Here are the key points you should note about buyback offers in India

Buybacks are a tax-efficient way of selling shares by investors as the capital gains on sale are exempt from tax

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With TCS, one of the most valued companies in India, announcing a buyback offer lately, many new investors might wonder its implication on their investments. With profitability of India Inc expected to improve, companies may decide to reward the shareholders via buybacks going ahead. Here, we look at what buyback is and how investors should decide on tendering the shares in the offer.

Taking advantage

Some investors buy shares at market price and tender shares in the buyback, which is at premium. Acceptance ratio plays an important role for such transactions. Here's an example.

Current market price ₹1,000
Buyback price ₹1,200
Potential profit ₹200

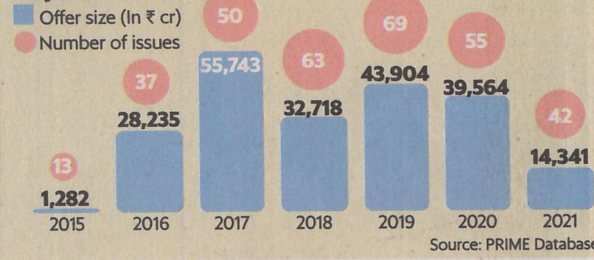
Differences between tender and open route of buybacks

	Tender route	Open market route
Buyback price	Fixed price	Multiple pricing subject to maximum buyback price
Shareholders participation	Only shareholders as on the record date	All shareholders
Retail shareholders reservations	15% of buyback size to be reserved for small shareholders	
Offer period	10 working days	up to 6 months

Source: NSDL

Profit at various acceptance ratios

	Acceptance ratio 40%	Acceptance ratio 50%
Shares bought to be tendered	100	100
Investment amount	100,000	100,000
Shares accepted for buyback (a)	40	50
Profit on buyback (a)*₹200	8,000	10,000
Approx return	8%	10%



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What is a buyback?

A share buyback, also known as share repurchase, is a corporate action to buy back its own outstanding shares from its existing shareholders at a premium to the prevailing market price.

TCS's offer price for the recently announced buyback is ₹4,500 per share. The stock is currently trading at ₹3,796 per share. But why do companies do this? Buyback is another form of rewarding shareholders, in addition to paying dividend, by returning surplus cash generated by the company. As the number of shares come down after the buyback, it also improves key return ratios such as earning per share (EPS), return on net worth and assets for the continuing shareholders. Sometimes, corporates may also go for buyback to support market price of the share in a volatile market. As per Deloitte's report on 'Buyback of shares' in 2020, Dalmia Bharat, a sugar manufacturer, went for ₹500 crore buyback to provide support to its share price. For an investor, a buyback usually signals the confidence of the management in the underlying fundamentals of the business. "By reducing cash on the balance sheet and enhancing earnings per share, it is an indicator that the company is confident of its future business," said Vishal Dhawan, board member, Association of Registered Investment Advisors (ARIA). Buybacks are also a tax-efficient way of selling shares by investors. The capital gains on sale of shares via buyback are exempt from tax. However, any loss incurred from buyback is also not available for set-off/carry forward purposes since the capital gain from buyback is an exempt income.

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Types of offers

Corporates may offer buybacks in two ways, either through tender form or through open market. In a tender offer, the company fixes a fixed price for the buyback and investors can tender their shares by placing a bid with the broker. The TCS's buyback offer mentioned above is through tender offer. The company will buy back shares from those who are shareholders on the record date. The record date has not yet been specified by the company. In the open market buyback, in which promoters cannot participate, the company fixes a maximum buyback price and purchases shares from the secondary market at a market price within the fixed limit.

To give an example, Infosys held a buyback in 2021 via open market route. Shareholders were offered the option to sell their shares at a price below the maximum buyback price of ₹1,750 per share, which was at 21% premium to the market price on date of intimation about buy back.

Acceptance ratio

Acceptance ratio, one of the key points to consider by an investor in a buyback, is the number of shares accepted in a buyback offer by the company as compared to the total number of shares tendered.

For instance, if you tender 100 shares and the acceptance ratio is 60%, only 60 shares of the total tendered shares will be bought back by the company. The rest will be credited back to your demat account. The ratio could be higher for retail shareholders as Sebi mandates 15 % of the total buyback size is reserved for small investors with holdings up to ₹2 lakh in the company. Sriram Velayudhan, vice president, Alternative Research, IIFL Securities, said, "Presence of less retail holding in a stock vis-à-vis allocation of more shares to retail category in a buyback ensures higher acceptance."

A few investors take advantage of the difference between the buyback price and prevailing market price. They buy shares at market price and tender shares in the buyback, which is at premium. They must however do so before the record date in case of buyback through tender offer. Acceptance ratio plays an important role for such transactions as it decides the profitability ratio *(see table)*.

Should you tender?

Participation in buyback is voluntary. Investors can tender shares and take cash or may also decide not to sell and get a resultant increase in their percentage shareholding without any additional investment.

If you think that the share is overvalued at the buyback price considering the future prospects of the company, you can decide to tender the shares.

"The buyback price versus the fair value estimates using a discounted cash flow, as well as the current market price indicate, whether it is good to tender or not," said Dhawan.

"For investors holding onto the shares for dividend yields, buybacks can be viewed as a tax-efficient alternative. For most use-cases, strong buyback offers by high quality companies, are a winning bet for investors. Long term investors can always buy more shares after participating in the buyback." Said Rakesh Singh, chief executive officer, broking, Fisdom.

Mint takeaway: If you are a long-term investor and believe in the long-term return generating potential of the stock, you can decide not to tender the shares as buybacks are earnings per share (EPS) accretive in the long-run.