase quite recently. In the recent past many companies are resorting to this route to reward the shareholders. It has become buzz word after the recent trigger of companies announcing buybacks. The major objective of a share buyback programme is to reward the shareholder in most tax efficient manner. It also reduces the free float from the market. Further it helps to arrest the fall in the value of a stock by reducing the supply of the stock, which essentially pushes up the share price through a better P/E multiple. In some situation company may want to bring down the public holding and increase promoters holding. If the company sees there is no better opportunity to deploy its cash reserves then it may decide to buy back its shares. The other impact would be increase in Earnings per share. Share Buy-back technique has suddenly become popular owing to, what is now called, the HNI taxation.

The Government PSUs are utilizing this route to meet their disinvestment programme. Nearly 65% of the amount raised through buy-back of shares was contributed by public sector units (PSUs), including Coal India, NMDC, and MOIL. Since majority of them are cash-rich PSUs,

leveraging cash through buybacks improves shareholders returns.

For small Investor share buyback provides good liquidity with the premium. Off late few multinational companies were also in the buyback race. In a buyback process, companies purchase their own shares from shareholders at a pre-decided price that leads to reduction in capital base and higher earnings per share.

Fiscal 2017 has seen a record number of buyback offers from cash-rich Indian businesses. As per the latest estimates by Prime Database, as many as 41 companies announced buybacks amounting to Rs 29,398 crore till February 2017, the highest ever in the history of Indian capital markets. While dividends are still going strong, the current wave of buybacks may continue due to its financial impact and tax implications.

Buy-back of shares has generated lot of investor interest and has suddenly triggered lot of share purchasing activity in such companies to benefit from the arbitrage opportunity. People take interest in analyzing various buying back opportunities available in the market. Let's understand the concept of buyback and its impact with the help of a case study. Hope you will enjoy reading this newsletter.

-Team Nrups



Buyback of Shares: A Concept

- **What is Buyback of Shares:**

Buy-Back is a corporate action in which a company buys-back its shares from the existing shareholders usually at a price higher than market price. When it buys back, the number of shares outstanding as Capital gets reduces. A buyback allows companies to invest in themselves.

Buybacks can be carried out in two ways:

- Shareholders may be presented with a tender offer whereby they have the option to submit (or tender) a portion or all of their shares within a certain time frame and at a premium to the current market price. This premium compensates investors for tendering their shares rather than holding on to them.
- Companies buy back shares in the open market over an extended period of time.

- **Norms and Rules of Buyback of Equity Shares:-**

There are certain prescribed norms under the act as well as the rules to make buyback eligible under Section 68 (2) of the companies act 2013 as follow:

- a) The Percentage of Buyback shall not exceed 10% of total equity capital and free reserves if the same is to be authorized by the board through a resolution in the Board Meeting.
- b) The Percentage of Buyback could exceed 10% but not beyond 25% of the total paid equity capital and free reserves if the same is authorized by the shareholders by means of a Special resolution.
- c) The ratio of the aggregate of secured and unsecured debts owed by the company after buy-back shall not be more than twice the paid-up capital and its free reserves.
- d) All the Equity Shares for buy-back have to be fully paid up
- e) The buy-back of the shares listed on any recognized stock exchange is in accordance with the regulations made by the SEBI in this behalf
- f) No offer of buy-back under shall be made within a period of one year reckoned from the date of the closure of the preceding offer of buy-back, if any
- h) Under Rule 10 (b) The Company shall not issue any new shares including Bonus shares from the date of passing the special resolution authorizing Buy back till the date of closure of offer of Buy back except those arising out of convertible debentures

Eligibility criteria for Buy-back under the Rules 17 as follows:

i) There should be:

- a) No defaults subsisting in repayment of deposits and interest payment thereon
- b) No defaults on redemption of preference shares
- c) No defaults in payment of dividend due to any shareholder
- d) No defaults in repayment of any loan or interest payable thereon to any financial institution or banking company. However Section 69 gives an exemption that if the above default is remedied and a period of three years has lapsed after such default ceased to subsist.

ii) There shall be no grounds on which the Company could be found unable to pay its debts

iii) The Company should be in a position to meet the liabilities as and when they fall due and shall not be rendered insolvent within a period of one year from the date of buy back.

Why Buyback of Shares?

