

## **Share Buyback : Indian Experience**

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### **Abstract**

A share buyback is the term describing the actions of a company that buys some of its own shares and then cancels them. US started this practice in late 1970s. But in India till 1998 stock buyback was strictly prohibited. Many companies have gone for stock repurchase since then. This paper studies the companies who have gone for share buyback recently to examine how they were positioned in relation to industry at the time of buyback.

This study is based on seven companies from multiple industries who have gone for share buyback during 2005-07. The companies are taken from different industries like Paint, Pharmaceuticals, Security, Forgings, Solvent Extraction, Finance and Computer. This paper studies the brief history of companies, the terms of share buyback, reason for buyback, funds used for buyback, share buyback price, director's holding on buyback date, percentage of shares buybacked out of total shares, maximum price offered for share buyback, and comparison of these companies with industry in terms of liquidity ratios and turnover ratios. An attempt is made to know, whether purpose of buyback differs from industry to industry or do these companies share some common characteristics in relation to industry. It is essentially an exploratory study.

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### **INTRODUCTION**

Share buyback is a method for company to invest in itself since they can't own themselves. Thus, buybacks reduce the number of shares outstanding on the market which increases the proportion of shares the company owns (Jensen, 1986). Buybacks can be carried out in two ways :

- (a) Shareholders may be presented with a tender offer whereby they have the option to submit (or tender) a portion or all of their shares within a certain

time frame and at a premium to the current market price. This premium compensates investors for tendering their shares rather than holding on to them.

- (b) Companies buy back shares on the open market over an extended period of time (Reilly and Brown, 2005).

The popularity of share buybacks has catapulted over the past twenty years (Tirole, 2006). Companies' buyback shares are meant (a) to increase the earning per share and value of shares still available (reducing supply); (b) to eliminate any threats by shareholders who may be looking for a controlling stake; (c) to return shareholders the surplus cash not required in near future; (d) to raise promoters' voting power; (e) to provide an exit route to shareholders in case of illiquid shares; (f) to signal management's view that shares are undervalued in market in relation to their intrinsic value; (g) to raise debt-equity ratio of company; and (h) to delist the company from stock exchange (De Matos, 2001).

### RESEARCH OBJECTIVES

Till 1998, buyback was prohibited in India. As from 1998 only SEBI permitted Indian companies to buyback their shares and lot of companies are going for share buyback (Gupta et al., 2006). Similar evidence was observed in the context of developed economy like US. There was a sudden rise in repurchase of shares after 1982 in US. In 1982, SEC adopted Rule 10b-18 which allows the firm to repurchase its own share and protects the firm against prosecution (Grullon & Michaely, 2004). We don't have long history of buyback in India and there is hardly any Indian literature available to help and guide corporate managers, investors, market regulators and policymakers, and academicians on this subject. This paper deals with the analysis of Indian companies gone for buyback. This study will help to create deeper understanding of various issues of share buyback in Indian context.

### DATA AND ANALYSIS

The study is primarily based on secondary databases like Capitaline, SEBI websites, etc. In addition, data has also been collected from newspapers, public announcements, business magazine articles, cases and books available on the subject. Sample consists of seven Indian companies which have gone for buyback from year 2005-07. Table 1 presents a brief description of sample.



**Table 1**  
**Sample Description**

Year	Company	Industry	Number of Companies in Industry	Method of Buyback
July, 2007	ICI India Limited	Paint/Varnishes	35	Open offer
September, 2006	Natco Pharma Ltd.	Pharmaceuticals- Indian - bulk drugs & Formln Lrg	22	Open offer
January, 2006	India Bulls Financial Services Ltd.	Security / commodity Trading Services	15	Tender offer
May, 2005	India Forge & Drop Stampings Ltd.	Forgings - Medium/ Small	25	Tender offer
April, 2007	Gujarat Ambuja Export Ltd.	Solvent Extraction - large	48	Open offer
December, 2007	Apollo Finvest (I) Ltd.	Finance - Small		Tender offer
May, 2005	Polaris Software Lab Ltd.	Computer - software - large	12	Tender offer

Out of seven companies 4 companies (India Bulls Financial Services Ltd., India Forge & Drop Stampings Ltd., Apollo Finvest (I) Ltd., and Polaris Software Lab Ltd.) have gone for tender offer; and 3 companies (ICI India Limited, Natco Pharma Ltd., and Gujarat Ambuja Export Ltd.) have gone for open offer.

