BUYBACK WAVE

India's rising buyback tide doesn't raise all boats equally

TCS' recent $2.4 billion share buyback has shone a spotlight on Indian companies' increased affinity for buybacks. The number and quantum of buybacks has spiked—the first three months of 2022 saw more value distributed through buybacks than all of 2021. However, over a decade's worth of data shows that not all buybacks are created equal

Anand Kalyanaraman, Prajakta Patil, 28 Mar 2022

Share repurchases, or buybacks, by Indian listed companies have shot up manifold over the past few years. 2016 was the inflexion point

Favourable tax treatment relative to dividend payouts have driven the buyback surge. Software companies dominate the league tables

But most buybacks in India have not measured up well on a key touted benefit—superior stock price gains compared with the market

Software companies have a better post-buyback track record than most others on improvement in financial and market metrics

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HIDE SUMMARY

Last week, Tata Consultancy Services (TCS)—India's largest software company by revenue and its second largest by market capitalisation—concluded its Rs 18,000 crore ($2.4 billion) share buyback. It received a roaring, rockstar-like reception, and was oversubscribed 8.5X. With good reason. The offer price of Rs 4,500 ($60) a share was at a tidy premium of ~20% to the current market price.

TCS may have hogged the limelight in India for its mega-sized share buyback, the country's largest so far. But globally too, a massive buyback wave is making its way to the shores of stock markets. Many companies, flush with cash, seem to be taking advantage of the volatility and weakness in the stock markets over the past few months to repurchase their shares. Amazon, Alibaba and a host of others have planned big repurchases in 2022. They could set a new record even, with analysts and investment banks such as forecasting $1 trillion in buybacks by companies this year. Buybacks, after all, help them kill many birds with one stone.

Managements often use buybacks to signal their confidence in the prospects of the company and its stock price. They're also handy tools for distributing excess cash to shareholders in a tax-efficient manner. And with repurchased shares required to be extinguished, buybacks improve financial metrics such as and on the remaining shares. This, in turn, aids their valuation multiples and the share price.

It's not all rosy, however. Buybacks are also criticised for not plowing money back into the business for future growth and for being a tool to manipulate stock prices and financial metrics linked to the compensation of executives.

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The debate is likely to be even fiercer this year, including in India, where buybacks in the first three months of 2022 have exceeded the entire sum of 2021. This is thanks largely to TCS, but nine other companies have already bought back shares this year. A few more offers, such as those from Gulf Oil Lubricants and engineering firm Pennar Industries, are underway. Many more buybacks could follow if the trends of the past few years are any indicator.

According to data on buybacks shared by markets information provider Prime Database, Indian companies successfully repurchased shares worth nearly Rs 2,46,000 crore ($32.2 billion) since 2010. *The Ken* ran the rule companies and investors. What we found should help investors take a call on whether to participate in a buyback or stay invested.

