

Stock Splits and Buybacks: An Analysis of their Role in Corporate Finance

Winter Project



Corporate Actions.

Corporate actions are events initiated by a company that can affect the value of its securities. These events can be mandatory or voluntary and are important for shareholders and investors to be aware of. Examples of Corporate Actions are:

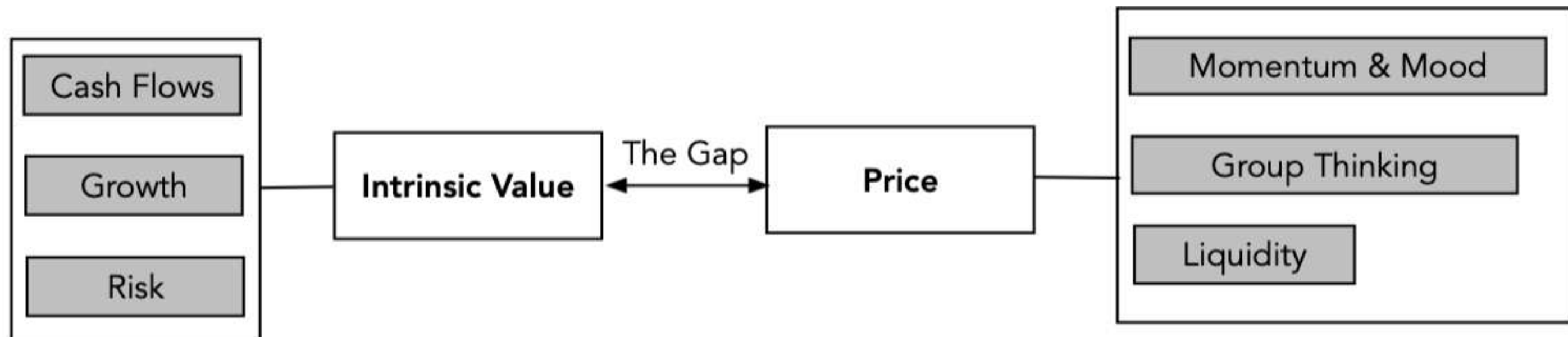
- 1.Dividends
- 2.Stock splits
- 3.Mergers and acquisitions
- 4.Capital structure changes
- 5.Stock buybacks
- 6.Spin-offs

Purpose of Corporate Actions

**Corporate
Restructuring**

**Impacting
Share Price**

**Distributing
Profit to
Shareholders**



To Make a change in this structure

Value Events

Actions that change expected cash flows, growth in those cash flows or the risk in them.

Gap Events

Actions designed to close the gap between price and value by drawing attention to its existence.

Pricing Events

Actions designed to increase the demand for the stock, by changing mood or altering liquidity.

Value of cashflows, adjusted for time and risk

INTRINSIC
VALUE

Value

THE GAP
Is there one?
Will it close?

Price

PRICE

Drivers of intrinsic value

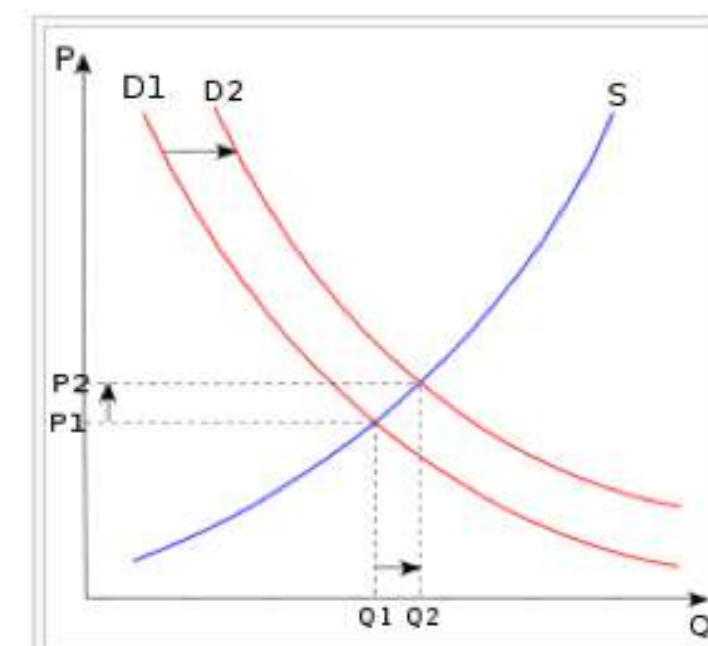
- Cashflows from existing assets
- Growth in cash flows
- Quality of Growth

Drivers of "the gap"

- Market attention
- Information
- Corporate governance

Drivers of price

- Market moods & momentum
- Surface stories about fundamentals
- Liquidity



Value Effects

By changing expected cash flows and the risk in these cash flows, these actions affect value.

Gap Effects

The value does not change, but if the action works, the gap between price & value will close.

Pricing Effects

Value will not change, but price can, sometimes increasing the gap between value & price.

Important Dates for Corporate Actions

1

**Announcement
Date**

2

Action Date
(largely ceremonial)

Stock Split



Stock splits are corporate actions in which a company divides its existing shares into multiple shares

Buyback



A share buyback is when a company buys back its own shares from its shareholders. Buybacks reduce the number of shares outstanding in the market

STOCK SPLIT

Stock Split Deep dive

2 Types of Stock Splits are there, Forward Stock Split and Reverse Stock Split. The latter is less popular, further we'll be referring Forward Stock Split as simply Stock Split.

Looking at splits from a value perspective, they are a purely cosmetic event, because of a split nothing fundamental changes in a company

Why companies do stock Split:

- To make the stock more affordable for individual investors.
- To increase the liquidity of the stock
- To signal the company's growth and success
- To align the stock price with the company's peers

Expectations from Stock Split

Complete Details regarding
these expectations and
their testing methods can
be found [here](#)

Abnormal Positive Returns

.....

Better Fundamentals

.....

Higher Volume

.....

**Increased Media
Attention on the company**

.....

Increased No. of Shareholders

Events selected for Case Study.



April 2022

5:1

A report of the company and details regarding the split can be found [here](#)

July 2022

10:1

A report of the company and details regarding the split can be found [here](#)

Methodology of testing!

Click [here](#) to see detailed methodology and its testing on the events.

Two 41 days event windows were selected for the study, one around Announcement Date and another around the execution date. (-20 to +20)



Abnormal Returns were calculated by subtracting Expected Returns for Actual Returns



