Share buybacks galore

SHARE buybacks, where a listed company buys and sells its own shares, can be lucrative. Shareholders of 40 Bursa Malaysia listed companies are in for a huge windfall as their companies have pocketed RM911 mil in the last two years from the resale of their treasury shares.

by Doreen Leong

Conglomerate Hap Seng Consolidated Bhd and Public Bank Bhd are among the companies with the highest resale, cashing in RM660 mil year-to-date (see table below).

In some countries, treasury shares are created when the shares of a company are initially issued. Not all shares are issued to the public as some are kept in the company's treasury to be used to create extra cash when needed. Alternatively, treasury shares can also be created when a company does a share buyback and purchases its shares on the open market, as in Malaysia.

The company can either retire or cancel the shares – retired shares are however not listed as treasury shares on the company's financial statements – or hold them for resale later.

While the proceeds from resale of treasury shares will add to the coffers of the companies, effectively enhancing their asset base, shareholders will also benefit from the possible issuance of bonus shares as any gains from the resale of the treasury shares will be reflected in the companies' share premium account.

Baker Tilly Monteiro Heng partner Lock Peng Kuan tells ***FocusM*** that any gain from the resale of treasury shares will not be recognised in the statement of profit or loss but in equity, where it will be added to the share premium account.

He says there are limited uses for share premium accounts, as governed under the Companies Act 1965. A share premium account may be used to issue bonus shares, write off equity-related expenses like underwriting costs, etc. This account is where the amount of money paid – or promised to be paid – by a shareholder for a share is credited to, only if the shareholder has paid more than the cost of the share.

On the other hand, is the resale of treasury shares beneficial to shareholders although the company would have increased its cash from the resale? This is because some quarters believe the resale of treasury shares by a company does not meet the original objectives of having a share buyback programme.

A corporate adviser says share buybacks are intended to manage undervalued stock. "If a company buys and is inclined to cancel the treasury shares or distribute them for free to shareholders, this enhances the company's earnings per share (EPS) and also serves as distribution of dividend-in-specie to shareholders, enhancing their yield on their investment," she explains.

"Share buyback is to enhance EPS and return capital to shareholders. So why should the company which undertakes the share buyback resell these shares to benefit the company and not shareholders directly?" she asks.

Hap Seng manages growth and buyback well

Hap Seng, a diversified company with interests in plantations, automotive and property, has done well in managing growth and share buyback strategy.

Lock says dividend-in-specie is not the only way to reward shareholders

Eng says a buyback generally signals to the market that management thinks the share price is too low

Notably, it has received RM484 mil cash from selling treasury shares year-to-date. It spent RM168.25 mil on share repurchases for the six months to June 30 versus RM130.62 mil a year ago and cancelled RM115.24 mil worth of treasury shares in the six months just ended.

However, within three months beginning August, Hap Seng resold 133.41 million treasury shares worth RM484.43 mil. It repurchased 56.77 mil shares worth RM181.02 mil year-to-date versus 135.21 million shares worth RM266.04 mil last year. Based on the amount repurchased last year, the company could have made some RM200 mil from the resale of its treasury shares.

The proceeds of some RM484 mil will increase Hap Seng's cash and cash equivalent of RM701.82 mil as at June 30 versus RM470.39 mil a year ago.

Hap Seng's share price has largely been traded range-bound between RM1.60 and RM1.80 from September 2012 to March last year. However, the counter reached a year-high of RM4.32 on Oct 29 from a low of RM2.36 on Oct 30 last year. It traded at RM4.31 on Oct 29, a 150.5% premium to its net asset value per share of RM1.72 as at June 30. Its EPS improved to 18.5 sen from 14.51 sen a year ago.

Hap Seng's share buyback activity can be traced to 1999. It started cancellation

Scientex and Protasco are among companies with the highest resale of treasury shares this year