The primary objective of a share buy-back programme is to arrest the fall in the value of a stock by reducing the supply of the stock, which essentially pushes up the share price through a better P/E multiple. The other objective is to improve earnings per share (since the same earning amount is now distributed among fewer shares). Share buyback is a more tax efficient way of distributing earnings of the company. While dividends under Rs 10 lakh are not taxable in the hands of shareholders, companies have to pay tax on dividends. A share buyback program is a more tax efficient way of distributing earnings from a company's perspective.

Let's look at some reasons why companies go for share buy-back:

- To Improve earnings per share:- Buy-back reduces outstanding shares from the market which leads to increase in EPS.
- To Improve return on capital, return on net worth and to enhance long-term shareholder value:- Buy-back of shares reduces outstanding shares which reduces share capital from balance sheet which also increases return on capital and return on net worth. Additionally it also generates strong shareholder's value if company is having strong fundamentals.
- To provide an additional exit route to shareholders when shares are undervalued or are thinly traded:- Many a times investors may have an stress about the company's current situation and also because of thinly traded stock company gives investor a relief by giving buy-back offer.
- To enhance consolidation of stake in the company:- Buy-back also enhance the proportion of shares company owns which leads consolidation of its stake in the company
- To prevent unwelcome takeover bids and to return surplus cash to shareholders
- To achieve optimum capital structure:- Through Buy-back company can increase its stake and also achieve optimum capital structure
- To support share price during periods of sluggish market conditions and to service the equity more efficiently
- Undervalued shares:- At times when company feels the shares are undervalued, a share buyback is used to pump up the stock price, which acts like a support or new base for the stock. There could be number of reasons why shares traded at lower despite stable fundamentals. A buyback reassures investors that the company has confidence in itself and is determined to work towards creating value for shareholders.

According to buy-back norms laid out by SEBI, there are two ways where listed company can go for buy-back;

1. Open market purchase:

If a company opts to buy shares from the open market, it makes an offer to shareholders indicating the max price and the number of shares it wishes to purchase. However, the company is at liberty to pay less than the initially offered price and is not obligated to purchase the entire quantity as announced in the repurchase plan. Only public shareholders are permitted to participate in the open market buyback.

2. Tender route:

Here the company directly purchases shares from the shareholders on a proportionate basis. The biggest plus is the company fixes the price at which it intends to buy the shares, which are generally higher than the market prices, thereby benefiting shareholders. Both promoters as well as public shareholders participate in the process.

Impact of Buy-back on various Shareholders' Segment

There are various reasons as narrated above for the company to go for buy-back of shares and the shareholders like retail, HNIs, FIs who participate in the buy-back programme have their own reasons too. It is important to know how far it would be beneficial to all categories of shareholders if they opt buy-back. It is necessary to analyze the holdings of each category of investment in the company like how much each category like promoter group, FIs portion, Retail investor's etc are holding. Let us study impact of buy-back on various classes of shareholders:-

Retail:-

Considering the buy-back size and retail investor's acceptance ratio, overall retail investors' probability of opting buy-back would be derived. Based on this analysis and along with percentage of premium offered by the company, retail investor should consider company's long term view and can take a call whether they would like to tender their shares or not?

By tendering the buy-back in such a small size of overall holdings, chances would be minimal to get the offer. Also if one gets the offer of buy-back with premium in tendering, the same has to compare with reduction in exposure and benefits from long term growth in the form of dividends and capital appreciation. In the same way retail investor can also hold their offer of tendering shares for buyback considering company's current situation and future roadmap. If Investors may find the same shares lucrative in the long run than they might not choose to give back the shares to the company

HNIs:-

It is equally important for HNIs to analyze decision whether to go for a buy-back or not. The finance minister in his last years budget announced a special tax of 10% on dividends above Rs. 10 Lakhs in addition to a distribution tax of 20%. Many companies went on to declare dividends earlier than its due. Up till last financial year budget private and family trusts were excluded from the tax brackets but this year budget included family trusts too so, any income above Rs. 10 lakhs fall in trusts would also taxed at the defined tax rate. For HNI, buy-back is a tax efficient option instead of receiving dividend and taxed at the applicable tax rate. However for HNI's equity holdings is also part of their long term Investment portfolio and if they have strong conviction in the stock than they might not opt for buy back to benefit from the long run appreciation. So, HNIs needs to analyze all prevalent situations for buy-back of shares.

Taxation Impact:

For every class of investors taxation is important. If shares are held for more than one year before buy-back than it will be considered as long term which will be exempted from the capital gain. If the holding is less than a year than short term gain tax would be levied. Companies tend to offer buy-back through tender or buy from open market. The tax treatment for each is different.