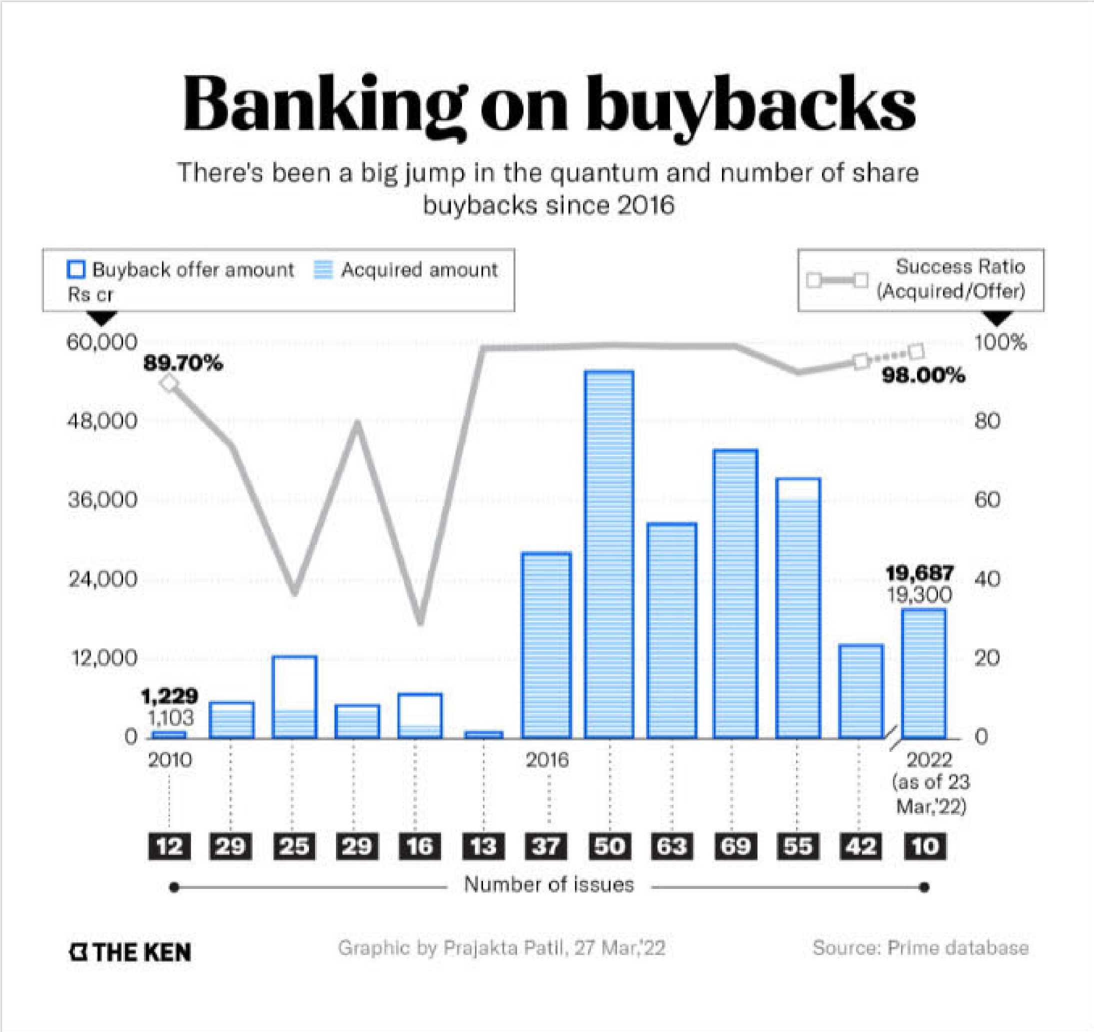
Burgeoning buybacks...

The year 2016 was a clear inflection point for buybacks in India. From less than Rs 1,300 crore ($170 million) in 2015, the value of shares repurchased by listed Indian companies in 2016 shot up to nearly Rs 28,000 crore ($3.7 billion)—a jump of more than 2000%.

Since then, the quantum of buybacks has been higher in each of the years since. The only aberration to this trend came last year, when the value of buybacks dropped to Rs 13,658 crore ($1.8 billion). The surge in stock prices last year might have given the companies some pause.

It isn't just the quantum of buybacks—the number of buybacks and investor participation have surged as well.

Of course, these trends weren't a coincidence.