Companies with the highest resale of treasury shares

#	Company	2010 Share price (RM)		2011 Share price (RM)		2012 Share price (RM)		2013 Share price (RM)		2014 Share price (RM)		2013 Resale of treasury shares		2014 Resale of treasury shares		Shares sold at	
		52-week high	52-week low	52-week high	52-week low	52-week high	52-week low	52-week high	52-week low	YTD high	YTD low	No. of shares	RM	No. of shares	RM	Min (RM)	Max (RM)
1	Hap Seng Consolidated	1.65	0.53	1.72	1.05	1.56	1.27	2.85	1.38	4.31	2.61	NA	NA	133,415,700	484,429,765	3.49	4.02
2	Public Bank	11.04	8.98	11.81	10.43	14.89	11.60	18.29	14.17	20.69	17.82	NA	NA	9,156,400	176,039,288	19.16	19.32
3	Scientex	1.72	1.06	2.50	1.695	2.98	2.02	5.61	2.84	7.53	4.93	6,115,500	27,747,011	NA	NA	4.45	5.11
4	Protasco	0.82	0.61	0.94	0.69	0.92	0.70	1.45	0.88	2.07	1.33	NA	NA	17,355,100	24,747,335	1.41	1.45
5	Glomac	0.68	0.445	0.78	0.56	0.76	0.66	1.28	0.74	1.17	1.01	NA	NA	19,213,300	22,602,479	1.18	1.19

Research by **Nigel Ng**

Buybacks a contentious issue in the US

SHARE buybacks have become one of the most contentious issues in corporate America in recent times. Giant companies such as Apple Inc spent an incredible US$17 bil to buy up its own stock. Since the beginning of fiscal 2014, Apple has spent a massive US$45 bil to repurchase its stock from fleeing investors.

Apple's stock is now hovering at an all-time high, having appreciated 37% over the past year. However, for half of the last 12 months (and throughout last year), Apple shares have languished at prices from 60% to 75% of their current valuation.

Despite recent gains, Apple's current price is only 3% higher than it was two years ago at the launch of iPhone 5.

Since initiating its buyback programme two years ago, Apple has worked to aggressively use its capital to take advantage of irrational stock market valuations in what has turned out to be the largest stock repurchase scheme and the most successful since the US Securities and Exchange Commission enhanced the transparency of issue repurchases in 2005.

Some shareholders feel Apple should do even more to buy back its own shares, estimating that the counter's appreciation over the last two years is just the beginning and that it is on a trajectory to again double in value in the near term.

Nevertheless, rather than returning excess cash to shareholders, many believe companies should invest in their businesses and recruit more workers at higher wages to sow the seeds for sustained long-term growth of the economy.

Already, many companies have cut capital expenditure and even increased debt to boost dividends and increase share buybacks and this can affect an entity's ability to generate sustainable long-term returns.

For example, ExxonMobil Corp is said to spend US$21 bil a year on buybacks but virtually nothing on alternative energy research, drawing criticism that such a move may not be in the best interests of the company or its stakeholders.

Share buybacks are not new and US companies have been actively buying back their stocks in recent years. Among the companies that repurchase shares on a regular basis are IBM, Wal-Mart, Exxon-Mobil, Coca-Cola and McDonald's.

According to reports, share buybacks and dividends absorb more than 90% of corporate earnings, leaving little for innovation or worker pay. Between 2003 and 2012, it is estimated that about 54% of all the money earned by companies in the Standard & Poor's 500 index was spent on repurchasing shares. Another 37% were distributed in dividends, leaving only 9% of earnings to reinvest in the business.

In the 12 months to the end of June, S&P 500 companies have returned a record amount of cash to shareholders, consisting of US$533 bil in buybacks and paying out US$332.9 bil in dividends, according to S&P Dow Jones Indices. Since the start of 2011, buybacks have exceeded US$1.6 tril.

The most pressing question, some ask, is whether US equities can continue rising as the Federal Reserve ends quantitative easing (QE). Companies will face a higher cost of buying back their stock while having not yet really committed capital for long-term expansion.

Critics say devoting large amounts of cash to buybacks can also signal that a management team has run out of ideas for long-term growth. A common example is how RIM splurged on buybacks when the BlackBerry dominated the mobile handset market, while underestimating the challenge mounted by Apple and Samsung.

Share buybacks are popular among boards and CEOs due mainly to how these chief executives are remunerated. Many CEOs and senior executives derive much of their income from stock grants or options. As a result, share buybacks are the quickest, easiest and safest thing they can do to give themselves a raise.

To address the issue, many believe companies should reward senior executives only when they create value and not simply for moving it around.

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of treasury shares in 2001. The company actively embarked on a resale of treasury shares only from Aug 4 at RM3.51 per share.

Hap Seng's net profit grew to RM404.63 mil for the six months ended June 30 from RM317.3 mil on the back of revenue of RM1.95 bil from RM1.62 bil a year ago.

