Buyback, for wrong reasons

GAZI TOWHID AHMED

EVEN with a bearish mood on the stockmarket, the government is determined to introduce an extensive "buyback" programme, but market experts said it hikes the chances of manipulation.

A buyback is a situation when a company buys back shares from its investors. This may be considered a sign that the company's management is optimistic about their future and believes the current share prices are undervalued, said Akter H Sannamat, a market analyst.

Former caretaker government adviser Mirza Azizul Islam, also a former SEC chairman, said the purpose of a buyback is to put unused cash to use, raising the earnings per share, increasing internal control over the company and obtaining stocks for employee stock option plans or pension plans.

Buybacks affect the earnings per share and book value per share of a super-sized corporation carrying out a large one-time buy-back.

Let's look at this example.

XYZ Corporation: pre-buyback scenario

1. Total assets Tk 300 billion (Total liabilities: Tk 150 billion and book value: Tk 150 billion)
2. Book value Tk 150 billion / shares outstanding: Tk 1 billion = book value per share: Tk 150
3. Annual earnings Tk 20 billion / shares outstanding: Tk 1 billion = earnings per share: 20
4. EPS 20 / book value: Tk 150 per share = return on equity: 13.3 percent.

Let's assume XYZ's stock is trading for Tk 200 per share and XYZ buys back half of its shares for a total of Tk 100 billion. In the real world, this would take place over a number of years at various prices, but for illustration purposes, let's assume it all happened at once.

XYZ Corporation: post-buyback scenario

Tk 100 billion of cash was spent to buy 500 million shares at Tk 200 per share.

1. Total assets: Tk 200 billion (liabilities: Tk 150 billion and book value: Tk 50 billion
2. Book value: Tk 50 billion / shares post-buyback: Tk 0.50 billion = book value per share: Tk 100 per share
3. Annual earnings: Tk 20 billion / shares post-buyback Tk 0.5 billion = earnings per share: Tk 40
4. EPS: Tk 40 / book value per share: Tk 100 = return on equity: 40 percent

> *A buyback helps improve the company's price-earnings ratio (P/E). The P/E ratio is one of the most well-known and often-used measures of value. At the risk of over-simplification, when it comes to the P/E ratio, the market often thinks lower is better*

AFP/FILE

Investors are seen through a broken window during clashes in the commercial heart of Dhaka on February 14. Security personnel cracked down on investors after they pelted police with bricks, set fire to an office building and smashed scores of vehicles to protest a steep fall in share prices.

Share buybacks reduce the number of shares outstanding and the assets on the balance sheet (remember cash is an asset). As a result, return on assets (ROA) actually increases because assets are reduced; return on equity (ROE) increases because there is less outstanding equity. In general, the market views higher ROA and ROE as positives.

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In the context of Bangladesh, most investors consider buyback a process to stabilise the share prices of companies because the government has already used the phrase 'to stabilise the price of MJL Bangladesh Ltd and M I Cement to reduce the risk for small investors', said an official of the Securities and Exchange Commission (SEC).

Earlier, the SEC decided that if the market price of MJL is poised below the offer price -- Tk 162 -- within the first 30 days of trading, the company must go for a buy-back of shares of general investors intending to sell their shares at the 'offer price'.

The government decided to launch a share buyback scheme at a time when the market experienced a steep downslide.

In a recent parliament session, Finance Minister AMA Muhith said a buy-back programme would be introduced to prop up the stockmarket.

The statement gave rise to optimism among the investors as most of them went into heavy buying, said market insiders. The general index of Dhaka Stock Exchange (DGEN) gained 860 points during Monday to Thursday.

Akter H Sannamat, a market analyst, said: "It is a process of market manipulation because markets pose no risks at that time because of a buyback spree."

"The top brass of listed companies, who happen to have price sensitive information about companies, might attempt manipulation of share prices as that would be risk-free when the government asks for a buyback," Sannamat said.

"If the government decides to go for a buy-back to increase share prices, it becomes overshadowed by an uneasy sense of foreboding. But, if the government introduces it to increase the companies' corporate returns, it becomes a very positive action for the market," he said.

Sannamat said when the share prices will increase, the company's director will go for big selling of shares, while the share prices touch their offer prices or issue prices they will buy shares back from their investors.

The participation of investors will increase in the market while no big company will want to list on the capital market, he added. He also said the company will then be forced to buy back shares.

Islam, the former SEC chairman, said: "It will be a moral hazard if the buyback formula is deployed to stabilise the share prices of companies."

The company act will be changed if the government wants to implement a buyback because the Companies Act of Bangladesh has no clause on buybacks, Islam said.

"To introduce a buyback system, a High Court order is a requirement."

Islam also said before going for a buyback, the government should be carefully about making sure that companies are not able to take advantage of the special arrangement for manipulating their share prices.

Salahuddin Ahmed Khan, a former chief executive officer of the Dhaka bourse, said, "The government will create an opportunity for manipulation by implementing a buy-back to address share price fluctuations."

"The government should not allow any buy-back for 'Z' category shares," the former chief executive of DSE warned.

The Securities and Exchange Board of India (SEBI) in 1998 introduced the buyback system to increase the earnings per share. The USA also deployed the method, but not to stabilise the share price of companies.

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Analysts warn of low-profile companies' risky trends

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SOME high-profile companies are still lucrative to invest in, while most of low-profile companies' shares turn into overprices.

Salahuddin Ahmed Khan, a former chief executive officer of the Dhaka Stock Exchange (DSE) and a finance teacher at Dhaka University, said, "During the share market debacle, the prices of some high-profile companies dropped massively but some low-profile companies' shares were overpriced."

"It was not a good trend," he said.

Khan said the price-earnings (PE) ratio of most sectors is still lucrative to invest in but the prices of some low-profile companies increased hastily, which is risky for small investors.

The surveillance and market monitoring committee should be on the look out for such risky trends of the low-profile shares, he said.

He also said the surveillance and market monitoring committee failed to work properly.

Investors should be careful about investing in low-profile companies because most shares are already overpriced, Khan explained.

The current market PE ratio is 22.15 on the last day of trading of the previous week.

The highest market PE was 30.51 on December 5 last year, while the lowest PE of the market was 17.99 on February 28 this year. According to the last trading day of the week, the Indian market PE is 24.19.

Mahmud Osman Imam, who teaches finance at Dhaka University, said, "It is a sign of another stockmarket debacle that the share prices of the low-profile companies are increasing geometrically."

"The share prices of the low-profile companies, which have small market capitalisation, are very easy to manipulate. So, the surveillance and market monitoring committee should be cautious," said Imam.

Imam said the merchant banks should stop the loan facility for the low-profile companies whose share prices increased abnormally.

"To give margin loans, the merchant banks consider 40 PE. It is absolutely a wrong system."

Imam also spells out that the merchant banks should develop a margin loans outline soon.

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Sector	Price Earnings Ratio
Bank	16.91
Non-bank financial institutions	35.17
Mutual funds	10.83
Engineering	42.88
Food and allied sector	18.75
Fuel and power	18.75
Jute	31.75
Textiles	42.10
Pharma and chemicals	30.30
Paper and printing	95.77
Service and real estate	32.38
IT	56.18
Tannery	14.50
Ceramics	82.66
Insurance	47.60
Travel and leisure	73.84
Miscellanies	18.39
Telecoms	15.66

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