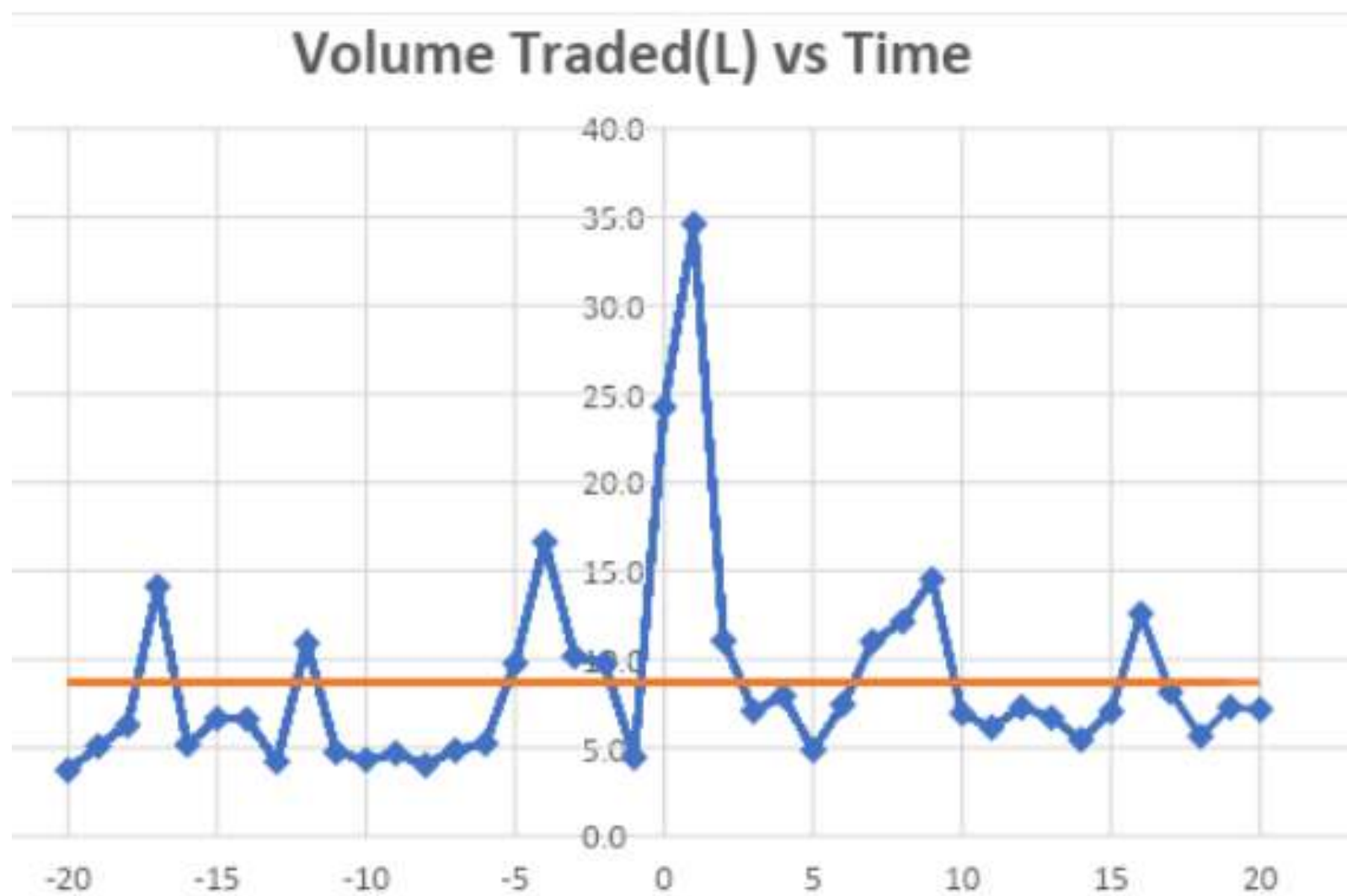
Expected Returns were calculated using the CAPM model



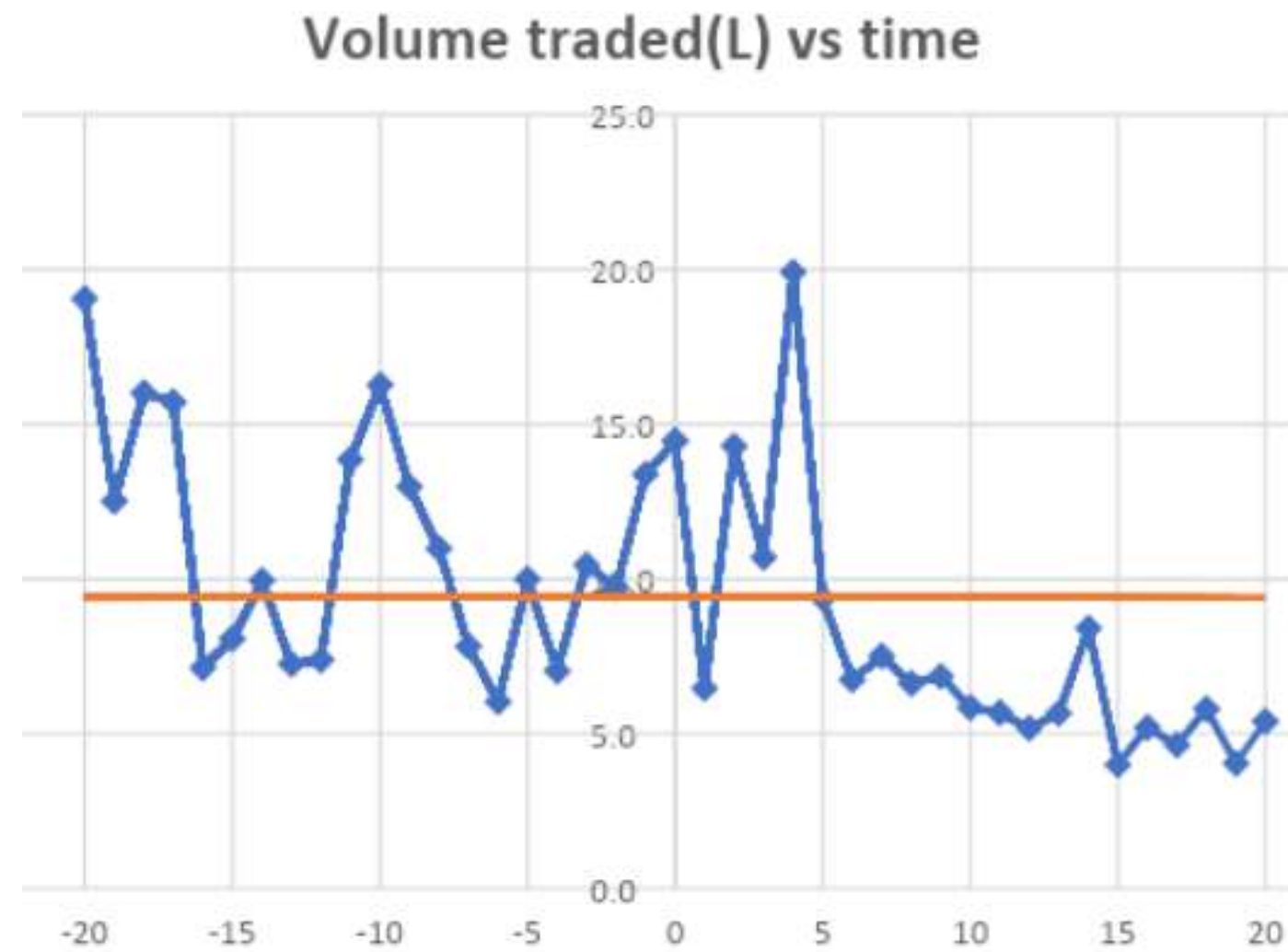
Abnormal returns and volumes were plotted and Observed