Meanwhile, Public Bank Bhd, which is relatively less active in share buybacks, resold 9.16 million treasury shares in August and September at between RM19.16 and RM19.32 per share, raking in some RM176.04 mil.

However, this accounts for just a small fraction of the bank's cash and balances at bank of RM25.94 bil as at Sept 30.

Its share price of RM18.58 on Oct 29 is way above its NAV per share of RM6.93 as of Sept 30.

The bank's EPS improved to 91.16 sen for the nine months to Sept 30 versus 86.78 sen a year earlier as net profit rose to RM3.26 bil from RM3.04 bil on the back of a higher revenue of RM12.33 bil from RM11.35 bil.

Etiqa Insurance & Takaful head of research Chris Eng says it will be better to distribute the treasury shares as dividend-in-specie as practised by companies such as Dialog Group Bhd and YTL Power International Bhd. "This will truly enhance shareholders' value," he says.

Independent power producer (IPP) YTL Power has been active in share buybacks since 2008 when it was trading at an average of RM2.31 per share, above its net asset value per share (NAV/share) of RM1.21 in the financial year ended June 30, 2008.

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Public Bank has sold 9.16 million treasury shares this year

40 companies with share resales in 2013 and 2014

#	Date	Company	Total number of treasury shares sold	Cumulative net outstanding treasury shares	Total amount received for treasury shares sold (RM)
1	4/8/2014 - 15/10/2014	Hap Seng Consolidated	133,415,700	67,778,300	484,429,765
2	29/8/2014 - 5/9/2014	Public Bank	9,156,400	20,644,304	176,039,288
3	28/5/2013 - 21/6/2013	Scientex	6,115,500	8,844,462	27,747,011
4	24/1/2014 - 29/1/2014	Protasco	17,355,100	nil	24,747,335
5	7/1/2013	Glomac	19,213,300	nil	22,602,479
6	22/4/2013 - 26/4/2013	Goldis	10,092,400	25,023,000	20,119,352
7	10/1/2014 - 8/10/2014	Engtex Group	10,320,000	1,100,000	20,016,793
8	9/10/2014 - 27/10/2014	LPI Capital	1,014,600	nil	17,824,144
9	24/3/2014 - 19/9/2014	Fitters Diversified	16,161,536	nil	15,640,176
10	3/10/2014 - 17/10/2014	BHS Industries	4,425,000	3,475,000	13,581,285
11	5/6/2013 - 16/12/2013	LBS Bina Group	7,370,000	6,401,500	11,349,614
12	24/7/2014 - 3/10/2014	Berjaya Land	13,094,000	10,943,104	11,060,614
13	9/23/2013	NTPM Holdings	13,301,900	nil	8,247,178
14	11/10/2013 - 29/10/2013	Kossan Rubber Industries	1,114,400	nil	7,627,303
15	19/9/2013 - 14/2/2014	Daya Materials	15,720,700	nil	5,697,426
16	22/2/2013 - 27/2/2014	Daibochi Plastic and Packaging Industry	1,538,000	52,300	4,866,222
17	8/7/2013 - 16/7/2013	Redtone International	5,452,800	nil	3,938,194
18	13/5/2013 - 28/10/2013	Success Transformer Corp	2,344,400	3,330,777	2,974,654
19	2/7/2014 - 8/7/2014	Bonia Corp	507,000	nil	2,721,873
20	4/2/2013	Crescendo Corp	1,210,000	nil	2,667,195
21	7/11/2014	Century Logistics Hldgs	1,083,974	nil	2,530,909
22	29/11/2013 - 2/12/2013	Prestariang	950,000	nil	2,470,178
23	11/6/2013 - 1/4/2014	MQ Technology	19,380,100	nil	2,376,562
24	31/12/2013 - 11/4/2014	Vitrox Corp	1,757,200	nil	2,356,919
25	7/8/2014 - 22/8/2014	Astino	1,323,423	37	2,325,383
26	20/8/2014 - 28/8/2014	I-Bhd	971,890	nil	1,983,342
27	7/7/2014	Signature International	1,056,000	nil	1,799,601
28	12/17/2013	Dayang Enterprise Holdings	300,500	nil	1,694,820
29	19/5/2014 - 6/8/2014	Wong Engineering Corp	1,830,000	123,900	1,354,352
30	10/6/2014 - 16/6/2014	Borneo Oil	2,083,000	nil	1,350,701
31	14/3/2013 - 15/1/2014	N2N Connect	2,862,700	nil	1,345,694
32	2/12/2013 - 3/12/2013	WZ Satu	1,150,000	nil	1,049,352
33	4/15/2013	Komarkcorp	1,540,000	nil	782,608
34	1/31/2013	Patimas Computers	6,100,000	nil	759,784
35	14/4/2014 - 17/4/2014	LNG Resources	2,449,300	nil	733,387
36	11/11/2013	Industronics	1,131,000	nil	701,220
37	5/20/2014	PIE Industrial	73,900	nil	582,438
38	8/13/2014	Unimech Group	300,000	13,052,366	475,226
39	2/8/2013	Grand-Flo Solution	1,613,200	nil	346,838
40	2/1/2013 - 4/1/2013	LBI Capital	252,000	491	272,200
	Total		**337,130,923**		**911,189,414**