Buy-backs conducted through open market route are done in the stock market. Investors selling during this period have to pay a securities transaction tax (STT). The sale works like any other stock-market transaction. Therefore, the capital gains tax on this will be lower. STCG will be taxed at 15 percent while long term capital gains are exempt from taxes.

A buyback conducted through a tender is an off-market transaction and not subject to STT. Like other open offers or de-listing offers, a buyback through this is subject to tax as in any other capital asset. Long-term gains will be taxed at 10 per cent without indexation or 20 per cent with indexation whichever is lower. Short-term gains are taxed at normal Income tax slab rates.

A Case Study – Buy-back of Equity Shares

There is a definite impact of buy-back on various classes of shareholders but how it impacts the company's shares, its performance, its market ratios etc is interesting to know. Let us understand the impact of buy-back on company by taking a real example as a case study:

Details of Buy-back

Name of the Company	: Tata Consultancy Services Ltd
Board Consider Proposal of Buy-back	: 15 th Feb 2017
Board Approves Proposal of Buy-back	: 20 th Feb 2017
Face Value	: Re. 1/-
Buy-back Size (No of Equity Shares)	: 5, 61, 40, 351 Equity Shares
Offer Price for Buy-Back	: Rs. 2,850/- Per Equity Share
Premium on Offer Price	: 17.98% on BSE on closing of 15 th Feb & 18.08% on NSE on closing of 15 th Feb
Closing Price as on 15th Feb 2017 on BSE	: Rs. 2415.70/-
Closing Price as on 15th Feb 2017 on NSE	: Rs. 2413.70/-
Buy-back Size (In Rs. Cr)	: Rs. 16 ,000 Crore
Offer size (% of Total paid up Equity share capital)	: 2.85%
Offer size (% of Total paid up Equity share capital And free reserves)	: 21.89%
% of Buy-back of shares from Shareholder	: 15% as on record date
Buy-back route	: Through tender route
Record Date of Buy-Back	: May 8 th 2017
Buy-back Offer Period	: 18-05-2017 to 31-05-2017

Objective of Buy-back:

The Buyback is a capital allocation decision taken with the objective of seeking a fairer valuation of the Company's stock while improving the Company's Return on Equity and increasing shareholder value in the longer term.

The Offer Price represents:

(i) Premium of 26.34 % and 25.51 % to the volume weighted average market price of the Equity Share on BSE and NSE, respectively, during the three months preceding the date of intimation to the Stock Exchanges for the Board Meeting to consider the proposal of the Buyback.

(ii) Premium of 17.98 % and 18.08 % over the closing price of the Equity Share on BSE and on NSE, respectively, as on February 15, 2017, being the date on which the Company intimated the Stock Exchanges of the date of the Meeting of the Board of Directors wherein proposal of the Buyback was considered.

Scenario of Pre-Buy Back & Post Buy-back

Shareholding Pattern

Category	Pre-Buyback*		Post-Buyback#	
	No of Equity Shares	% of Shareholding	No of Equity Shares	% of Shareholding
Promoter and Promoter Group	144,45,15,152	73.31%	140,91,96,938	73.61%
Foreign Investors (including NRIs/FIIs/ FPIs/Foreign Nationals/OCBs)	33,61,33,881	17.06%	50,50,90,652	26.39%
Financial Institutions/Banks/NBFCs and Mutual Funds/Insurance Companies	10,60,89,871	5.38%		
Others (Public, Bodies Corporate, Clearing Members, Trusts, and HUF)	8,36,89,037	4.25%		
Total	197,04,27,941	100.00%	191,42,87,590	100.00%

*As on Record Date

assuming full acceptance of Equity Shares in the Buyback as per the Buyback Entitlement