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...Thanks to tax tweaks

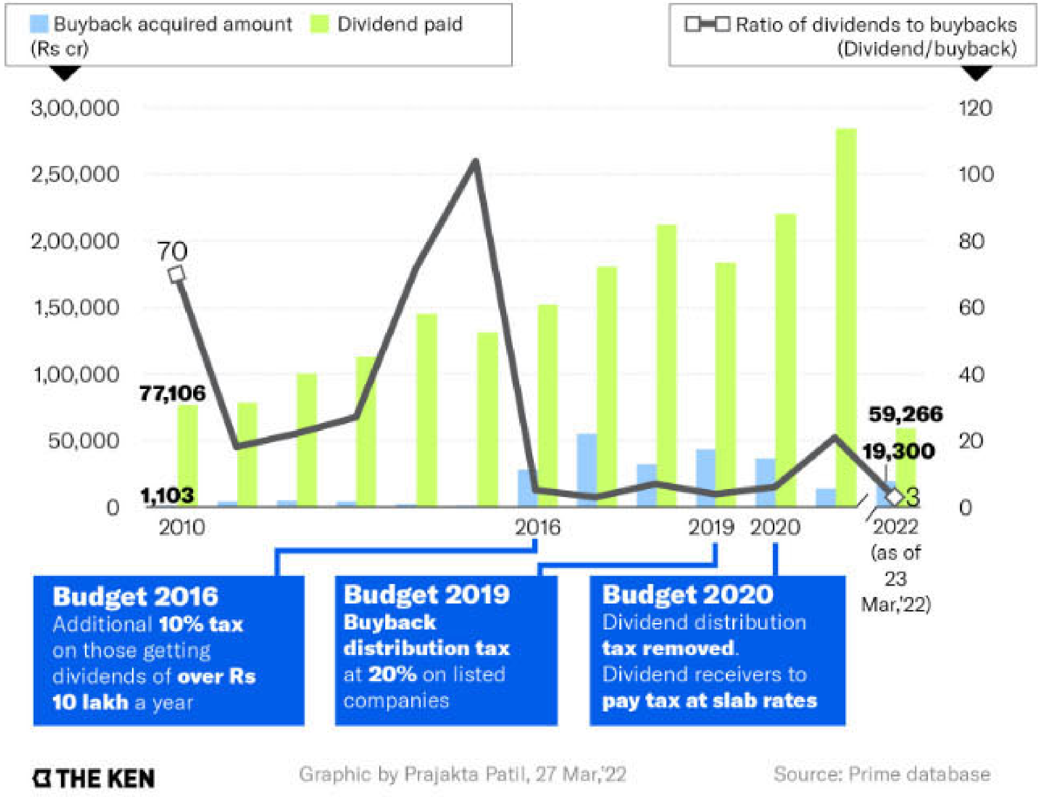
Never underestimate the power of the taxman. In 2016, a tax squeeze on dividends—Indian companies' most favoured route of returning cash to shareholders—opened the floodgates for buybacks. That year, the Union Budget delivered a googly by imposing an additional 10% tax on those getting dividends above Rs 10 lakh ($13,100) a year. Additionally, because companies already had to pay dividend distribution tax of 15% on payouts. This made buybacks the better deal from a tax perspective; they were taxed as capital gains, with long-term gains exempt from tax and short-term gains taxed at 15%. Not surprisingly, they saw a lot of traction.

But buybacks lost some of their tax sheen when long-term capital gains were subjected to 10% tax in the 2018 budget, and also when a 20% buyback distribution tax was imposed on listed companies the following year. Despite this, buybacks still had tax advantages over dividends. In 2020, the budget added to this by removing dividend distribution tax and taxing dividends in the hands of the receiver at slab rates. Long story short, dividends entail a higher tax outgo than buybacks for rich shareholders.

Still, most cash distribution by Indian listed companies continues to be through dividends. Among other reasons, dividends are quicker to execute and also because buybacks come with many conditions, including having a debt-to-equity ratio of less than 2X. That said, the ratio of dividends to buybacks has fallen sharply over the past few years, attesting to increased use of the latter. Much of this is attributable to software companies, led by

Less taxing

Tax changes since 2016 have made buybacks much more tax-efficient than dividends. The dividend to buyback ratio has fallen sharply since then



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...With IT biggies leading the charge