Company details (taken from Capitaline database), Method used for buyback, Reason for buyback, Company's financial key ratios, Market position, share price and Comparison with industry are the aspects studied in this paper. Table 2 sums up these details for all the seven companies under study.

All companies in the sample have used cash surplus and free reserves to buyback and it is found that the reason of buyback is either to optimize returns to shareholders or to enhance overall shareholder value. In the following section, this paper discusses the individual company characteristics and findings regarding the buyback decisions of specific companies.

The details (i.e., debt-equity ratio, long-term debt-equity ratio, current ratio and turnover ratios) for all the seven companies are summarized in Table 3.

**Table 2**  
**Details of Buyback**

Company	Director's Holding	Reason of Buyback	Total Paid-up Capital	Shares Buy-backed	Prices	Fund Used for Buyback	Monthly Avg. Share Price on Buyback Date
ICI India Ltd.	50.83% & Not participating in buyback	-Optimize returns to shareholders -Enhance overall shareholder value	Rs. 844.25 crore	25% of the aggregate paid-up share capital & free reserves (as on 31 <sup>st</sup> March, 2007) or maximum 36,70,600 shares	Rs. 575 per share (max. buyback price) or Rs. 211.06 crore	Cash surplus and / or cash balance and / or internal accruals of the company	NSE price = 508.13 BSE price = 507.63
Natco Pharma Ltd.	38.08% & Not participating in buyback	-Optimize returns to shareholders -Enhance overall shareholder value -Reflection of confidence in the future growth prospects of the company	Rs. 12238.91 lakh	5.72% of the aggregate paid-up share capital & free reserves (as on 31 <sup>st</sup> March, 2006 or maximum 4,66,665 shares)	Rs. 150 per share (max. buyback price) or Rs. 700 lakh	Free reserves	NSE price = 103.00 BSE price = 104.50

Table 2 (Contd.)

India Bulls Financial Services Ltd.	30% & Not participating in buyback	-Optimize returns to shareholders -Enhance overall shareholder value -Reflection of confidence in the future growth prospects of the company	Rs. 324.08 million & free reserves of 9,769.30 million	10-25% of the aggregate paid-up share capital & free reserves (as on 30th September, 2005)	Rs. 210 per share (max. buyback price) or Rs. 380 million	Free reserves	NSE price = 185.40 BSE price= 186.30
India Forge & Drop Stampings Ltd.	63.55% of paid-up equity & intend to tender their shares under buyback	-Optimize returns to shareholders -Enhance overall shareholder value -Reflection of confidence in the future growth prospects of the company -To provide liquidity to existing shareholders and also an exit route	Rs.339,12,470 (3391247 shares of 10 each)	6.01% of the aggregate paid-up share capital & free reserves (as on 30th September, 2005) or 5,08,687 shares	Rs. 12 per share aggregating to Rs. 61.04 lac	Free reserves	Listed at Madras Stock Exchange and shares have not been traded since 1997



Table 2 (Contd.)