Results For Jubilant FoodWorks

Volume



Announcement Date

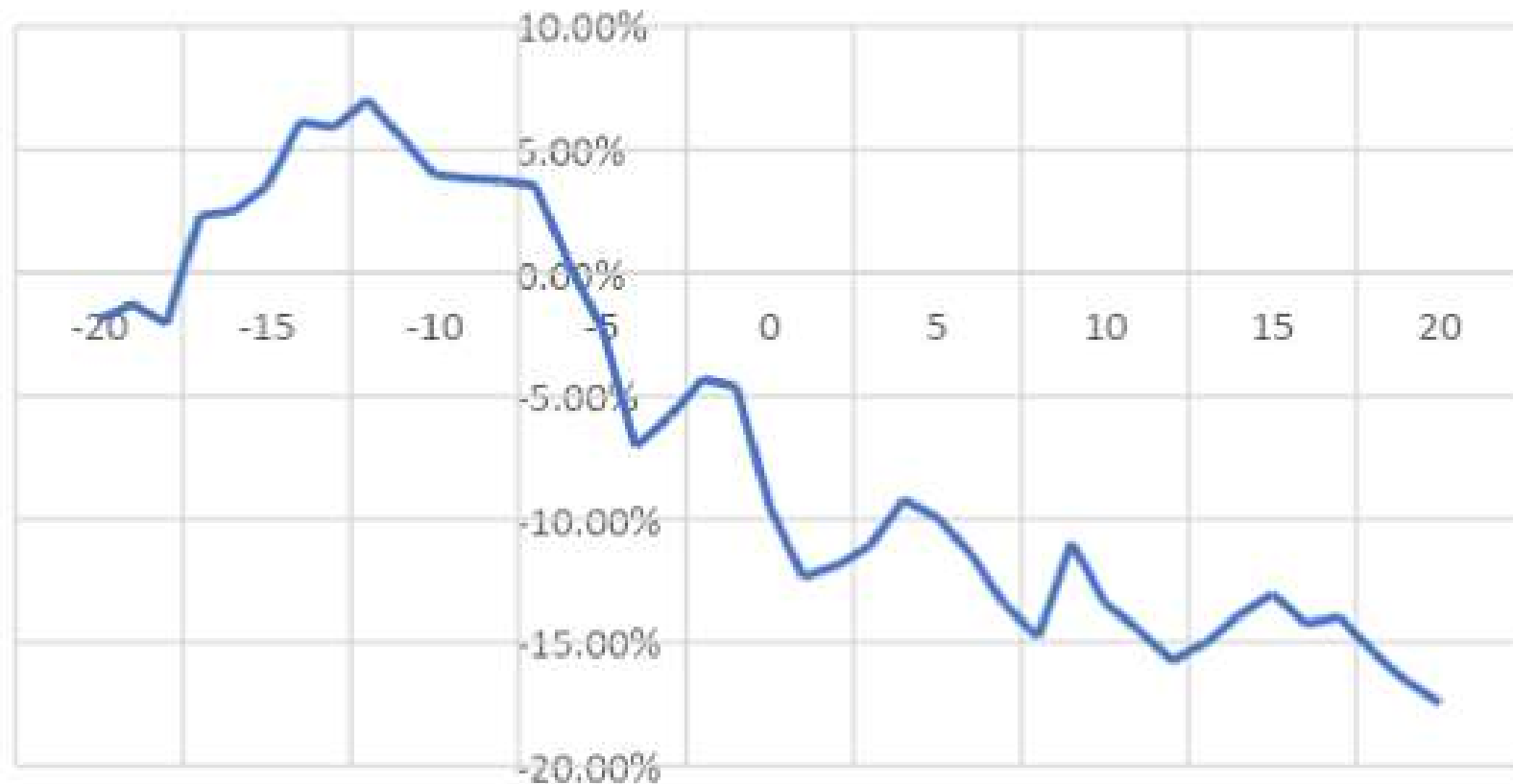


Execution Date

Cumulative Abnormal Returns

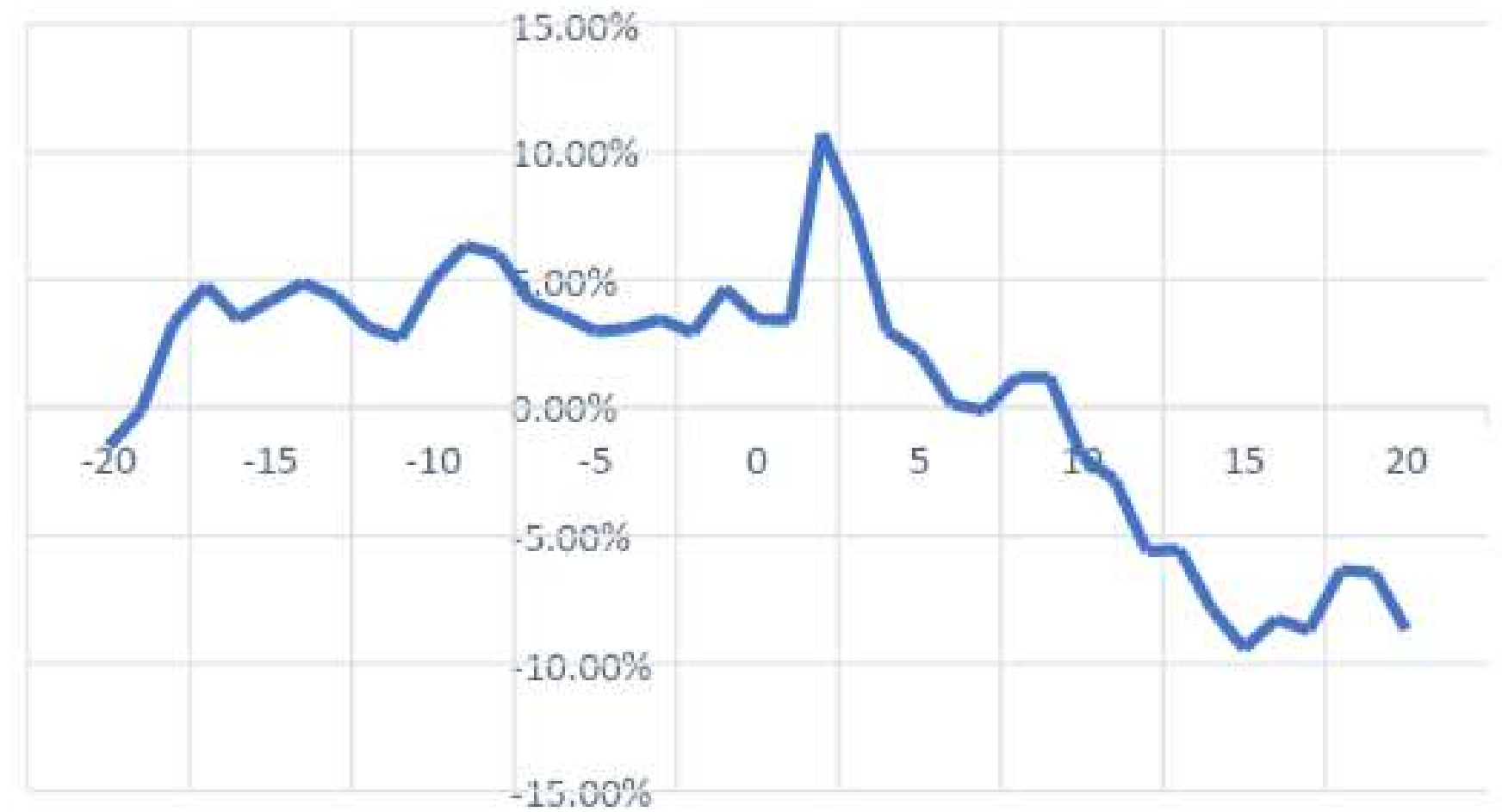
Execution Date

CAR vs Time



Announcement Date

CAR vs TIME



Change in Volumes

The average volume traded after the split dropped to almost half of its pre-split value.

Abnormal Returns

CAR of around 7 percent was observed on t_0-12 day, the intimation day. After this, CAR decreased continuously to -17 percent on t_0+20 .

No apparent reason was found for this drastic decrease in the share price.

Similarly, around the execution date, CAR increased from 3 percent on $t_1 0$ to 10 percent on t_1+2 and then decreased to around -8 percent on t_1+20 .

Increased Media Attention

Jubilant Foods is popular stock and is among one of the most widely tracked stocks in the FMCG sector of India. Therefore, Increased media attention did not affect the share significantly.

Change in Fundamentals after the split :

Company's fundamentals did not change significantly post-split. Moreover, since this event happened recently, this expectation could not be tested effectively for the stock.