Research by **Nigel Ng**

Reducing stock dilution

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YTL Power then redistributed its treasury stock to shareholders twice in 2008. It also distributed a cash dividend of 15.75 sen per share in FY09. However, its EPS was lower at 19.99 sen in FY08 versus 23.53 sen a year ago as its net profit dipped to RM1.04 bil from RM1.17 bil.

The IPP slowed down its share repurchases between 2009 and 2012 but stepped up the exercise again from February last year, fuelling speculation of a corporate restructuring exercise. The counter closed at RM1.55 on Oct 29. Its EPS stood at 18.05 sen in FY14.

Nevertheless, Lock says dividend-in-specie is not the only way to give returns to shareholders. "The allocated fund for the share buyback can indeed be utilised for dividend payments. There are reinvestment schemes in the market now which shareholders can opt to re-enter into a company from their dividend entitlement or take cash dividends.

"Share buyback schemes coupled with dividends of treasury shares give no option but only the shares in a company, although such dividends in treasury shares can also be sold in the open market for cash," he explains.

He adds that the repurchased shares are not entitled to dividends, thus reducing the cash outflow of a company in terms of dividend payments.

Stock repurchases are often used as a tax-efficient method to put cash into shareholders' hands, rather than paying dividends, in jurisdictions that treat capital gains more favourably.

Sometimes, companies do it when they feel their stock is undervalued in the open market. Other times, companies do it to reduce dilution from incentive compensation plans for employees. Another reason is to keep a controlling interest with the treasury to help ward off hostile takeovers.

No one size fits all

According to Lock, what companies decide to do with the repurchased shares – cancel, hold as treasury shares for distribution as dividends or resell to the market – depends on the strategic direction of the companies as to how they want to structure their equity base. No one size fits all.

"A company should carve out the strategic reasons before embarking to buy its own shares. To improve the efficiency in the capital base of a company should be the driving reason in such corporate moves," he says.

Paran says a well-managed share buyback scheme should not result in the company losing money

Engtex sold 10.3 million of its treasury shares for some RM20 mil this year

"However, to buy with the sole anticipation of gain from subsequent resale is not a walk in the park as it hinges on many other external factors that are beyond control or expectations due to the volatility of the market. It is possible that the result may go the other direction," Lock cautions.

He explains that some companies, which have excessive financial resources, regard share buybacks as a way to use excess funds in anticipation of better returns.

"The return in this respect can be from the accounting improvement in EPS or from the possible gain from their resale subsequently. As treasury shares are excluded from the computation of EPS, the EPS is expected to improve as the capital base of the company is reduced by the shares repurchased," Lock says.

Meanwhile, Eng believes that if a company has sufficient cash and is waiting for a suitable capex opportunity, some of the cash can be utilised for share repurchase if the shares are cheap.

"It generally signals to the market that management thinks prices are too low and there are longer-term opportunities in the company. Of course, borrowing for share buybacks would not be viewed positively," he says.

PricewaterhouseCoopers Malaysia executive director Paran Puvanesan says a share buyback should be seen as a mechanism to help companies stabilise or maintain their share price at or above its deemed "true" value. Therefore, it helps long-term investors maintain their investment value.

However, he says companies should not view resale of treasury shares as an avenue to speculate and make gains on these share buyback schemes.

"Nevertheless a well-managed share buyback strategy should not result in the company losing money in the process, and hence a gain should give comfort to shareholders that the shares were indeed undervalued and therefore justify the share buyback in the first instance," Paran adds.

He says the decision whether to distribute the treasury shares as dividend-in-specie should be made based on the cash requirements of the company, that is as per any dividend policy and not on the share buyback scheme.