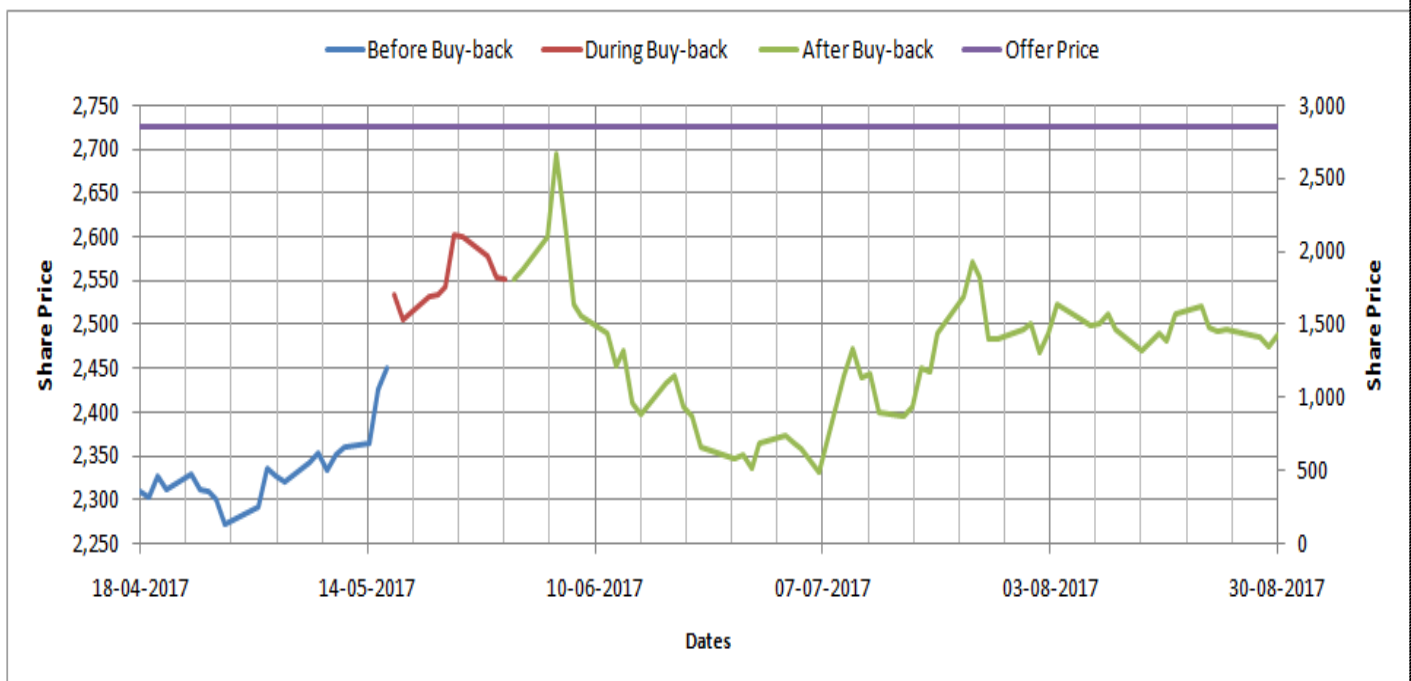
Salient financial parameters pursuant to the Buyback based on the audited standalone financial statements of the company

Parameters	Pre-Buyback (As on March, 31 2017)	Post-Buyback (As on March, 31 2017)
Net worth (Rs In Crore) ^(a)	Rs. 78,022	Rs. 62,022
Return on Net worth (%) ^(b)	30.32%	38.14%
Earnings per Equity Share ^(c)	120.04	123.56
Book Value Per Equity ^(d)	395.97	324.00
PE ^(e)	20.26	19.68
Total Debt/Equity Ratio ^(f)	0.003	0.004

Note:-

Pre and post buyback calculations are based on audited standalone financials of the company as on March 31 2017. The post buyback numbers are calculated by reducing the net worth by the proposed buyback amount (assuming full acceptance) without factoring in any impact on the profit & loss account. Net worth used excludes revaluation reserves and miscellaneous expenditure to the extent not written off.

- a.) For the above purpose, “net worth” means the aggregate value of the paid-up share capital and all reserves created out of the profits and securities premium account, after deducting the aggregate value of the accumulated losses, deferred expenditure and miscellaneous expenditure not written off, as per the audited standalone balance sheet, but does not include reserves created out of revaluation of assets, write-back of depreciation and amalgamation.
- b.) Return on Net worth is computed as profit after tax for the relevant period divided by closing net worth for period
- c.) Earnings per share calculated as profit after tax for the relevant period divided by total number of shares pre buyback and total number of shares post buyback
- d.) Book value Per Equity Share is calculated as pre Buyback net worth divided by total number of shares pre Buyback and post buyback net worth divided by total number of shares post buyback
- e.) Price/Earnings is calculated as closing market price of the Equity Shares on NSE on March 31 2017 divided by Earnings per equity share pre Buyback and closing market price of the Equity Shares on NSE on March 31, 2017 divided by Earnings per equity share post Buyback
- f.) Total debt/equity ratio is calculated as total debt divided by net worth