Information Leakage

The expected market reaction to the announcement of the split came before the intimation date and the expected reaction to the event of 'Resignation of CEO' also came before it was publically announced. These observations show that the news is being reflected in the stock prices before being publically announced; this shows strong signs of **leakage of information**.

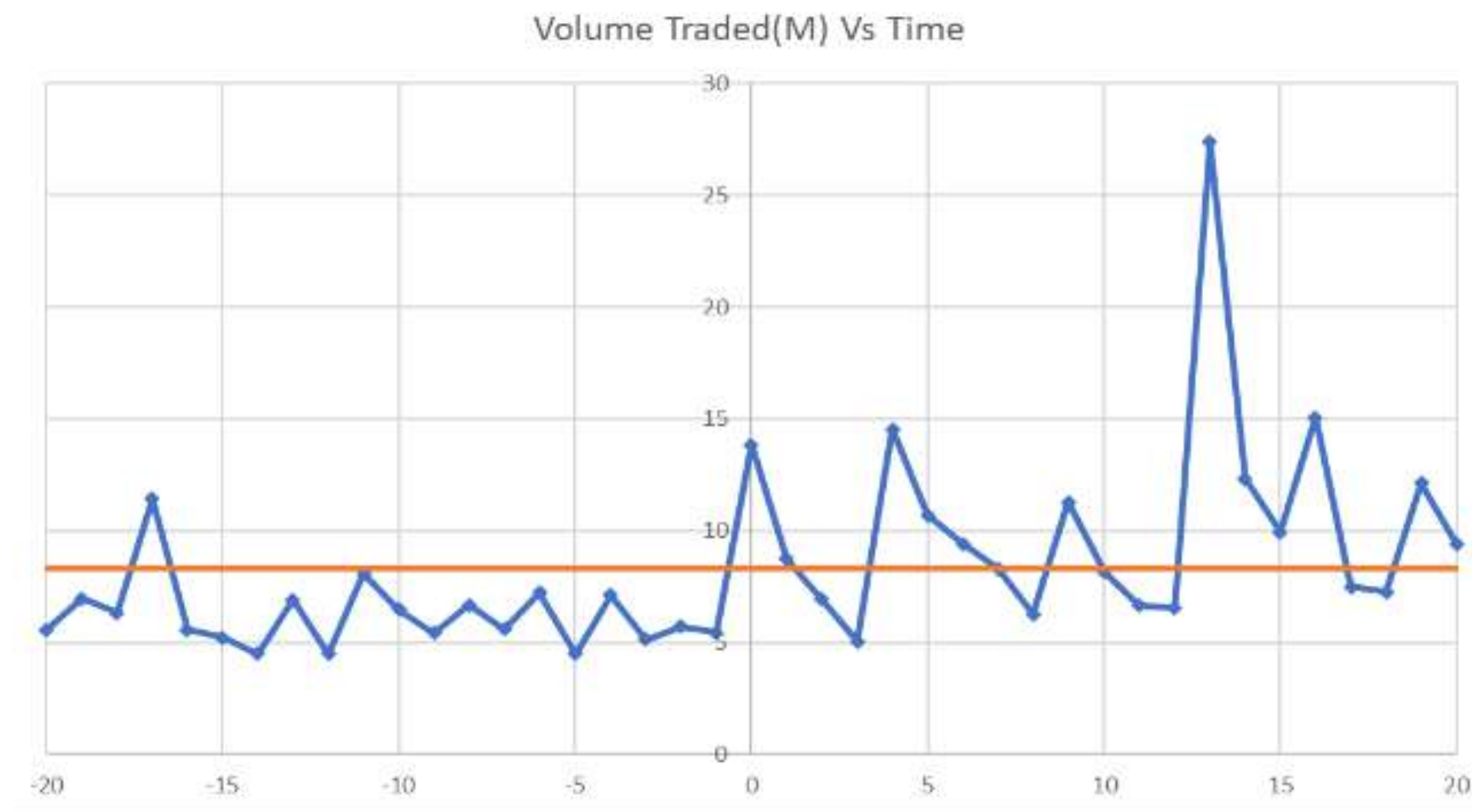
Change in No. of Shareholders:

The no. of investors increased significantly after the event of execution. The no. of investors almost doubled during the quarter in which the stock split was announced.



Results For Tata Steel

Volume



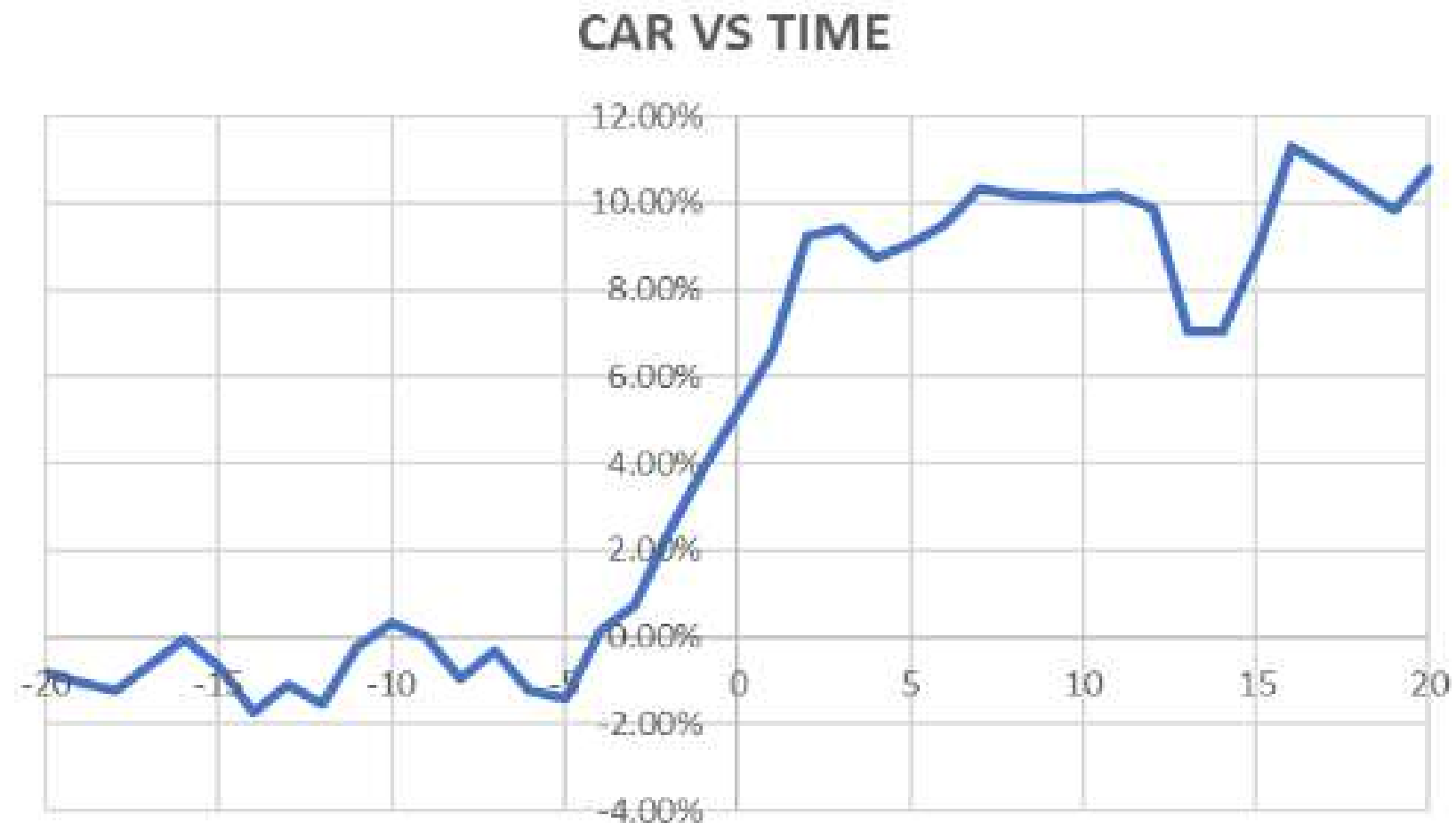
Announcement Date



Execution Date

Cumulative Abnormal Returns

Announcement Date



Execution Date



Change in no. of Shareholders

The split occurred in Q1 FY23 and a substantial increase in the number of investors after the split was observed.