Gujarat Ambuja Export Ltd.	63.11% & Not participating in buyback	-Optimize returns to shareholders -Enhance overall shareholder value	Rs. 27.86 crore and free reserves of Rs.262.55 crore	10% of the aggregate paid-up share capital & free reserves (as on 31st March, 2006) or maximum 69,07,894 shares	Rs. 38 per share (max. buyback price) or Rs. 26.25 crore	Cash surplus and / or cash balance and / or internal accruals of the company	NSE price = 26.52 BSE price = 26.49
Apollo Finvest (I) Ltd.	58.94% & participating in buyback	-Optimize returns to shareholders -Enhance overall shareholder value	Rs. 27.86 crore and free reserves of Rs.262.55 crore	12.31% of the aggregate paid-up share capital & free reserves (as on 31st March, 2007) or maximum 9,25,000 shares	Rs. 15 per share (max. buyback price) or Rs. 138.75 lac	Cash surplus and / or cash balance and / or internal accruals of the company	BSE price = 13.96
Polaris Software Lab Ltd.	24.42% & Not participating in buyback	-Optimize returns to shareholders -Enhance overall shareholder value	Rs. 49.01 crore and free reserves of Rs. 480.91 crore	9.25% of the aggregate paid-up share capital & free reserves (as on 31st March, 2005) or minimum 4,260,869 shares	Rs. 115 per share (max. buyback price) or Rs. 49 crore	Security premium and / or free reserve	NSE price = 96.21 BSE price = 96.10

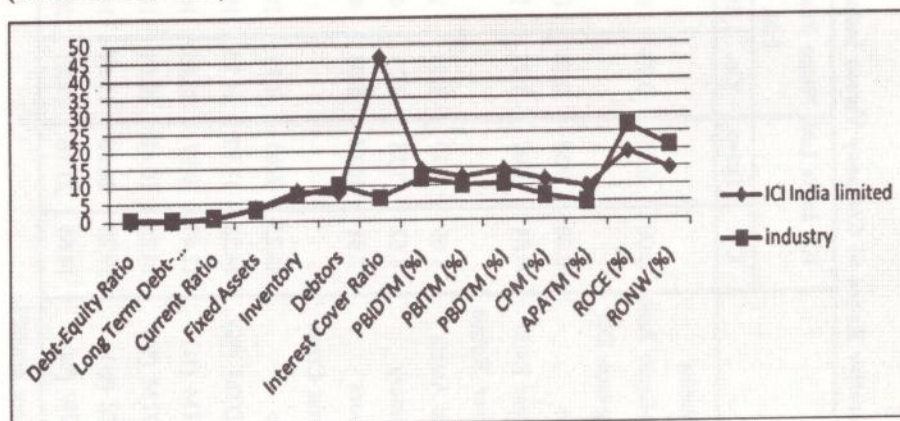
Source : <http://www.sebi.gov.in>

Table 3 presents the information of all the seven companies with respect to the industry standards comparing company's ratio by industry ratio. It is found that out of seven companies, six companies have long-term debt-equity ratio lower than industry's debt-equity ratio (the data is not available for the remaining company). It is pertinent to note that out of six companies (for which data was available) for five companies the debt-equity ratio and return on net worth ratio is lower than industry's respective ratio. Interestingly, out of six companies four companies have higher Debtor turnover, PBIDTM, PBITM, and PBDTM ratio than industry's respective ratio, whereas two companies have lower than industry average and data is not available for one company. And, finally, out of six companies three companies have higher current ratio, fixed asset turnover ratio, inventory turnover ratio, interest coverage ratio and ROCE ratio than industry's respective ratio, three have lower than industry's average. In conclusion, we can say the overall analysis of all the companies represents a mixed scenario.

### ICI India Limited

The company manufactures and markets paints, specialty chemicals, adhesives and starch. The company was formed in 1954 under the name Indian Explosives Ltd. as a joint venture between ICI PLC and the Government of India. ICI India limited is an unlevered growing company. Company's current assets are just 0.84% of its current liabilities and are very less as compared to industry, i.e., 0.84 to 1.07 but has high interest coverage ratio of 46.25. If we compare turnover ratios according to industry company is doing fine with respect to fixed assets and inventory turnover ratio but has trouble collecting debtors.