Price,- Pre, During & Post Buyback Buyback Period - 18-05-2017 to 31-05-2017

Scenario Analysis on various Possibilities from the Investor point of view

The impact of share buy-back offer on a retail investor can be studied as follows:

Particulars	
Share Price at announcement date	Rs. 2,309/-
Buyback Price (18-05-2017 to 31-05-2017)	Rs. 2,850/-
Post Buyback Price @ 01 st June 2017	Rs. 2,551/-
Possible Buyback Offer*	15% of Shares
Shareholding	85
No of Shares offered in Buyback	13
Pre-Tax Gain in shares offered in Buy-back	23.43%
Pre-Tax Gain on remaining shares (i.e. 72 shares)	10.48%
Weighted Average Pre-Tax Gain on Total Shares	12.46%

From the above analysis it can be clearly seen that the impact of share buy-back on a pre-tax basis works out to be 12.46%.

Now let's take Scenario in which shareholder who had purchased 85 shares twelve months ago and who would get the benefit of long term capital gain. In this case the price prevailing twelve month prior to the buy-back offer was Rs. 2,522/-. If he had purchased 85 shares than the buyback offer would have resulted into long term gain of Rs. 6,352/- by offering 13 shares for buy-back and rest sell in the open market post buy-back. The resultant gain would be 2.96% only. Hence, in this case the shareholder does not stand to gain in case of buy-back offer.

Arbitrage Opportunity

In the current volatile scenario share buy-backs are being used more like an arbitrage opportunity. Let us consider two scenarios in this respect.

Scenario I

If Investor Purchase Shares at the time of announcement of buyback and opt for Buyback and sell remaining shares post buyback

Scenario II

If Investor Purchase Shares at the time of announcement of buyback and does not opt for Buyback and sell all the shares post buyback

Particulars	Scenario I	Scenario II
Share Purchase on announcement	18-04-2017	18-04-2017
No of Shares Bought	85	85
Share Price at announcement date (18-04-2017)	Rs. 2,309/-	Rs. 2,309/-
Buyback Price (18-05-2017 to 31-05-2017)	Rs. 2,850/-	Rs. 2,850/-
Post Buyback Price @ 01 st June 2017	Rs. 2,551/-	Rs. 2,551/-
Possible Buyback Offer*	15% of Shares	15% of Shares
No of Shares offered in Buyback	13	-
Pre-Tax Gain in shares offered in Buy-back	23.43%	-
Pre-Tax Gain on remaining shares (i.e. 72 shares)/ All Shares	10.48%	10.48%
Weighted Average Pre-Tax Gain on Total Shares	12.46%	10.48%
Weighted Average Post-Tax Gain on Total Shares	10.59%	8.91%

**Assuming 100% acceptance ratio*

As it is evident from the above two scenarios, investor who purchases shares after announcement and opts for buy-back eventually got higher short term gain.

In such cases and in a volatile market sometimes arbitrage opportunities provide more returns in the short term. Hence buyback can be seen as arbitrage opportunity wherein short term gain can be locked by purchasing the shares after announcement of buy-back. The investor who bets on long term on this stock, for him buy back event would be less important.

Another important derivation from this case relates to the objective of the company for the buy-back. Company's objective for buy-back was to fairly value the company at Rs 2850 per share however even after 3 months of buy-back, company's stock never touched Rs 2850.

Conclusion

Generally buybacks are priced at a premium over the existing stock price, it definitely excites the shareholders. The Financial pundits indicate a healthy position of the company since companies generally buy-backs the shares from its cash reserves. However it is crucial for the shareholders to gauge the objective of the company behind the buy-back. Research demonstrates that buybacks are generally ineffective in long term value creation, notwithstanding the short-term spikes in stock prices due to optically better earnings per share (EPS). Whether particular share holder will opt for buy back or not also depends upon the value one attachés to that company. If ones believe to hold the shares for long term then the shareholder may resist in selling the shares back to the company.

Companies offering buy-backs are not always rewarding its shareholders. Cash distributed to shareholders through buy-back might signal lack of growth opportunities. For Instance IT companies offering buy-backs might signal a fact that there is no better place to invest due to lack of growth opportunities within the industry. While short term holders of stock are least concerned with the growth story, the investors who invest for a long term in a company need to analyze the offer of buy-back and determine whether it is fruitful and serve their objective of investment. However for HNI investors the buy-back offers are more lucrative as they don't have to pay 10% income tax on dividend exceeding Rs. 10 Lakhs.

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About NRUPS

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