Change in Volumes

There was around a 25% decrease in the average volume traded in comparison to the pre-split values.

No. of Investors recorded after Each Quarter



Abnormal Returns:

We see significant abnormal returns around the announcement date from t_0 to t_0+2 which suggests there was a significant market reaction considering the news of the stock split. However, CAR did not change much after t_0+2 . Similar results were found around the execution date.

Increased Media Attention:

Tata steel is among the most popular and widely tracked stock in the Mining and metals sector. So Increased media attention did not affect the share much.

BUYBACKS

Buyback Deep dive

Reasons for Buyback

- Excess cash
- The stock is undervalued
- Improved fundamental ratios
- Tax-effective means of rewarding shareholders
- Consolidation of Ownership
- Boost in share price

Buyback is used as a method to return cash to shareholders instead of dividends to save on taxes as dividends are taxed under income tax. The gains to shareholders from the buyback are tax-exempt as the company has already paid the buyback tax.

What happens to stocks bought back

- Retention/Treasury Stocks
- Cancellation/Retired

Types of Buybacks

- **Tender Offer:** Company makes a public offer to purchase a certain number of shares of its own stock at a specific price.
- **Open Market:** Company has a specified share repurchase plan that involves purchases of shares on the open market at predetermined dates or intervals.
- **Dutch Auction:** Company specifies the number of shares it wants to buy back and the maximum price it is willing to pay and the share holders submit the lowest price.

Detailed descriptions regarding these expectations can be found [here](#).

**Future growth
Prospect or
Undervalued
Firm**



**Excess cash
flows**



**Anti-Takeover
measures**



**An Alternative
source of
payout**



**Expectations from
Buyback**

Events Selected for Case Study



The buyback was announced on 7 October 2020 with an opening date on 18 Dec 2020. Details concerning the company can be found [here](#).

Buyback was announced on 26 April 2021 with opening date on 8 June 2021.

Methodology of testing!

Detailed methodology and its testing on the events can be found [here](#)

Two 41 days event windows were selected for the study, one around Announcement Date and another around the execution date. (-20 to +20)



Abnormal Returns were calculated by subtracting
Expected Returns for Actual Returns