Chart 1 : Comparative Ratios of ICI India Limited Company Versus Paint Industry (Period March 2005)



**Table 3**  
**Comparative Ratios of Company Versus Industry (Period March 2005)**

	ICI India Ltd.		Natco Pharma Ltd.		Indiabulls Fin Serv. Ltd.		India Forge & Drop Stamp. Ltd.		Guj. Ambuja Exports Ltd.		Apollo Finvest (I) Ltd.		Polaris Software Lab Ltd.	
	Co.	Indus	Co.	Indus	Co.	Indus	Co.	Indus	Co.	Indus	Co.	Indus	Co.	Indus
<b>Key Ratios</b>														
Debt-Equity Ratio	0.00	0.65	0.73	0.75	1.25	0.56	0.00	7.72	0.70	1.71	0.00	*	0.00	0.02
Long-term DE Ratio	0.00	0.38	0.38	0.52	0.26	0.29	0.00	5.36	0.07	0.80	0.00	*	0.00	0.01
Current Ratio	0.84	1.07	1.37	1.69	2.02	1.63	1.28	1.32	1.21	1.17	0.87	*	3.54	2.18
<b>Turnover Ratios</b>														
Fixed Assets	3.69	3.39	1.13	1.80	805.23	4.02	2.85	2.44	3.77	7.61	0.62	*	2.47	4.44
Inventory	8.62	7.35	4.21	4.94	275.47	1.50	18.11	5.16	6.35	8.95	100.00	*	0.00	293.20
Debtors	7.91	10.01	5.08	4.60	14.95	2.45	16.83	8.06	21.26	15.64	33.33	*	4.70	5.93
Interest Cover Ratio	46.25	6.40	4.39	10.69	4.85	14.27	22.63	2.47	8.04	1.71	0.00	*	73.83	295.08
PBIDTM (%)	14.52	11.97	24.75	19.79	91.75	56.63	4.07	9.18	7.43	3.56	52.00	*	14.79	29.33
PBITM (%)	12.47	9.97	20.83	16.39	91.73	54.69	2.10	7.03	5.65	2.77	50.40	*	9.05	26.08
PBDTM (%)	14.26	10.41	20.01	18.25	72.83	52.80	3.98	6.33	6.73	1.94	52.00	*	14.67	29.24
ROCE (%)	19.28	26.88	15.87	14.92	11.27	29.26	15.77	14.35	16.58	12.97	11.77	*	11.83	40.23
RONW (%)	14.65	21.16	18.21	20.45	12.47	29.00	8.28	58.66	16.52	10.21	10.56	*	10.44	35.44

\*Data not available

Source : <http://www.capitaline.com>

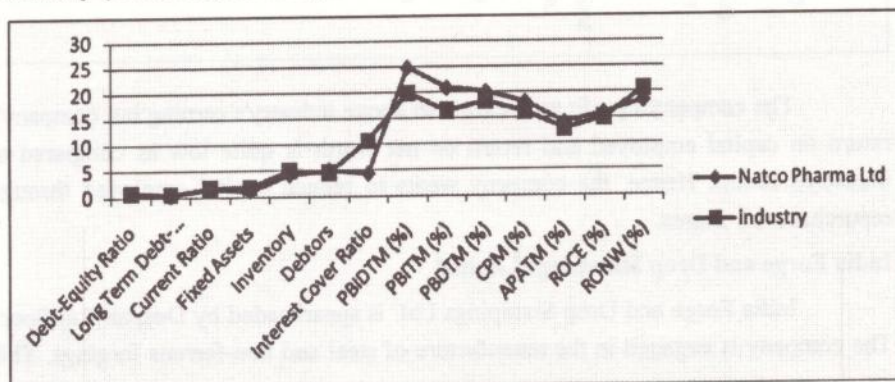


With respect to profit ratios company is in line with industry but company's return on capital employed and net worth is lagging behind industry. By buyback company is trying to offload the excess capital by open offer.

#### Natco Pharma Limited

This company was incorporated in September '81 as Natco Fine Pharmaceutical Limited. It became a deemed public company with effect from July '92; and in February '93, it changed its name to Natco Pharma Ltd. (NPL). The company's debt-equity ratio is at par with industry's debt-equity ratio but interest coverage ratio is far below industry standard, i.e., 4.39 to 10.69. The company is incurring 4.74% interest, whereas industry is paying just 1.54%. The company has low fixed assets and inventory turnover ratio as compared to industry which shows that company has inefficient utilization of assets and excess inventory.

