Note on Nation Media Group's Share Buyback

A share buyback, also known as a share repurchase, is the process where a company buys back its outstanding shares from the market either with its accumulated cash or through debt financing. The repurchased shares are then recorded as treasury stock in the company's financial statements. Treasury stock refers to the portion of shares of a company that are kept in its own treasury and are not available to the public. Treasury stock may have either come from the repurchased outstanding shares or they may have never been issued to the public at all. The repurchased shares are therefore absorbed by the company, which consequently reduces the number of outstanding shares in the market.

Share buybacks usually lead to the price of a stock rallying on the market, since they are perceived as positive indicators for the company. This is because buybacks indicate management's confidence in the company's business model and growth prospects or management's belief that the company's share price is undervalued in the market. Alongside dividend pay-outs, share buybacks are one of the common ways for companies to share their wealth with investors since they not only cause price appreciation, but also increase investors' ownership stake due to a reduction in the number of outstanding shares. There are two ways that companies can conduct a buyback:

- **i. Through the open market at the current market price –** A company can buy back its own shares on the open market at the market price, and,
- **ii. Tendering a fixed price offer –** This involves the company issuing shareholders with a tender offer that provides a price range for the shares being bought. In this case, investors who accept the offer state how many shares they want to tender along with the price they're willing to sell at.

In a bid to understand the buyback process and what it means, this note shall cover the following;

- I. Why Companies Decide to Buy Back Shares,
- II. Market Implications of the Buyback,
- III. Drawbacks to Buybacks,
- IV. Nation Media Group's Share Buyback, and,
- V. Conclusion

I. Why Companies Decide to Buy Back Shares

Following the announcement of the proposed buyback by NMG, we looked at some of the reasons why listed companies decide to undertake share repurchases. These include:

- **a. Undervaluation** – The most common reason why companies undertake buybacks is when the management believes that the current share price is undervalued, giving the company the opportunity to repurchase their shares at a low price, with the possibility of reissuing them once the share price appreciates,
- **b. Company consolidation** - The fewer the outstanding shares, the fewer people management has to answer to. A company can therefore repurchase outstanding shares to reduce investors' stake in the company and consequently consolidate the company's ownership. This can also be used as a defensive strategy for a company targeted for a hostile takeover, enabling it to regain control of corporate decisions and control,

c. **Lack of growth opportunities** – For established companies with a foothold in their respective industries, lack of growth or investment opportunities in the market coupled with adequate cash reserves could lead the company to invest the cash in their own shares,
d. **Equity Value increase –** A company can increase its equity value by repurchasing its shares. This is done through buying the shares at a strategically low price and issuing them as treasury stock then selling the shares later at a higher price to increase equity valuation without diluting ownership,
e. **Reducing cost of capital** – Instead of carrying the burden of unneeded equity and the dividend payments it requires, a company's management team may simply choose to buy existing shareholders out of their stakes. This in turn, reduces the business's average cost of capital,
f. **Boosting key financial ratios** – A company's management can decide to undertake a share repurchase to boost key financial ratios such as;
    i. Earnings Per Share (EPS) which increases due to a decrease in the number of outstanding shares,
    ii. Return on Equity (ROE) which increases as a result of a decline in shareholders' equity, and,
    iii. Return on Assets (ROA) which increases as a result of a reduction in the cash reserves, which consequently reduces the company's total assets.

II. Market Implications

Buybacks usually have positive effects on the equity market performance of a company. The positive effects of share buybacks for the repurchasing company include;

a. **Price appreciation due to reduced supply of shares** – Share buybacks have historically led to share price rallies in the stock market due to market perceptions of management's confidence in the company coupled with reduction in the supply of outstanding shares in the market,
b. **Increased company ownership by shareholders** – Due to a reduction in the number of outstanding shares, an investor who owned 10 mn shares out of the total 207.4 mn shares in NMG will see his/her holding increase to 5.4%, from 4.8% before the buyback, due to a reduction in the number of shares, and,
c. **Improved financial metrics –** Share buybacks result in positive financial metrics for the company such as EPS, ROE and ROA which improve the financial attractiveness of the company to shareholders.