Expected Returns were calculated using the CAPM model

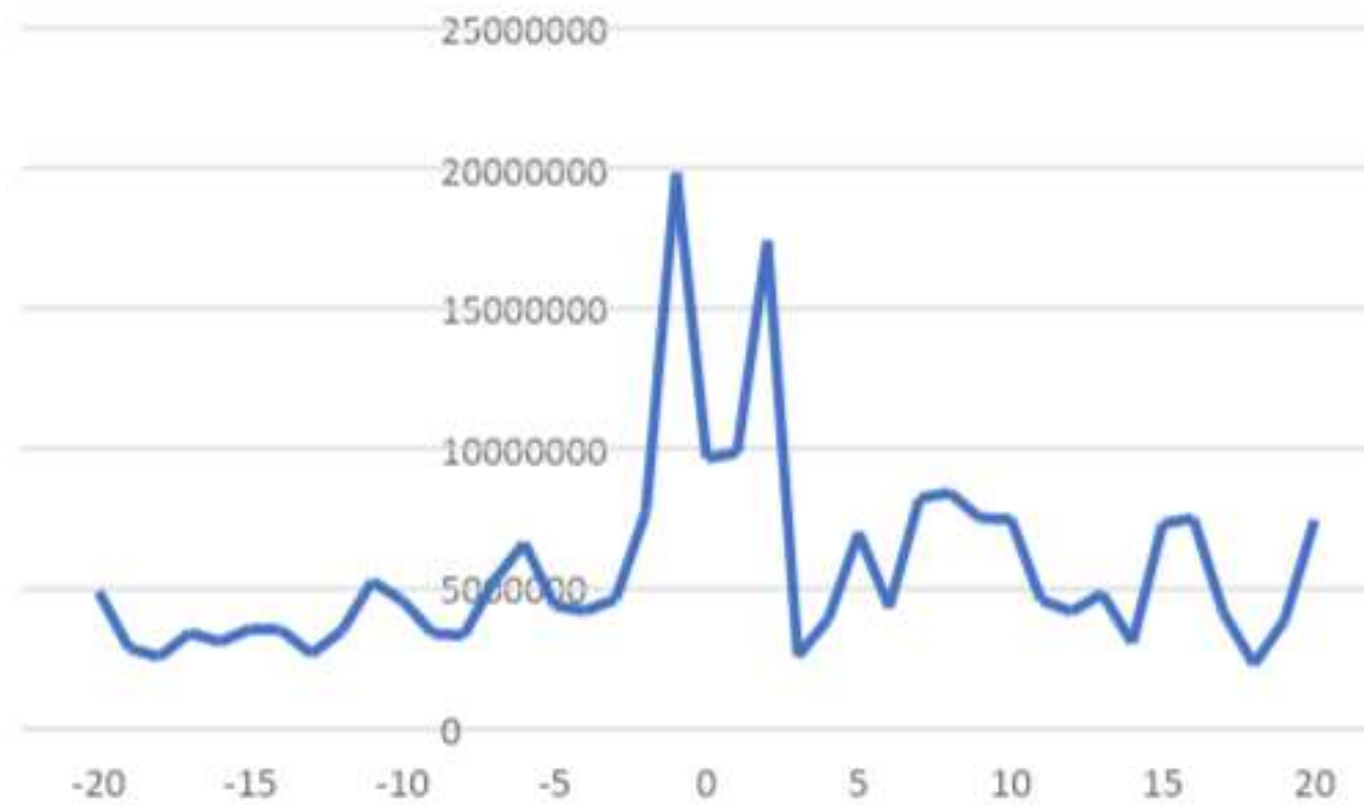


Abnormal returns and volumes were plotted and Observed

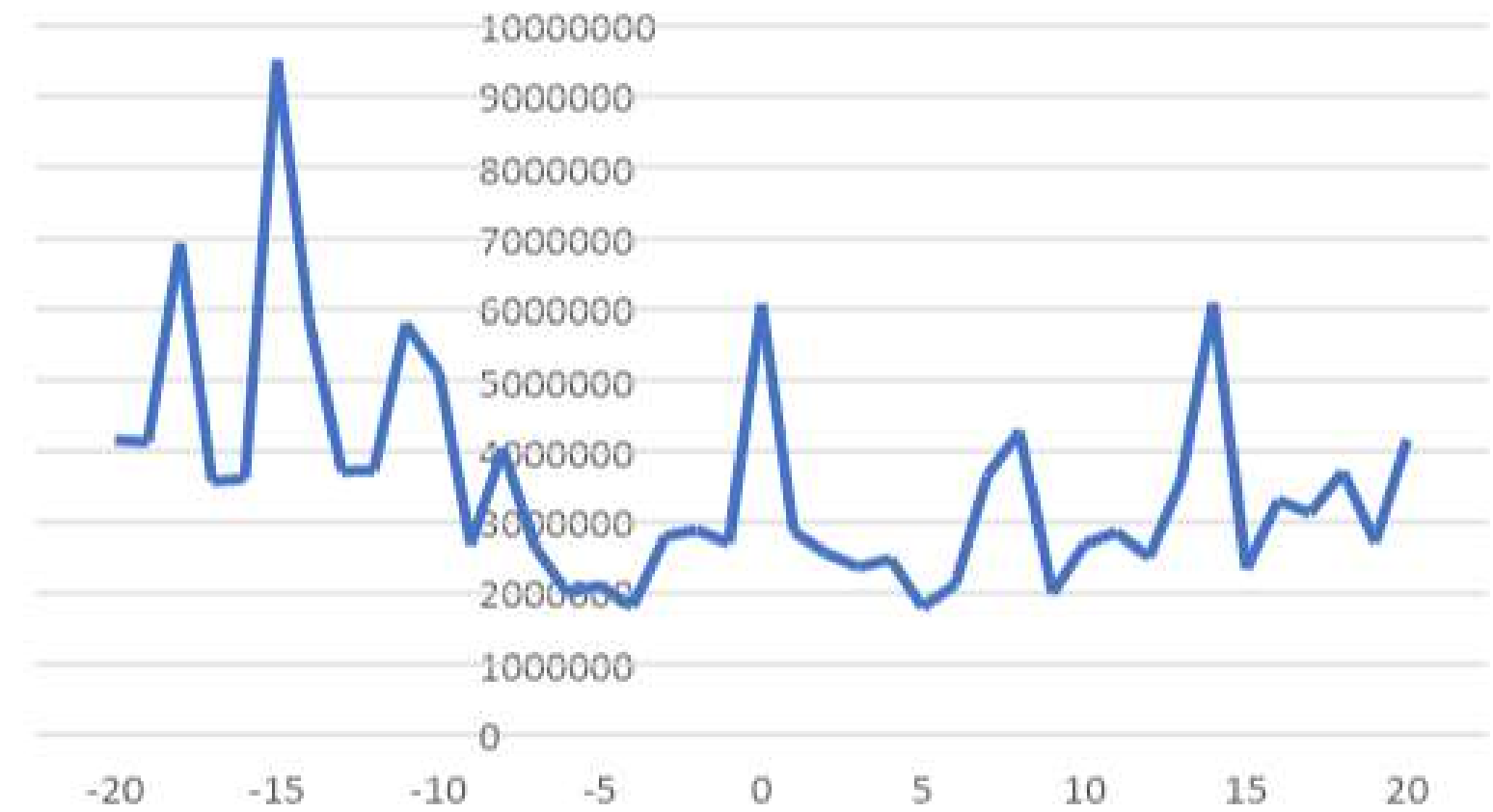
Buyback Results For Tata Consultancy Services