However, not all buybacks are a good move. For example, if a company merely buys stock to improve financial ratios such as EPS or price earnings (P/E), then the buyback is detrimental to the shareholders and it is done without the shareholders' best interests in mind.

One problem with buybacks is that companies too often overpay for the stock repurchased, which costs investors' money.

Strangely, some companies also tend to buy back their shares most aggressively when they are most expensive. For example, in the US when share prices were near their peak in the third quarter of 2007, companies on the S&P 500-stock index spent US$171 bil on buybacks. In the first quarter of 2009, when the market was near its low, they spent just US$31 bil.

A second problem is that, in many cases, companies that buy back stock don't end up reducing their overall share count. That's because they are also issuing new stock and options to management and staff.

Critics say most buybacks are meant just to mop up stock dilution. So investors should look more closely at share buybacks, combing the company's financial reports for details. Some of the things to look out for are whether shares are being awarded to employees and whether they are being bought when they are at a good price.

Share repurchase plans aren't always bad, but they can be if done with the wrong strategy. FocusM

The good and bad of share buybacks

Potential benefits

- **Increased shareholder value** – There are many ways to value a profitable company but the most common measurement is earnings per share (EPS). If earnings are flat but the number of outstanding shares decreases, an increase in period-to-period EPS will result.
- **Higher share price** – An increase in EPS will often alert investors that a stock is undervalued or has the potential for increasing in value. The most common result is an increase in demand and an upward movement in the price of the counter.
- **Increased float** – As the number of outstanding shares decreases, the shares remaining represent a larger percentage of the float. If demand increases and there is less supply, then fuel is added to a potential upward movement in the price of a stock.
- **Excess cash** – Companies usually buy back their shares with excess cash. If a company has excess cash, you can bank it doesn't have a cash flow problem. More importantly, it signals that cash re-invested in the company will get a better return than alternative investments.
- **Income tax** – When excess cash is used to buy back company shares in lieu of increasing or paying dividends, shareholders often have the opportunity to defer capital gains and lower their tax bill if the share price increases. Dividends are taxed as ordinary income in the year they are received whereas the sale of appreciated shares is taxed when sold.
- **Price support** – Companies with buyback programmes in place buy back shares more aggressively during market pullbacks. This reflects confidence that a company has in itself and alerts investors that the company believes that the stock is cheap. Frequently, you will see a company announce a buyback after its stock has taken a hit, which is merely an overt action to take advantage of the discount on the shares. This lends support to the price of the stock and ultimately provides security for long-term investors during rough times.
- **Fend off an acquirer** – In some cases, a leveraged buyback can be used as a means to fend off a hostile bidder. The company takes on significant additional debt to repurchase stocks through a buyback programme. Such leveraged buybacks can be successful in thwarting hostile bids by possibly raising the share value but adding a great deal of unwanted debt to the company's balance sheet.

Potential pitfalls

- **Manipulation of earnings** – Analysts rate stocks on many factors, but one of the most important is the EPS. Assume that an analyst estimates earnings using a higher number of outstanding shares existing before a buyback is executed. If the timing is right, companies could buy back shares and appear to beat consensus estimates that were based on a larger number of outstanding shares.
- **Borrowed money** – When share buybacks are done with borrowings, it can hurt the company's credit ratings, since it drains cash reserves that can serve as a cushion if times get tough.
- One of the reasons given for taking on increased debt to fund a share buyback is that it is more efficient because interest on debt is tax deductible, unlike dividends. However, debt has to be repaid at some time. It is important to note that what gets a company into financial difficulties is not lack of profits, but lack of cash.
- **Buyback percentage** – The higher the percentage of the buyback, the greater the potential for profits. However, the buyback percentage is not usually included in the announcement. A large number of shares does not necessarily represent a large percentage.
- **Execution of buyback** – There is a difference between announcing a buyback and actually purchasing the stock. A buyback announcement may initially boost the price of a stock, but this phenomenon (when it occurs) is usually short-lived. A good portion of announced buybacks are not executed in full.
- **High share prices** – When a stock is at or nearing an all-time high, a stock buyback can be used to manipulate less than desirable EPS expectations. It will be wise to compare the price earnings (PE) ratio relative to other stocks in the sector or industry. If a higher-than-normal PE ratio exists, then it doesn't make a whole lot of sense for a company to buy its stock at a premium unless there is something in the works that will add substantially to earnings. - **Various sources**