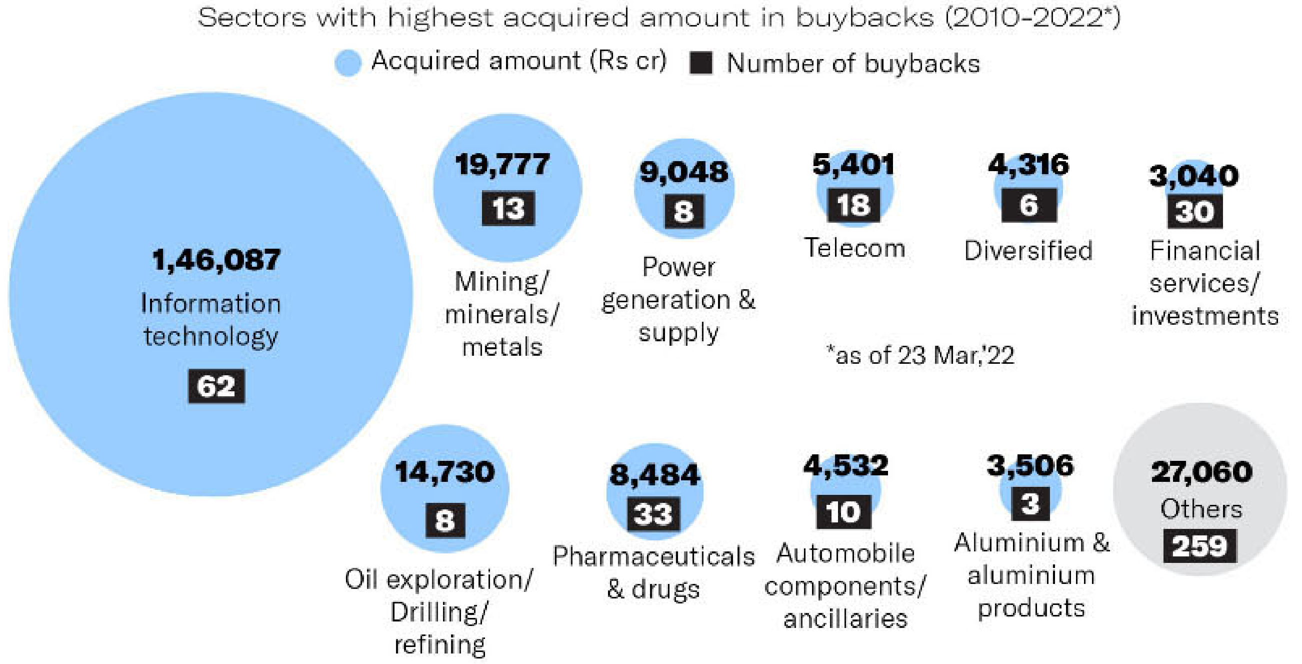
The information technology (IT) sector is the undisputed *numero uno* in India's buyback story, at least so far. Of the nearly Rs 2,46,000 crore ($32.2 billion) paid out by Indian listed entities through buybacks since 2010, software companies accounted for a whopping 60%—about Rs 1,46,000 crore ($19.1 billion).

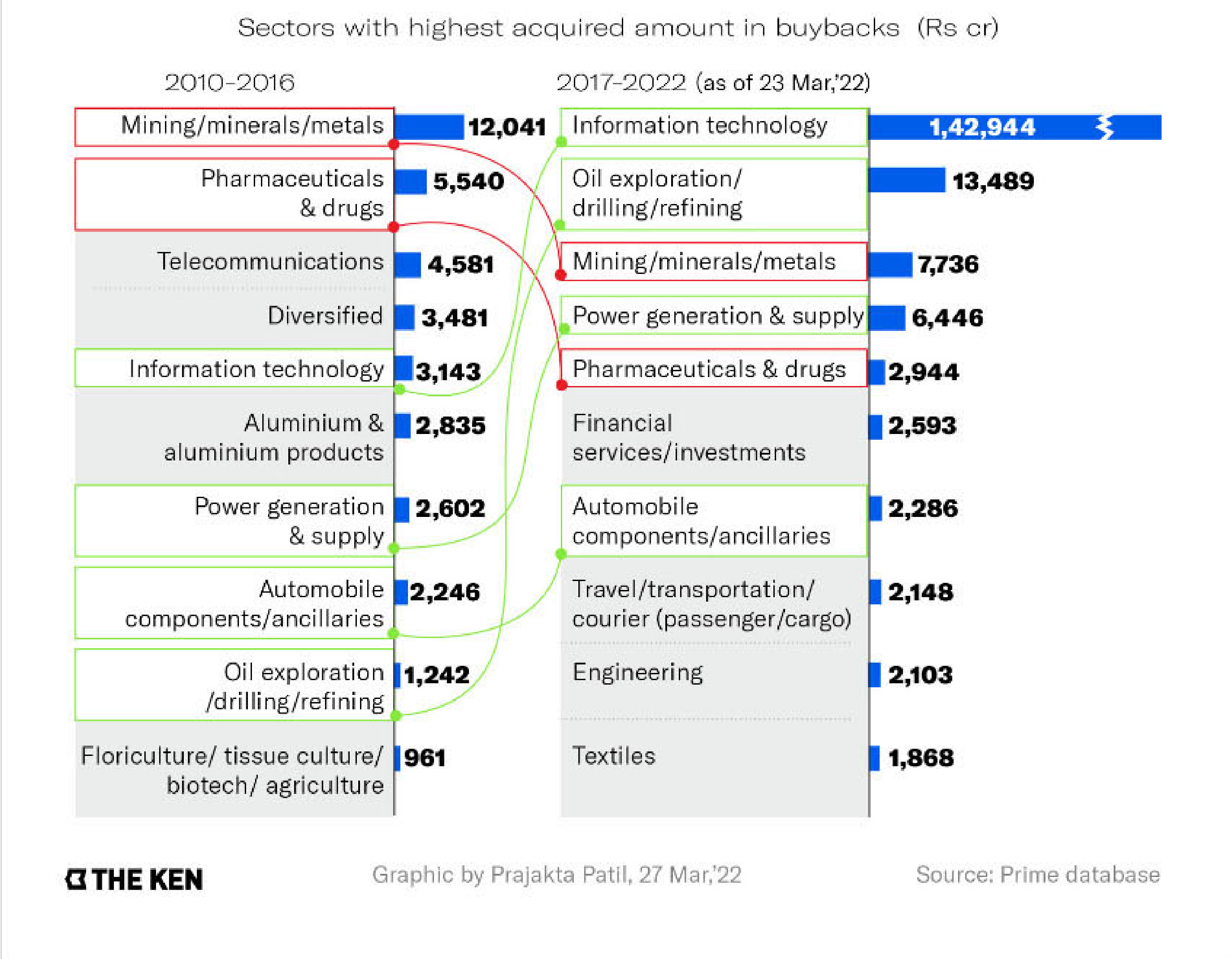
This would have been implausible even six years ago. The IT sector has been a late bloomer when it comes to buybacks. From 2010 until 2016, it paid out just about Rs 3,100 crore in buybacks, with other sectors like mining and pharma topping the buyback charts. In 2017, though, it took off like a rocket when the Big Four of Indian IT—TCS, Infosys, Wipro, and HCL Technologies—led the charge with buybacks in the range of Rs 3,500 crore ($459 million) to 16,000 crore ($2.1 billion) each.