Chart 2 : Comparative Ratios of Natco Pharma Company Versus Pharmaceuticals Industry (Period March 2005)



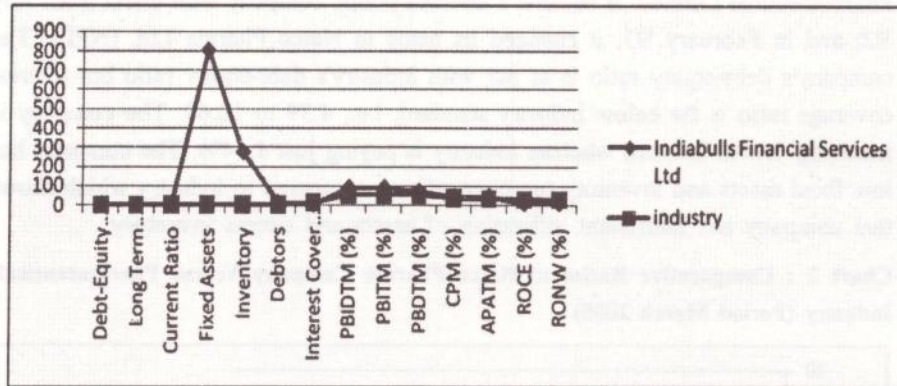
The company's return on capital employed is slightly more than industry's capital employed but return on net worth is less than industry's return on net worth. Since company is levered and incurring high interest charges, this study found that return on capital employed is slightly more than industry's return on capital employed but return on net worth is less than industry's return on net worth. It can be concluded that the company is going for buyback of shares in open offer instead of repayment of debt.

#### Indiabulls Financial Services Limited

Indiabulls is one of the leading integrated retail financial services company in India which was incorporated in the year 2000. It offers a full range of financial services and products ranging from Equities to Insurance. The company is highly levered as compared to industry, i.e., 1.25 to 0.56. The company has high current

ratio as compared to industry. This study found that the turnover ratios (i.e. fixed assets turnover ratio, inventory turnover ratio and debtor turnover ratio) are significantly higher than industry turnover ratios.

**Chart 3 : Comparative Ratios of Indiabulls Financial Services Versus Security Industry (Period March 2005)**

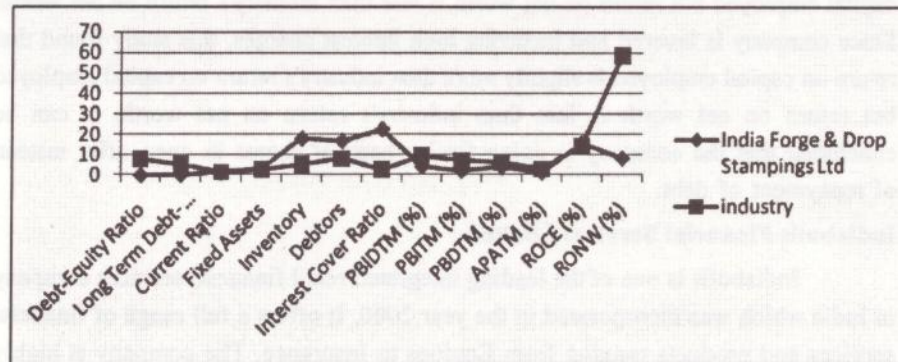


The company's profit ratios are also above industry's earning but company's return on capital employed and return on net worth is quite low as compared to industry's return. Hence, the company wants to reduce capital employed through repurchase of shares.

