Centum Investments Share Buyback Note

On 29th November 2022, Centum Investment Company PLC (Centum) issued a share buyback notice to shareholders, proposing a repurchase of up to 10.0% (66.5 mn shares) of its issued and paid-up share capital of 665.4 mn in accordance with Part XVI, Section 447 of the Companies Act, 2015 of the Laws of Kenya, and the Capital Markets Authority (CMA) guidelines. Share buyback refers to a company re-purchasing its company's shares from the public market, either though cash reserves or debt financing. Key to note, Centum Investments becomes the second company after Nation Media Group, as highlighted in our NMG share buyback note, to announce a share re-purchase program. In a bid to understand the implications of the buyback, this note shall cover the following:

i. Introduction,
ii. Type of share buybacks,
iii. Implications of the buyback to the company and its investors,
iv. Drawbacks of the buyback, and,
v. Conclusion

i. Introduction

Centum issued a circular to initiate a share buyback on 29th November 2022 following the approval of the program resolution by the board, with the main aim of reducing its issued shares in circulation and rewarding its long-term investors by enhancing the dividend per share (DPS). The transaction will be conducted as an on-market transaction, with Centum looking to reduce its outstanding shares to 598.9 mn shares, from the current 665.4 mn shares. The re-purchased shares will be classified as treasury stock, meaning that they will lose their rights to voting and cash flows until they are reissued. Key to note, the buyback program will run for a period of 18 months from the date of shareholders' resolution to adopt the program, with the board approving a maximum price of Kshs 9.0 per share and a minimum price of Kshs 0.5 per share for the buyback, in accordance with the CMA Guidelines on Share Buybacks for Listed Companies. The CMA guidelines allows for the maximum price to be capped at 10.0% above the weighted average price, 30 days prior to the board resolution on approving the buyback.

ii. Types of Share Buyback Programs

Share buybacks, are an alternative way that a company can increase investment value to various stakeholders by anchoring stock price and without additional investments made. Notably, when a company successfully conducts a share buyback, the repurchased shares can either be retired by losing their rights to voting and cash flows completely, or held as treasury stock until reissued. Share buybacks can be conducted in various forms. The most common techniques used include:

i. **Tender Offers -** A company places tender inviting shareholders to submit portions of their shares within a period of time and consequently compensate the shareholders by paying a share price above the market value. The tender offers can be categorized into;
   a. **Fixed tender offer –** A company offers to repurchase a specified amount of shares at a specific time and sets a single price. For example, On 16th February 2022, Standard Africa Holdings Limited (SAHL), as highlighted in Cytonn Weekly #07/2022, sought an extension to acquire a maximum of 10.6 mn ordinary shares of Stanbic Holdings Limited at a set price of Kshs 95.0 increasing its ownership stake to 75.0%. Additionally, on 14th October 2022, Diageo UK, announced that it intends to acquire an additional 15.0% of East African Breweries Plc (EABL) shares to increase its ownership stake to 65.0%, by buying an additional 118,394,897.0 ordinary shares at an average price of Kshs 192.00, through a tender offer made to minority shareholders,
   b. Dutch option – The Company sets a range of prices for buying back the shares with the minimum price set above the market value. This option allows shareholders to bid on the number of shares to be purchased as well as the share price range. Consequently, the share price is determined at the end of the tendering process,

ii. **Open-Market Repurchases -** The Company re-purchases its shares at the current market price from the stock exchange market. This type of repurchase can further be divided into;

  a. **On-market Purchase** – Repurchases are conducted on a securities exchange market in the normal course of trading and at current market prices,
  b. **Off-market Purchase** – The share buybacks do not occur in the exchange market directly, rather, the company makes its offers direct to its shareholders,

iii. **Privately Negotiated Repurchases/Direct Negotiation –** The Company reaches out and negotiates the terms with specific shareholders to buy the shares, usually targeting large shareholders with an ownership stake of 14.0% and above. This method allows involved parties to assess and understand the situation for the buyback, and agree on the price and amount of shares to be repurchased, and,

iv. **Accelerated Share Repurchase (ASR) –** A company buys back large amounts of its outstanding shares by entering into a contractual agreement with a financial intermediary such as an investment bank to facilitate the deal.

iii. <u>Implication of the Shares Buyback Program</u>

The buyback will be beneficial to both Centum Investments Company Limited and the shareholders