They have followed this up with big buybacks almost every year or every other year since. Such tax-savvy, cash-rich, and low-debt companies seem uniquely positioned to ride the buyback wave. The next biggest sectors on the buyback charts—mining and oil & gas—are largely public sector companies such as Indian Oil, ONGC, NMDC, and Coal India. These companies undertook big buybacks in the past to meet the needs of their biggest shareholder, the Indian government.

The IT sector

Since 2017, IT firms have led the buyback charge





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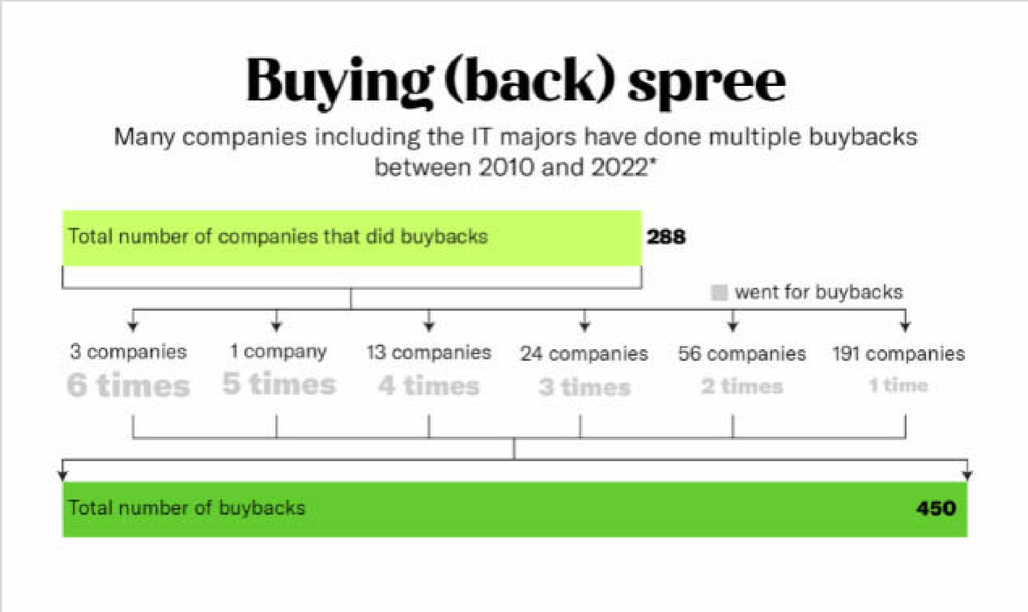
Interestingly, it is not just the software majors that have undertaken multiple buybacks over the years. In fact, smaller peers such as eClerx and companies from other sectors including pharma player FDC Ltd and telecom firm OnMobile Global have been more prolific on buybacks. For such companies, buybacks seem to have become as acceptable a route as dividends to return cash to shareholders.

