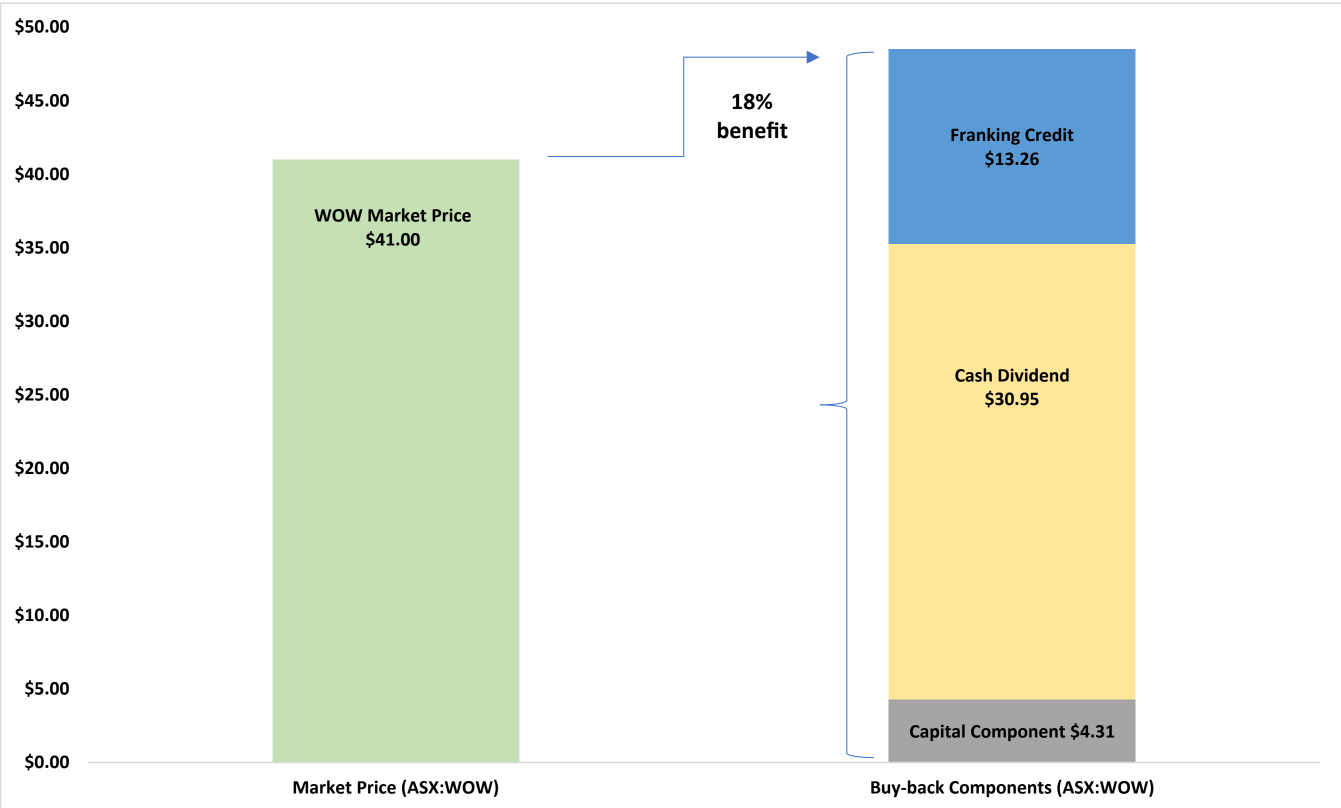
Share Buy-backs

On the back of a strong rebound in profits, some of Australia's biggest companies are in the midst of large share buy-backs. With buy-backs, the company can purchase the shares on the market or from shareholders directly ('off-market'). For investors, making the decision to participate in these buy-backs comes down to many factors, some of which we unpack below.

As the name suggests, an off-market buy-back is where the company offers to buy your shares directly from the shareholder and not via the ASX. This is distinct to on-market share buy-backs. The usual rationale for announcing a share buy-back is that the company has surplus capital available and wishes to return the excess to shareholders. When a company buys back shares, it lowers the number of shares on issue, thereby improving common business metrics and ratios (e.g. dividend rate). However, there is a catch – and this comes down to the value resulting from the transaction.

This is because the offer to buy your shares is set at a lower price than you could sell them via the traded ASX market. The lowest price that the company can buy the shares back it wants, is known as the final tender price (which is often at a 14% discount). So the question is why would anyone sell shares off market at a 14% discount to what can be achieved via the ASX. The potential value arises from the components as the sale proceeds aren't 100% 'capital'. Instead they are made up of a capital component and a fully franked dividend. It's this fully franked dividend that provides the additional value, particularly to very low or zero taxed individuals (such as Not-for-Profits and superannuation funds operating in pension phase). Franking credits, which can be summarised as credits for the company tax already paid, can be used to offset any personal tax payable. Importantly, if you have no tax payable, these are refunded in full.

Example: With respect to the Woolworths Group Limited buy-back, should the share price stay stable at a price of $41.00, the indicative return from this investment is approximately 18% on an after-tax basis for tax-free investment entities. This assumes the maximum 14% discount is applied and a final tender price of $35.26. Importantly, under the terms of the offer, only $4.31 is recognised as capital whilst the remaining $30.95 will accordingly be classified a fully franked dividend. A dividend of this size has a $13.26 franking credit attached – and as indicated above, the franking credit is refundable.



The decision of participate in buy-backs are entirely voluntary. However, due to this potential additional value, off-market buy-backs can be heavily oversubscribed. This means not all of the shares tendered to be sold will be bought.