i. Implications to the company

  i. **Improved financial metrics** – the share buyback reduces the number of outstanding shares in the company, and as a result, increases the Net Asset Value (NAV), return on assets (RoaA) and the return on equity (RoaE) ratios. The increase in both RoaA and RoaE consequently improve the investor confidence in both company and management, which ends up supporting the stock's share price. Key to note, the improved financial metrics can only be realized when a company is making profit. In Centum's case, Centum Investments made a Loss after tax of Kshs 1.3 bn in FY'2022 and a Profit after Tax of Kshs 0.2 bn in H1'2023. Taking the Loss after Tax in FY'2022, the RoaA would shift to (1.18%) from (1.17%), due to the Cash holdings reducing by 50.2% to Kshs 0.6 bn from Kshs 1.2 bn in FY'2022. Similarly, RoaE will also come in at (2.9%) from (2.8%) after the buyback due to a reduction of total equity by the treasury stocks on the balance sheet. The increase in Centum's financial metrics, in absolute terms, indicates that a buyback will be beneficial when the group's performance is making profits,
  ii. **Rebalancing Centum Investments' cash holdings** – Currently, Centum Investments has a cash holding of Kshs 2.2 bn as at H1'2023, in addition to an expected gain of Kshs 1.6 bn proceed from the sale of its Sidian Holdings to Access Bank, resulting in the total expected cash holding of Kshs 3.8 bn. The buyback is expected to help the company to rebalance its cash holdings with Kshs 0.6 bn from cash expected to repurchase shares, and reduce the cash balance to Kshs 3.2 bn. The reduction in cash holdings is expected to also increase the financial outlook of the company,
  iii. **Increase Equity Value** – Centum Investments can proceed to increase its equity value post share buyback. Since the buyback will be done at relatively low prices compared to the firm's historical prices and year open price of Kshs 14.7 at 3rd January 2022, and holding them as treasury stock, the firm can target specific investors, negotiate for higher share prices, or even sell the shares later at a higher price when market performance improves. This will lead to increased equity valuation of the firm without diluting shareholders' ownership, and,
  iv. **Anchor price performance** – Centum Investments share price has been on a downward trajectory recording a 45.3% year to date decline to Kshs 8.0 as at 30th November 2022, from an opening price of Kshs 14.7 in January 2022. The expected buyback is expected to anchor the share price at Kshs 9.0, equivalent to the maximum price of the buyback. In doing so, the share price will increase during the buyback period. Additionally, Centum Investments seeks to do away with lot sizes below 10,000 because such lot sizes weigh down on the share price due to low trade volumes. In doing so, the buyback will anchor the price performance in Nairobi Stock Exchange.

ii. Implications to investors

i. **Increase in EPS for investors retaining their shares** – Share buybacks ideally reduce the number of a firm's outstanding shares in the market. Using FY'2022 Loss after Tax (LAT) of Kshs 1.3 bn, the 10.0% share buyback will see Centum Investments' earnings per share (EPS) come in at Kshs (2.2), from Kshs (1.1) recorded in FY'2022. Further, assuming a constant dividend of Kshs 0.4 bn announced in FY'2022, the dividend per share will increase from 11.2% to Kshs 0.7 per share from Kshs 0.6 per share since the total outstanding shares will decline to 598.9 mn shares, from the current 665.4 mn shares,

ii. **Provide market liquidity to investors who want to opt out of the market**- Given the recent underperformance in the equities market driven by tightened liquidity and low trade volumes, the share buyback will ease liquidity to Centum's shareholders who want to exit the market by setting the price floor above the current market price, and,

iii. **Increase ownership stake for investors retaining the shares** - Due to a reduction in the number of outstanding shares through the share buyback programme, an investor who owned 10.0 mn shares out of the total current 665.4 mn shares in Centum will see their holding increase by 0.2% points to 1.7%, from 1.5% stake after the buyback. As such, the reduction will help investors who hold their shares to increase their ownership stake in the firm.

iv. <u>Drawback of the buyback programme</u>

i. **Short term price rallying** – Centum prices may increase during the buyback period as investors are certain to sell their shares above the current market price of Kshs 8.0 as at 30th November 2022. However, once the buyback period elapses, the prices may even drop further on the back of increased sell off and adverse market conditions, as was the case with Nation Media Group (NMG). The buyback only provides a short term price increase but does not guarantee long term price rally,

ii. **Opportunity cost** - Shareholders invest in a Company to earn a return on their investments. The returns could be in the in the form of dividends and capital appreciation. Initiating a share buyback, could act as a disincentive to shareholders and as such depletes the Company's equity financing. Therefore, Centum Investments could lose more from the share buyback in the long run by eroding shareholders' confidence if the buyback does not result into high dividend payments or capital appreciation,

iii. **Illusion of perfect operations** - The announcement of a share buyback creates an illusion of perfect operations with regard to the management of the company. However, this may not be the case and a critical analysis of a company's ratios is vital to assess the company's true performance or health. In the case of Centum Investments, the company recorded a 2.1% reduction in Loss after Tax (LAT) to Kshs 1.3 bn in FY'2022, from Kshs 1.4 bn loss recorded in FY'2021, signalling improvement in its operations, and,

iv. **Share buybacks reduce shareholders' claims in times of bankruptcy** – Share repurchases are mainly done using a company's cash holdings, which effectively makes a company more levered, while reducing the total number of shareholders, limiting the claims in the event of insolvency.

v. <u>Conclusion</u>

The buyback is a good initiative to award long term investors at Centum, as well as provide liquidity to investors who want to opt out of the stock by selling their shares. Additionally, the buyback is aligned with Centum 4.0 strategy to improve its balance sheet resilience since it will see the company rebalance its cash holdings, reduce its outstanding shares affecting the total equity claim on the company and improve the dividend per share. However, the share buyback will only be beneficial to Centum Investments if the group turns around its performance and reverses the loss of Kshs 1.3 bn in FY'2022, despite the slight improvement in H1'2023. We also expect more listed companies to initiate share repurchases given the increased selloffs in the Nairobi Securities Exchange resulting in undervaluation of stock prices in the bourse.