But when it comes to scale, the Big Four in IT and government-controlled entities such as NMDC, NHPC, and Coal India win hands down.



Companies with the highest number of buybacks (2010-2022*)

Company	Number of buybacks	Acquired amount (Rs crore)
FDC	6	**416**
Balrampur Chini Mills	6	**927**
eClerx Services	6	**1,170**
Jagran Prakashan	5	**845**
Tips Industries	4	**36**
Sasken Communication Technologies	4	**221**
Infinite Computer Solutions (India)	4	**221**
OnMobile Global	4	**138**
Gujarat Apollo Industries	4	**73**
R Systems International	4	**79**
Just Dial	4	**688**
Wipro	4	**33,500**
MOIL	4	**2,076**
Aarti Drugs	4	**136**
Tata Consultancy Services	4	**66,000**
Kaveri Seed	4	**716**
James Warren Tea	4	**106**

Companies with the highest value acquired in buybacks (2010-2022*)

Company	Number of buybacks	Acquired amount (Rs crore)
Tata Consultancy Services	4	**66,000**
Wipro	4	**33,500**
Infosys	3	**30,460**
NMDC	3	**9,906**
HCL Technologies	2	**7,500**
NHPC	3	**5,584**
Coal India	2	**4,700**
Indian Oil	1	**4,435**
Bosch	2	**4,177**
ONGC	1	**4,022**
National Aluminium	3	**4,089**
Reliance Industries	1	**10,440**
NLC India	2	**2,725**
Oil India	2	**2,613**
Bharat Electronics	2	**2,543**
Piramal Healthcare	1	**2,508**
Hindustan Petroleum	1	**2,500**
NTPC	1	**2,276**
Mphasis	2	**2,091**
MOIL	4	**2,076**

*as of 23 Mar,'22

THE KEN Graphic by Prajakta Patil, 27 Mar,'22 Source: Prime database

Gaining but lagging

The other touted benefit of buybacks is superior stock price gains for companies and investors who stick with them. This, however, has not panned out as either party would have hoped.

Among the expectations from buybacks is that such stocks would do better compared with the overall market. After all, a buyback gives a leg-up to many financial metrics such as EPS and ROE. This should help the stock price of a company. Sure, a host of factors, many of them unpredictable, influence stock price movements. But buybacks play a part too, or are at least supposed to.

However, while most stocks by themselves have gained since their buyback, they have lagged on a relative basis compared with the market bellwether Nifty 50 index.