Volume

Volume vs Time

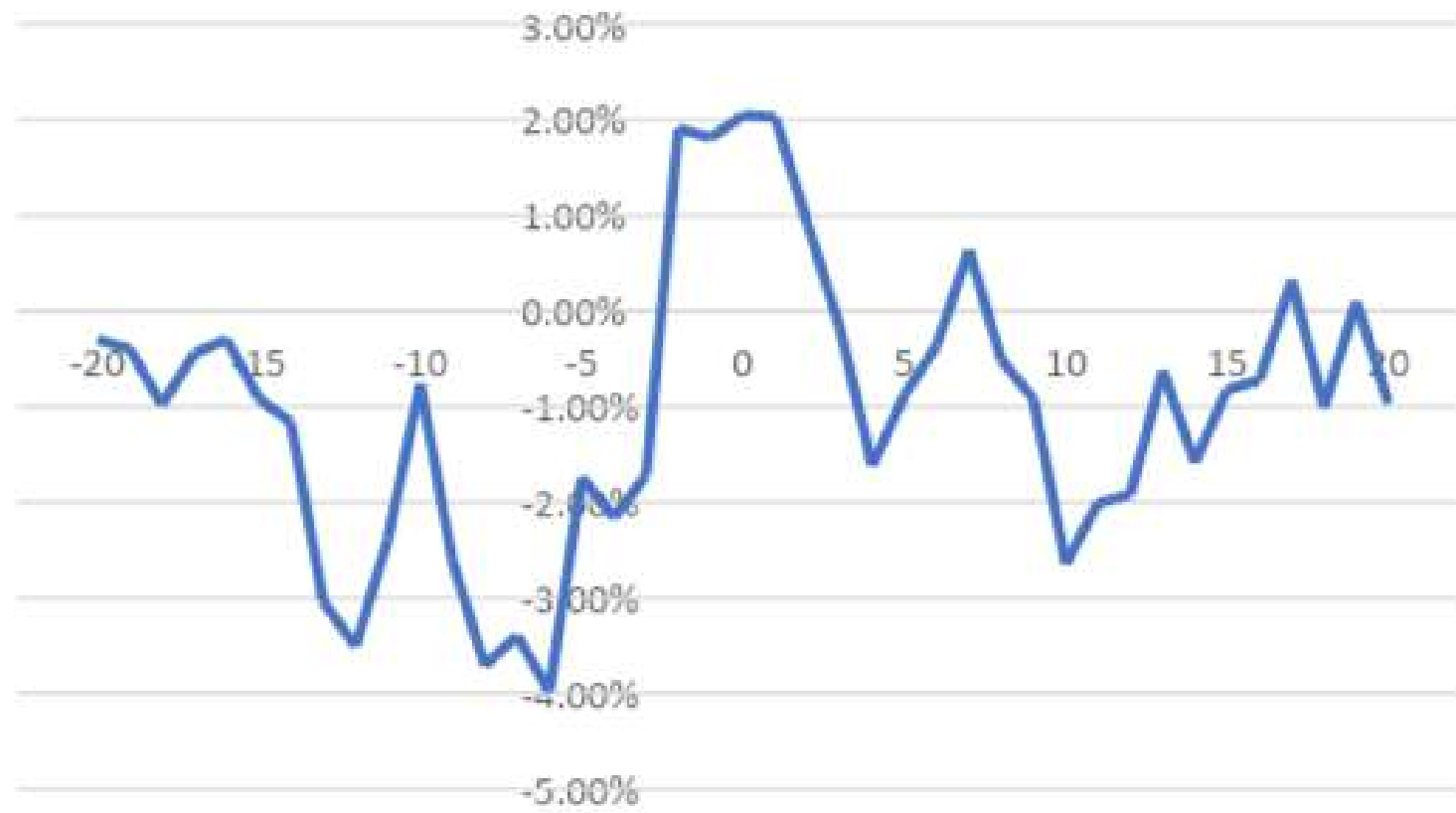


Volume vs Time

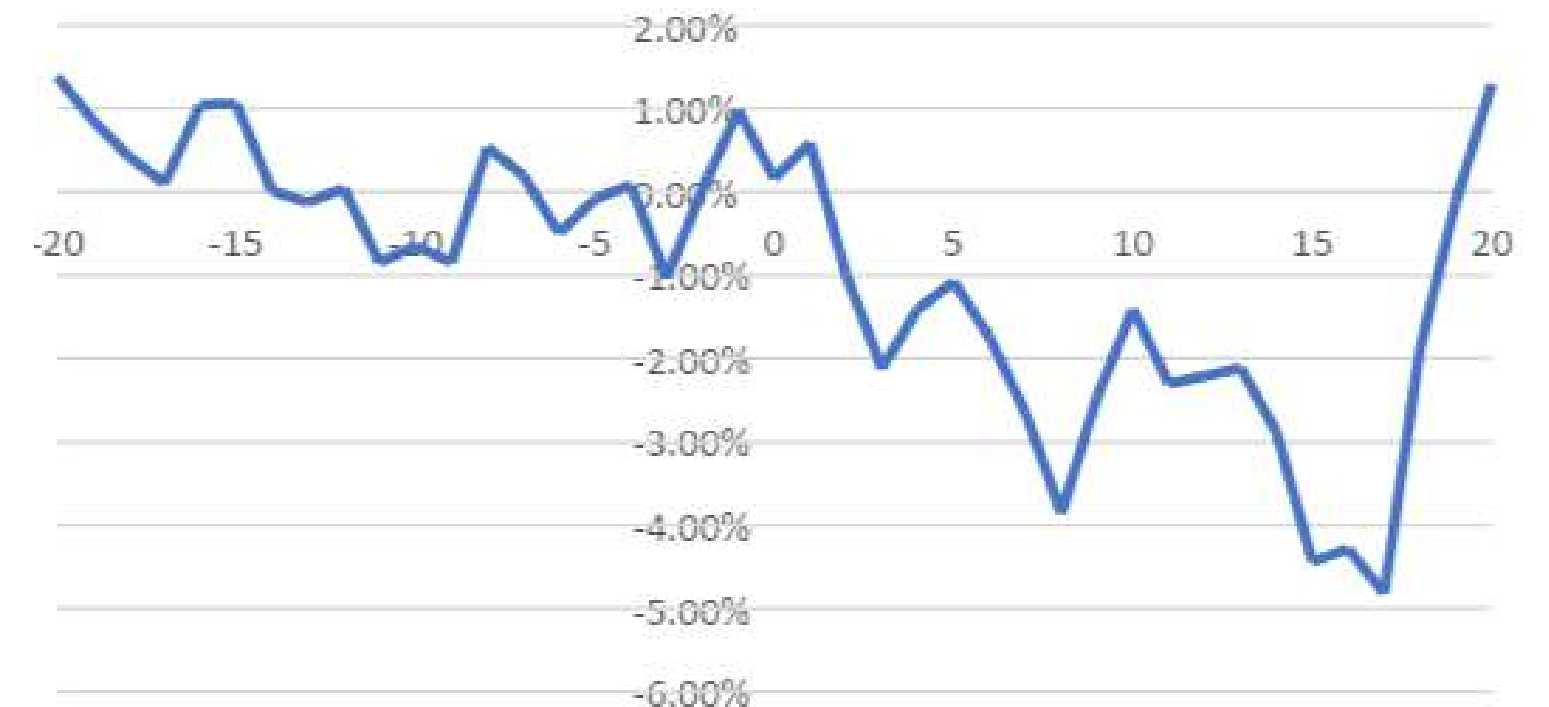


Volume increase was observed just after the announcement meaning that buyback had an impact on the perception of market about the company.

Cumulative Abnormal Returns



Above chart shows Cumulative abnormal returns around announcement date. No significant abnormal returns were observed during the period.



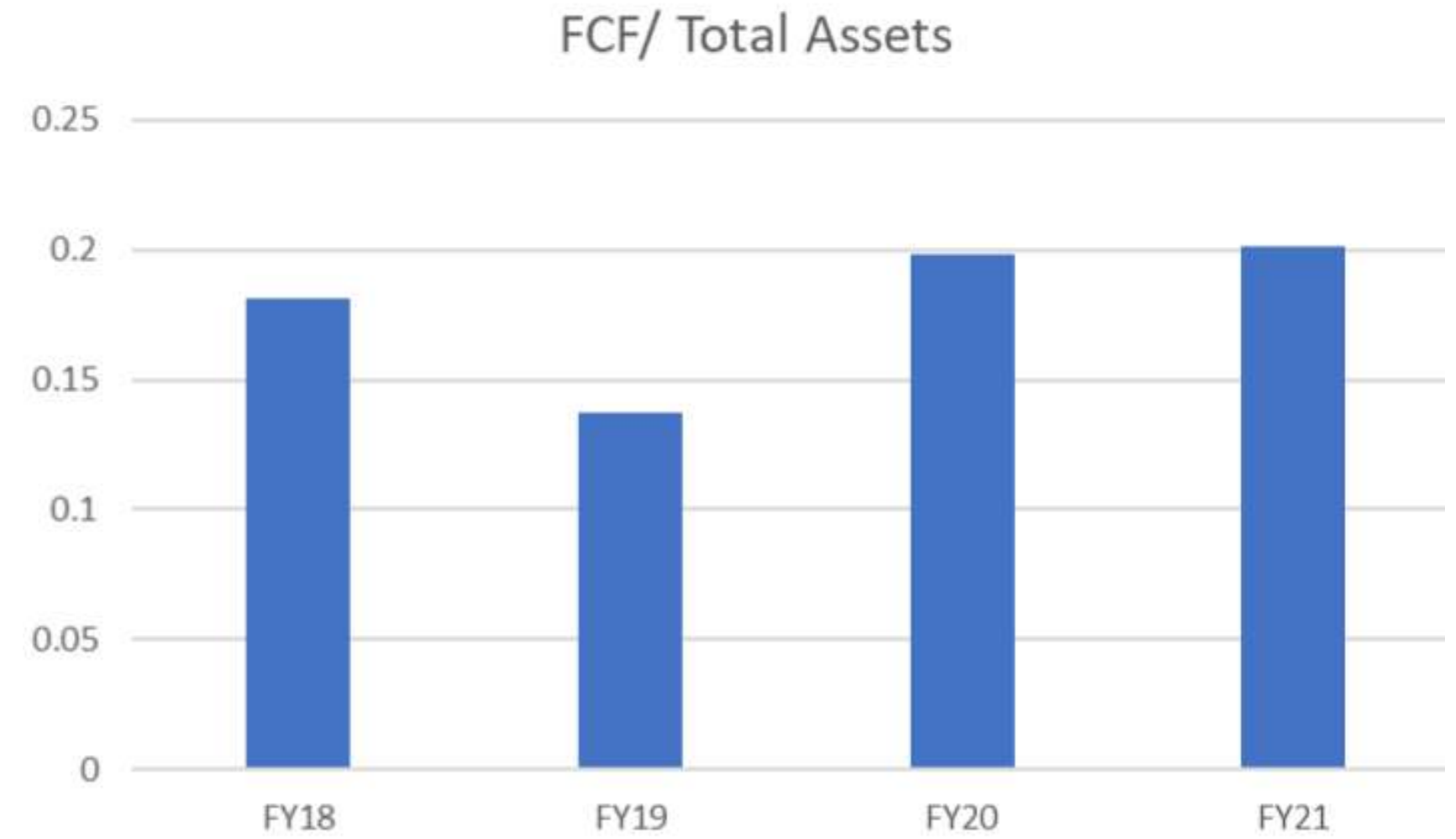
Above chart shows Cumulative abnormal returns around opening date. No significant abnormal returns were observed during the period.

Anti-takeover measures

TCS is the second-largest company in India by market capitalization. Also, the promoters hold more than 70% of the company's stake. This makes TCS invulnerable to a hostile takeover.

So the possibility that TCS used buyback as anti-takeover measures is nearly zero.

