MINORITY SHAREHOLDERS WATCH GROUP

BADAN PENGAWAS PEMEGANG SAHAM MINORITI BERHAD

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'CATCHING A FALLING KNIFE'

PERILS OF SHARE BUYBACKS

IN a June 8 report, it was pointed out that Top Glove Corp Bhd had spent RM1.42 billion on buying back its shares over a five-month period until February last year. There were several rounds of buybacks.

Based on the closing price of RM1.18 on June 8, the report said the 200.17 million shares the firm repurchased were worth RM236.2 million, which represented a difference of RM1.19 billion.

The share price has since then slipped below RM1, exacerbating the paper losses at those times.

Top Glove is not the only company that has carried out share buybacks during turbulent times — there were other industries too.

This begs the question as to whether share buybacks are suitable for all companies.

Companies that carry it out do not have to book any paper loss arising from the buyback activity as the exercise is not deemed as an investment. If it were, the auditors would have insisted that the impairment be recognised in the financial statements as a loss arising from impairment.

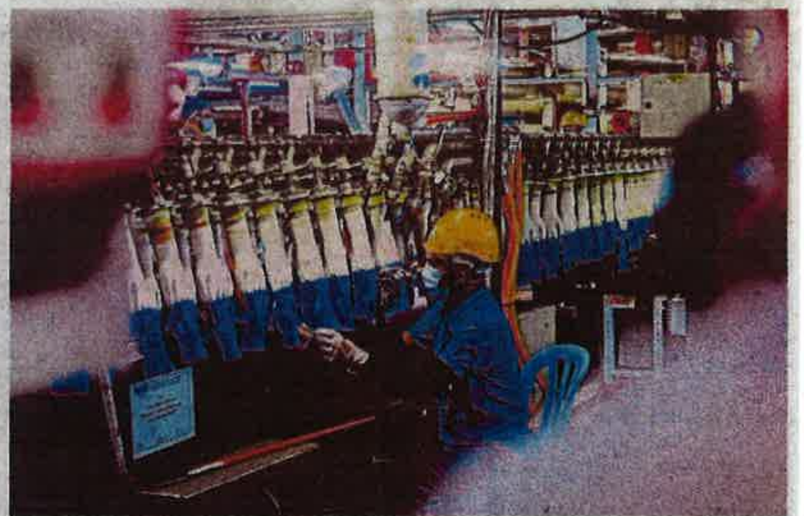
That loss would impact the bottom line. With buybacks, what a company pays for its shares is set off against capital, not the profit and loss statement.

This approach is outlined in the Malaysian Financial Reporting Standards which states that treasury shares are not an investment, but rather an equity that is captured as acquisition costs.

Top Glove said "no subsequent remeasurement is required as these are equity instruments, hence they would not be impaired at any point in time and the question of 'paper loss' does not arise".

But the fact remains that Top Glove paid RM1.42 billion for shares that were worth RM236.2 million based on June 8 market prices. Profits are an opinion; cash is a fact. Overpaying cash for shares is a fact. But then, hindsight is always 20-20.

There is always the thought as to whether minority shareholders would have been better off if they had received the cash paid for share buybacks as a cash dividend. There are other companies that find themselves in a similar situation. It probably seemed the right honest decision at that time.



Top Glove Corp Bhd paid RM1.42 billion to buy back its shares over a five-month period, according to a report. FILE PIC

> *Share buybacks may be suitable when there is no market turbulence, and for companies that are stable and have plateaued.*

Why share buyback?

The main reason for carrying out a share buyback is because the company sees its share price as severely undervalued and as such it is a screaming bargain. The collateral benefit is that it is a show of confidence to the market.

Another reason is to support the share price. But this is not a noble intention if the share price is grossly overvalued or has been manipulated to extremely high prices.

It has whiffs of manipulation. It must be realised that share buybacks are heavily laden with the potential for conflict of interest.

The company must decide whether its shares are undervalued. It is human nature to always overestimate oneself and ascribe a far greater value than is real. We realise this whenever we conduct a self-assessment of ourselves compared with a peer assessment.

Given this conflict of interest, it is unsurprising why companies get their market worth wrong. Often companies do several rounds of share buybacks at lower and lower prices while ending up with shares that the market values even lower.

This, in stock market parlance, is called "catching a falling knife" — and this is self-explanatory. It is a risk of doubling-down (or averaging-down) at lower and lower prices and eventually ending up with an all-time low price.

Minority shareholders must be mindful of what economist John Maynard Keynes said: "Markets can stay irrational longer than you can stay solvent."

Share buybacks may be suitable when there is no market turbulence, and for companies that are stable and have plateaued. In times of turbulence, there is a higher risk of "catching a falling knife".

As an example, the glove industry was in much turbulence due to the waning-off of the pandemic (and hence the demand for gloves) and the lower average selling prices (due to the supply glut) of gloves. The bottom was not clear.

How low things can go was also uncertain. Maybe a sobering perspective is that companies are not set up to buy back their shares per se. They are set up to run their business. If a firm has excess cash, just return it to the shareholders instead of indulging in share buybacks, especially when there is a risk of grossly overpaying for its shares.

The writer is chief executive officer of Minority Shareholders Watch Group