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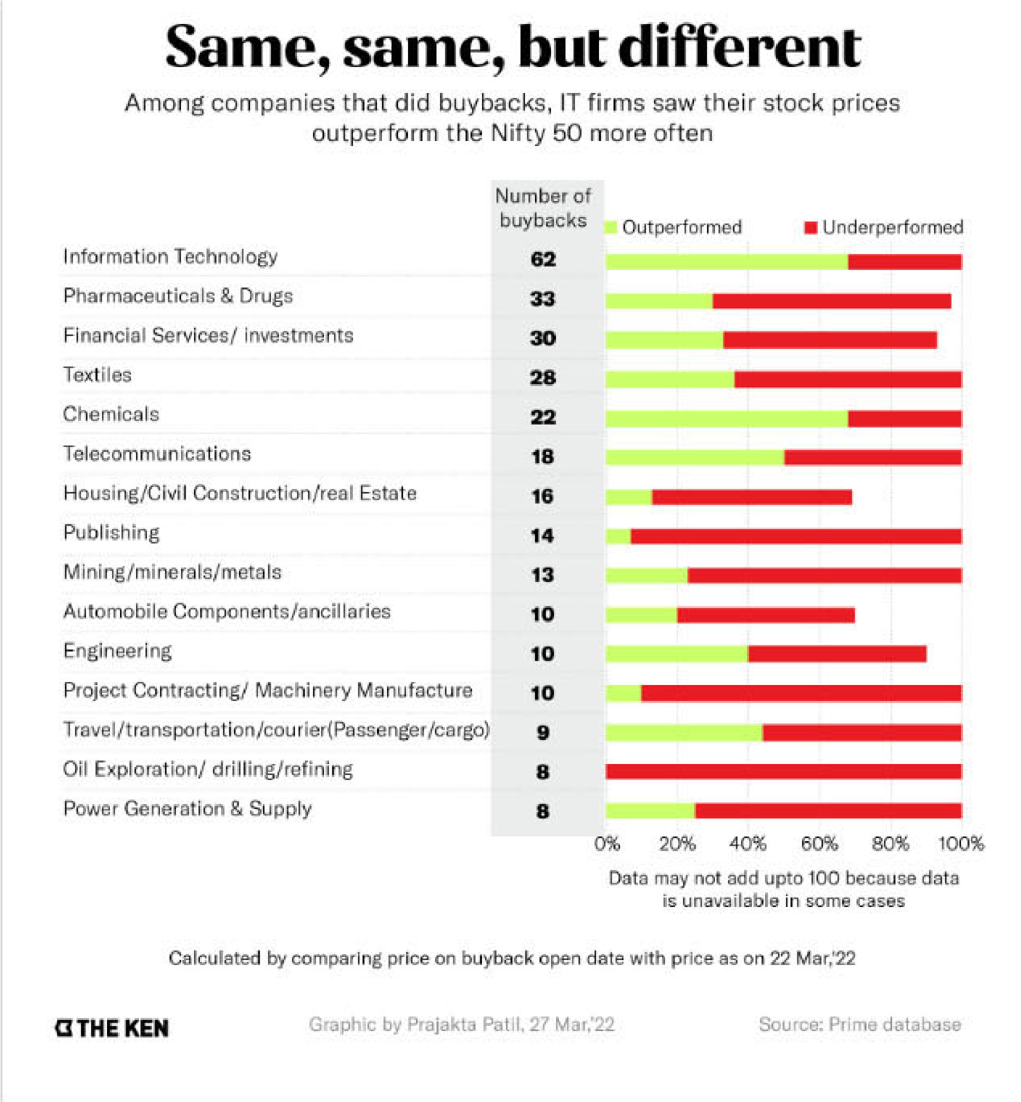
Here too, though, the IT sector has done much better than most others. Success, it appears, begets more success. The IT sector is among the largest contributors to economic growth in the country, and has been on a roll in the past few years. Their good showing is reflected in their stock prices.



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Among the top stock outperformers in the buyback list are relatively small names such as Tips Industries and Tanla Solutions, both of which have rallied massively over the past two years. The worst underperformers list is also filled with small names such as Amtek Auto, Geodesic, and Deccan Chronicle Holdings, which have destroyed significant investor wealth over the years. Some of these stocks no longer trade on the bourses—a cautionary tale of the risks of betting blindly on buyback stories, especially in smaller stocks.

Among the big names, the usual suspects—the Big Four in IT—have outperformed the Nifty 50 in most cases, while public sector energy majors such as ONGC have largely lagged.

The contrast is also visible in financial metrics such as EPS that are ideally supposed to rise after buybacks. After its earlier buybacks in 2017, 2018 and 2020, the EPS of TCS has risen, while in the case of ONGC, it has fallen sharply since its buyback in 2019. Both companies likely shared the same motivation for buybacks—to return cash to their primary shareholder, Tata Sons in the case of TCS, and the government in ONGC's case.

But the outcomes on their respective financial metrics have turned out rather different. That's primarily because while Tata Sons has been regularly taking its pound of flesh, it has also been leaving enough with TCS to invest in growth. The government, on the other hand, has been using ONGC as a cash cow, often milking it dry through big dividends and forced costly acquisitions of government stakes in other companies.

The results are there for all to see. The market capitalisation of TCS has nearly tripled since its first buyback in 2017, and risen more than 70% and nearly 30% since its subsequent buybacks in 2018 and 2020. This vastly outperforms the Nifty 50. In the case of ONGC, the 20% gain in its market capitalisation since its early 2019 buyback lags far behind the Nifty 50.

Buybacks matter, but who does them and how they do them seem to matter more.