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In Street's worst year in three, buybacks soar

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Share buybacks in 2011 so far have soared as much as seven times to Rs4,058 crore from Rs571.84 crore in 2010 (Rs2,412.30 crore in 2009 and Rs1,034.60 crore in 2008) as a combination of cheap valuations and some regulatory push encouraged 16 Indian companies to spend all of their money earmarked for the purpose.

According to the Capital Market magazine, Piramal Healthcare (Rs 2,508.16 crore), Hindustan Unilever (Rs625.3 crore), Deccan Chronicle (Rs227.66 crore) and Lakshmi Machine Works (Rs225.51 crore) accounted for much of the buybacks in 2011.

Typically, a company repurchases part of its stock held by public at a premium through tender or open market operations over an extended period of time. This shrinks floating stock and boosts promoters' stakes. In fine, the company invests in itself, enhancing the shareholder's value as well as financial ratios like earnings per share (EPS) and return on net worth (RoNW).

Experts believe that the sharp fall in stock prices of mid-cap companies this year could have prompted companies to invest all of their buyback funds.

"Prices have been depressed so much that it makes sense for companies whose internal worth is much more than the market price, to do a buyback and cancel a certain percentage of equity shares. Companies that are interested in buybacks would want to scoop up their shares at the earliest," said Dara Kalyaniwala,vice-president (investment banking), Prabhudas Lilladher, a Mumbai-based brokerage.

Another reason for the 2011 buyback spurt is sustained weakness in prices over a longer period, unlike in earlier years.

"The valuations, especially for mid-caps, have come down sharply. It made sense for companies to utilise the excess reserves to buy back their shares. In 2009, the fall was for a short duration. By the time companies actually resorted to buyback, there had been a sharp pullback in markets, taking the prices of many stocks above the set maximum buyback price," said Girish Nadkarni, executive director and head (equity capital markets), Avendus Capital.

In 2009, as many as 44 companies bought back their floating stock. But their investment was much less (Rs2,412.30 crore) as repurchases were only half of their commitments. This prompted tighter regulation from Sebi.

Mehul Savla, director, Ripple-Wave Equity Advisors, recalled that Sebi had been quite categorical that the money set aside for buyback must be spent fully. "This would have deterred many of the companies from misusing the buybacks to just prop up the share prices like in the past."

The notable trend this year has been that companies have completed buybacks well before the permitted timeline. Among ongoing buybacks, companies like Infinite Computers and SRF have bought close to, or more than, the maximum offer shares.

There are a few companies like Reliance Infrastructure, Allied Digital and Bhagyanagar India, however, that have bought only about 30% of the maximum limit of shares, in spite of their shares trading deeply lower than offer price.

Such companies' intentions remain unclear. But experts believe liquidity might be a concern for some of them. They had rather use cash for business operations.

"Over the last few months, the economic environment has changed. And now, the business outlook itself is not certain. So, some of the companies may have thought that it's better to preserve cash rather than using it for buybacks. Also, it could be that some promoters might have realised they had committed a higher price for buyback and so are now turning cautious," said Savla.

Looking ahead, experts don't see companies getting euphoric on buybacks in 2012 and beyond. Promoters who feel their companies' shares are undervalued, may use creeping acquisition to raise their shareholding.

Buyback offers may decrease as one of the two conditions required for buyback does not hold true in the current environment: even as the shares are available below fair value, few companies have surplus cash over and above what is required by business.

Also, those promoters who want to increase their stake would now prefer to use the creeping acquisition route as the limit has been raised under the new takeover norms, said Savla.

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