**India Forge and Drop Stampings Limited**

India Forge and Drop Stampings Ltd. is spearheaded by Deepak Raj Sood. The company is engaged in the manufacture of steel and non-ferrous forgings. This

**Chart 4 : Comparative Ratios of India Forge Versus Forgings Industry (Period March 2005)**





**Table 4**  
Percentage as compared to Industry\*

	ICI India Limited	Natco Pharma Ltd.	Indiabulls Financial Services Ltd.	India Forge & Drop Stampings Ltd.	Gujarat Ambuja Exports Ltd.	Apollo Finvest (I) Ltd.	Polaris Software Lab Ltd.
Debt-Equity Ratio	0	97.33	223.21	0	40.94	N/A	0
Long-term Debt-Equity Ratio	0	73.08	89.66	0	8.75	N/A	0
Current Ratio	78.50	81.07	123.93	96.97	103.42	N/A	162.39
<b>Turnover Ratios</b>							
Fixed Assets	108.85	62.78	20030.60	116.80	49.54	N/A	55.63
Inventory	117.28	85.22	18364.67	350.97	70.95	N/A	0
Debtors	79.02	110.43	610.20	208.81	135.93	N/A	79.26
Interest Cover Ratio	722.66	41.07	33.99	916.19	470.18	N/A	25.02
PBIDTM (%)	121.30	125.06	162.02	44.34	208.71	N/A	50.43
PBITM (%)	125.08	127.09	167.73	29.87	203.97	N/A	34.70
PBDTM (%)	136.98	109.64	137.94	62.88	346.91	N/A	50.17
ROCE (%)	71.73	106.37	38.52	109.90	127.83	N/A	29.41
RONW (%)	69.23	89.05	43.00	14.12	161.80	N/A	29.46

\* Calculated as : company ratio/industry ratio



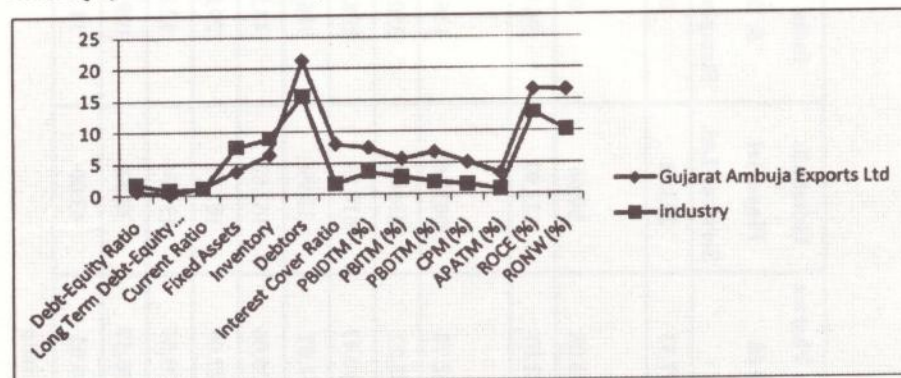
study found that company is unlevered and company's all turnover ratios are higher than industry's turnover ratios.

The company is having high interest coverage ratio of 22.63 to 2.47 of industry though the return on capital employed is at par with industry's return on capital employed. Return on net worth of company is considerably less than industry's return, i.e., 8.28 to 58.66. It can be argued that the company by repurchasing its shares is reducing its capital base so that it can improve return on net worth.

#### Gujarat Ambuja Exports Limited

Gujarat Ambuja Exports Ltd. (GAEL) incorporated in August 1991 and was promoted by Vijay Kumar Gupta, is engaged in the manufacture of refined castor oil, hydrated castor oil and hydrogenated castor oil. The Company's performance is considerably good as compared to industry standard. However, company's fixed asset turnover ratio is less than industry's fixed asset turnover ratio, which may be because of inefficient utilization of assets or lower sales.

**Chart 5 : Comparative Ratios of Gujarat Ambuja Exports Ltd. Versus Solvent Extraction Industry (Period March 2005)**



The company's inventory turnover ratio is less than industry's inventory turnover ratio that may be because of poor sales. The company's interest coverage ratio, profits ratio and return on net worth ratios are higher than respective industry's average ratio.