III. Drawbacks to Buybacks

Although share repurchases usually have a positive effect on the share price and increase value to shareholders, a company's management may conduct a share buyback program to achieve personal gains. Buybacks could also be a signal that a company has run out of growth opportunities for which to utilize its spare cash. The drawbacks of share buybacks include;

a. **Debt Accumulation** – Most buybacks are financed with debt, which can strain a company's cash flow. If purchased via debt, the buyback may negatively impact the company's credit rating since credit rating agencies view taking up debt to repurchase shares as an increased level of financial risk tolerance at the expense of creditors, and,
b. **Can be used by executives to increase compensation** – Buybacks are sometimes utilized by executives as a way to boost compensation. Since many corporate bonus programs are based on the business attaining certain financial goals based on benchmarks such as increased EPS and ROE ratios,

repurchasing outstanding shares enables executives to increase their compensation by making the company appear more profitable.

IV. Nation Media Group's Share Buyback

On 31st May 2021, Nation Media Group (NMG) issued a share buyback circular to shareholders, proposing to buy back of up to 10.0% of its issued and paid-up share capital (20.7 mn shares) in accordance with Part XVI, Section 447 of the Companies Act, 2015 of the laws of Kenya. This would reduce the company's outstanding shares to 186.7 mn shares from 207.4 mn shares. Key to note, NMG is the first company in the Nairobi Securities Exchange (NSE) to undertake a share repurchase program. The proposed buyback, which will be through the open market, shall be proposed to the company's Annual General Meeting (AGM) that will be held on 25th June 2021 and will be subject to shareholders' approval. The board proposed a minimum price of Kshs 2.50, equivalent to the par value of an ordinary share and a maximum buyback price of Kshs 25.00 per share. NMG gained 9.3% on 25th February, the day the company issued the cautionary statement on the proposed buyback, and has gained 68.7% since 24th February 2021 to Kshs 22.60 as at 4th June 2021 from Kshs 13.40 in 24th February. Year to Date, NMG has gained 47.7% to Kshs 22.6 from Kshs 15.3 recorded on 4th January 2021. The buyback is expected to run from 28th June 2021 to 24th September 2021, subject to shareholders' approval. NMG's profit declined by 94.4% in FY'2020 to Kshs 47.9 mn from Kshs 862.6 mn recorded in FY'2019, attributable to a 26.5% decline in advertising revenue to Kshs 4.4 bn in FY'2020, from Kshs 6.0 bn in FY'2019 coupled with a 23.4% decline in circulation revenue to Kshs 1.8 bn in FY'2020, from Kshs 2.4 bn in FY'2019. Total revenue declined 24.7% to Kshs 5.7 bn in FY'2020 from Kshs 7.2 bn in FY'2019.

V. Conclusion

At the maximum buyback price of Kshs 25.00, the share repurchase will cost NMG a maximum of Kshs 518.5 mn. NMG's cash and cash equivalents as at FY'2020 stood at Kshs 1.3 bn, indicating the buyback will be paid for using the company's cash reserves as opposed to debt. The buyback will therefore take up a maximum of 38.6% of the company's cash, leaving Kshs 825.7 mn cash in the company's balance sheet. The company's liquidity position will also remain relatively strong, with the liquidity ratio, which measures a company's ability to settle its debt, declining marginally to 1.9x from 2.0x as at FY'2020 while the quick ratio, which measures a company's ability to convert assets into cash and settle short term debt, declining to 1.7x, from 1.9x in FY'2020. Key to note, NMG issued a bonus share issue of 1 share for every 10 held as at close of business on 12th June 2020, amounting to an additional 18.9 mn shares issued in 2020. The bonus issue in 2020 followed by the buyback in 2021 is an indication that the company is pursuing alternative methods to provide returns to investors other than dividends, hence making NMG appear more attractive to investors. The buyback also presents NMG with the opportunity to reissue the shares back into the market if the price appreciates, therefore realising a significant gain.

We expect NMG's shareholders to approve the share buyback, which will make NMG the first company in the NSE to conduct a share repurchase. More buybacks in the NSE are likely to follow, especially with price valuations at historically low levels. Prior to NMG proposing the buyback, Centum Plc and Crown Paints had expressed the intention of buying back shares before the existence of guidelines by the regulator. The Capital Markets Authority (CMA) has since issued guidelines on share buy-backs. The draft guidelines were issued in June 2020 and are in the process of being revised following public participation. In our view, the move by the CMA to issue guidelines on the share buybacks is commendable, and we expect more listed companies to follow NMG's suit and initiate share repurchases while valuations remain low.