MINORITY SHAREHOLDERS WATCH GROUP
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MINORITY SHAREHOLDERS' DILEMMA

AYE OR NAY TO SHARE BUYBACKS

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SHARE buybacks have become a regular feature among public-listed companies (PLCs), with the minority shareholders typically voting for resolutions seeking their authority to carry out these exercises.

Reputable institutional investors have their mandates on how they will vote in relation to share buybacks. This is done in the interest of transparency; they indicate when they will vote for or against them.

Recently, there was media coverage of how the Employees Provident Fund (EPF) approaches share buybacks. From the commentaries, we can discern an approach to share buybacks that may find favour with the minority shareholders.

The EPF has substantial stakes of over five per cent in about 80 companies listed on Bursa Malaysia. It sometimes votes for a share buyback resolution and sometimes against.

From the voting mandates and commentary, certain discerning principles can be ascertained that may be useful for the minority shareholders when deciding how to vote.

The considerations at play

Firstly, if a company has declared lower-than-expected dividends and then seeks a mandate for a share buyback, the EPF will vote against it. Retirement savings and pension funds expect cash inflows from their investments as they have a moral duty to declare reasonable interest to their members. So, cash inflow is crucial.

The EPF does not say "no" to share buybacks. Rather, it says if a company has enough cash to consider a share buyback, it should first give a reasonable dividend. Thus, the EPF voted against the proposed share buybacks in seven companies that had declared lower dividends last year.

The EPF disclosed on its website that the rationale for opposing these companies' proposed share buyback schemes was that spare cash should be utilised for higher dividends to reward shareholders or for business expansion for better growth.

The pension fund does not insist on cash dividends at all costs. It is prepared to forego dividends when a company has plans for a business expansion. In such instances, it makes perfect sense to plough back the potential dividends into working capital or capital investments. That way, there may be future streams of cash dividends and, consequently, share price increases.

The EPF has voted for the proposed share buyback schemes in some companies that maintained their dividend payout or paid higher dividends during the year.

Also, it is likely to vote for a share buyback resolution if a company has consistently declared high dividends in the past but a lower dividend for the year, albeit a still decent one at that.

The message seems to be that although a high dividend is preferred, it will settle for a lower, but decent, dividend and approve a share buyback resolution.

In rejecting some share buybacks, the EPF said the PLC had weak free cash-flow generation with no dividend policy.

"We view that the proposed share buyback will not bring value enhancement to the company and its shareholders," it said.

This makes sense because the PLC should be conserving cash rather than using it to buy back its shares when there is weak free cash flow generation.

Where there are negative performances and growth prospects, PLCs should not be carrying out share buybacks. Dividends are preferred to share buybacks in such instances.

"Taking into consideration the company's negative performance and growth prospects, we are in favour of dividend payments."

A possible approach for minority shareholders may be summarised as a four-principled approach:

❑ A company can carry out share buybacks if it gives decent dividends.

❑ No share buybacks if there is weak cash flow or negative company performance.

❑ Shareholders are prepared to wait for future dividends if a company is ploughing back the current potential dividends into the company for business expansion.

❑ If a company is sitting on more than the required cash, do give at least a decent dividend.

Theoretically, there is no doubt that share buybacks can increase the share price by reducing the free float of shares. The only problem is that the correlation is not linear.

If, instead of giving a dividend of 10 sen per share, the company uses the cash to buy back shares, there is no guarantee that the share price will go up by 10 sen.

There are many aberrations as share prices are the results of market sentiments and do not succumb to simple linear correlations which can be quantified with mathematical precision.

So, it is perfectly understandable for minority shareholders to prefer the cash dividend in lieu of benefits through share buybacks, which are subject to the vagaries of the market.

Blessed be the company that has a consistent net cash inflow and can strike a balance doing three things — declare a decent dividend, have sufficient cash for its investments and expansion and carry out share buybacks — all at the same time.

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The writer is chief executive officer of Minority Shareholders Watch Group.