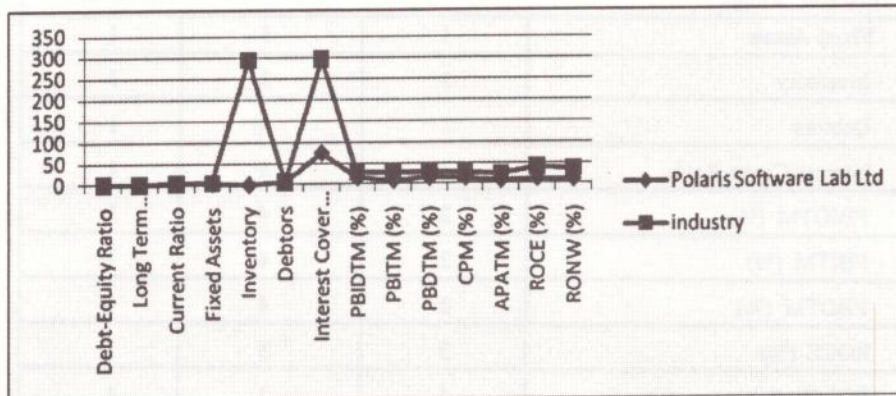
#### Apollo Finvest (India) Limited

Incorporated on 29th July, 1985 as a public limited company Apollo Finvest (India) Ltd. was formerly known as Apollo Mercantile Limited and obtained Certificate of Commencement of Business on 10th December, 1985. The company is unlevered. Due to unavailability of industry's figure it was not possible to make any comparison.

### Polaris Software Lab Limited

It was incorporated in January '93 as a private limited company by Arun Jain; and later in June 96 it was converted into a public limited company. The company is unlevered and growing but company is performing far below the industry's performance. Its interest coverage is just 73.83 to 295.08 of industry. Return on capital employed is just 11.83% as compared to industry's 40.23 and return on net worth is just 10.44 as to 35.44 for industry.

**Chart 6 : Comparative Ratios of Polaris Software Lab Ltd. Versus Computer Software Industry (Period March 2005)**



Hence, the company has solid reason for going for share buyback, i.e., to improve shareholder's value and overall ratios of company.

### ANALYSIS

It is found that in general all these companies are growing companies. The most common features found between these companies irrespective of industry are *purpose of buyback* and *fund used for buyback*. All seven companies wanted to optimize returns to shareholders and enhance overall shareholder value. They all have used free reserves, cash surplus or internal accruals for repayment of shares.

The following table presents the information in percentage form calculated by dividing company's ratio by industry ratio. For instance, debt-equity ratio of Natco Pharma Ltd. of 97.33 shows that if industry's debt-equity ratio is 100, Natco Pharma is using debt-equity ratio of 97.33.

Almost all companies have return on net worth far less than industry's return on net worth. Out of seven companies, four are unlevered companies not



**Table 5**  
**Comparative Ratios of Number of Companies Versus Industry (Period March 2005)**

Number of Companies	Lower than industry	Higher than industry	Data not available
<b>Key Ratios</b>			
Debt-Equity Ratio	5	1	1
Long-term Debt-Equity Ratio	6	0	1
Current Ratio	3	3	1
<b>Turnover Ratios</b>			
Fixed Assets	3	3	1
Inventory	3	3	1
Debtors	2	4	1
Interest Cover Ratio	3	3	1
PBIDTM (%)	2	4	1
PBITM (%)	2	4	1
PBDTM (%)	2	4	1
ROCE (%)	3	3	1
RONW (%)	5	1	1

using any debt. So, on having a bird eye view of analysis it can be said that except one or two common characteristics (low return on net worth and low return on capital employed) all other characteristics are case specific.

Table 5 shows that out of total seven companies, with respect to particular ratio how many companies have ratio lower and more than industry.

This study covered a little part of share buyback in India. It is not comprehensive but gave an overview of what common features these companies share that is presently going for buyback in India. Further, comprehensive research is needed in this field to explore: whether companies within the same industry going for buyback of shares have common characteristics? It is noticed that even if company is levered and it is earning above industry's earning, its return on net worth is less than the industry standard, so does it make sense to reduce equity base or should company go for repayment of debt?



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