Excess Cash Flow

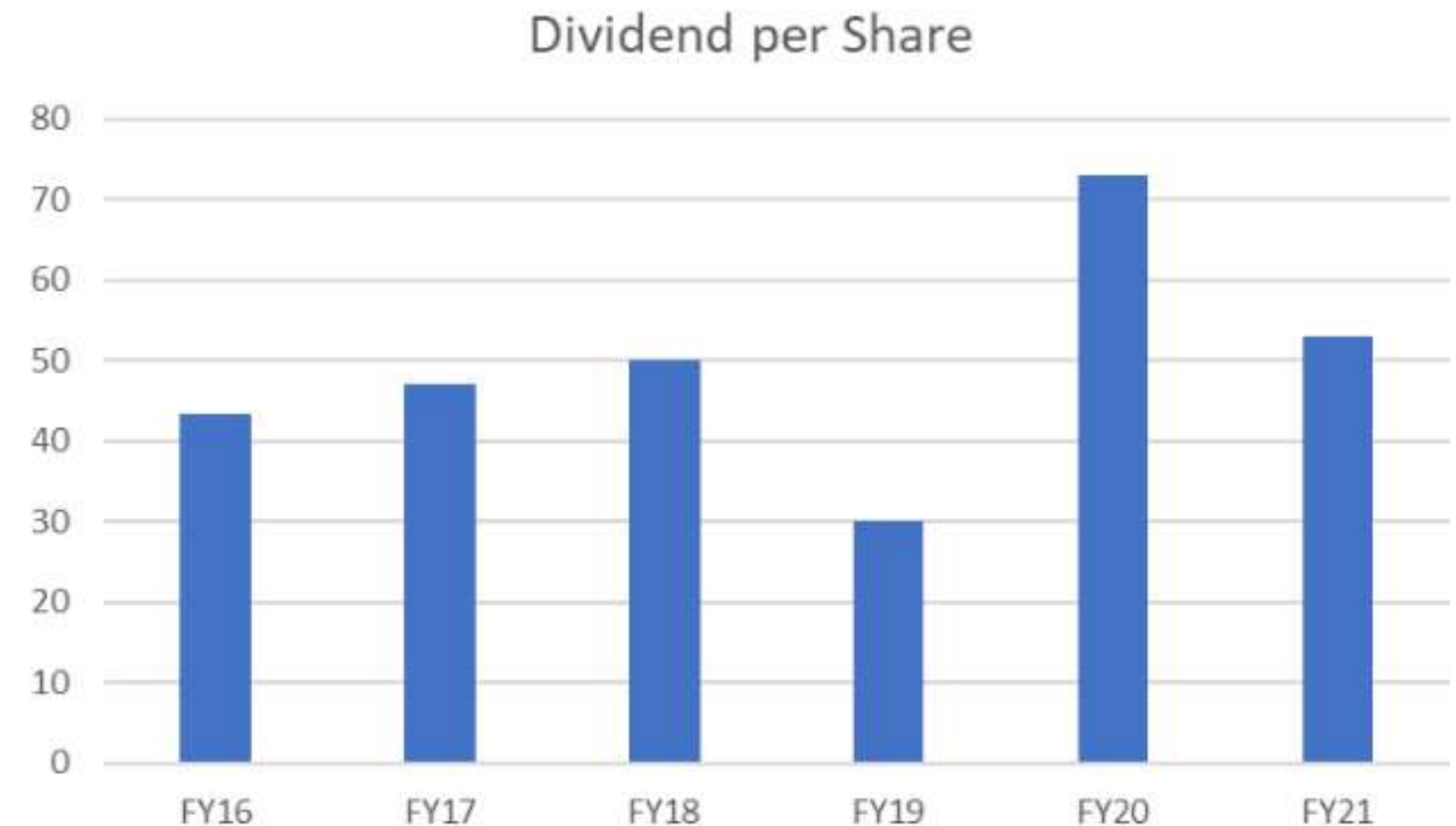


From the above chart, we can see that the company's FCF/Total assets was above its 3-year median. Also, this ratio increased significantly from FY19. The company also bought back its shares in FY19. So excess cash flows seem to be a strong reason for buyback.

Future growth prospects or Undervalued firm

On announcement, both of P/E and P/B were higher than the company's last 5-year median values of these ratio and were also higher than the industry. We can conclude that the company was not undervalued during the time of the announcement. Growth in revenues and profits were observed after buyback but they were close to industry median.

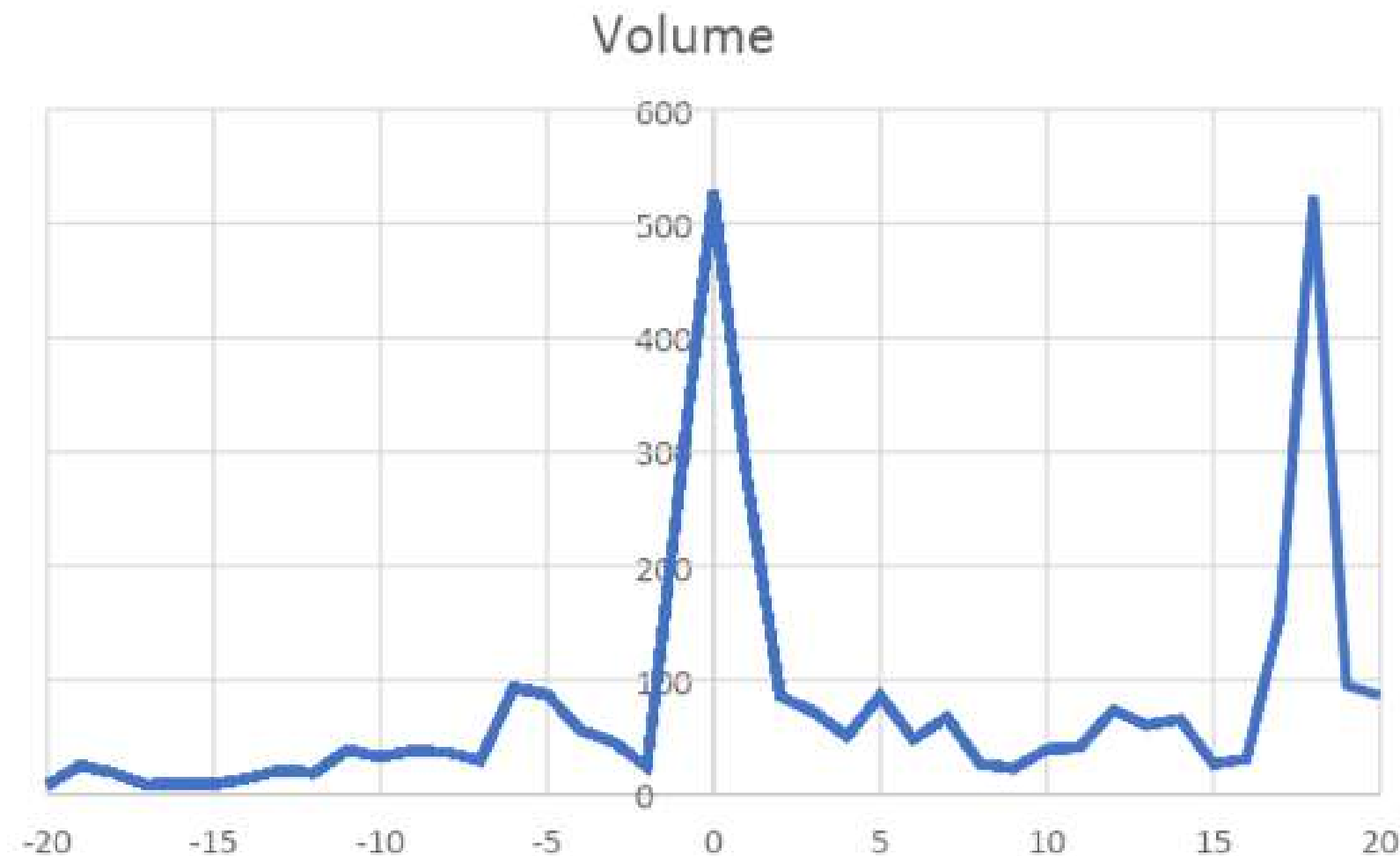
An Alternative source of payout



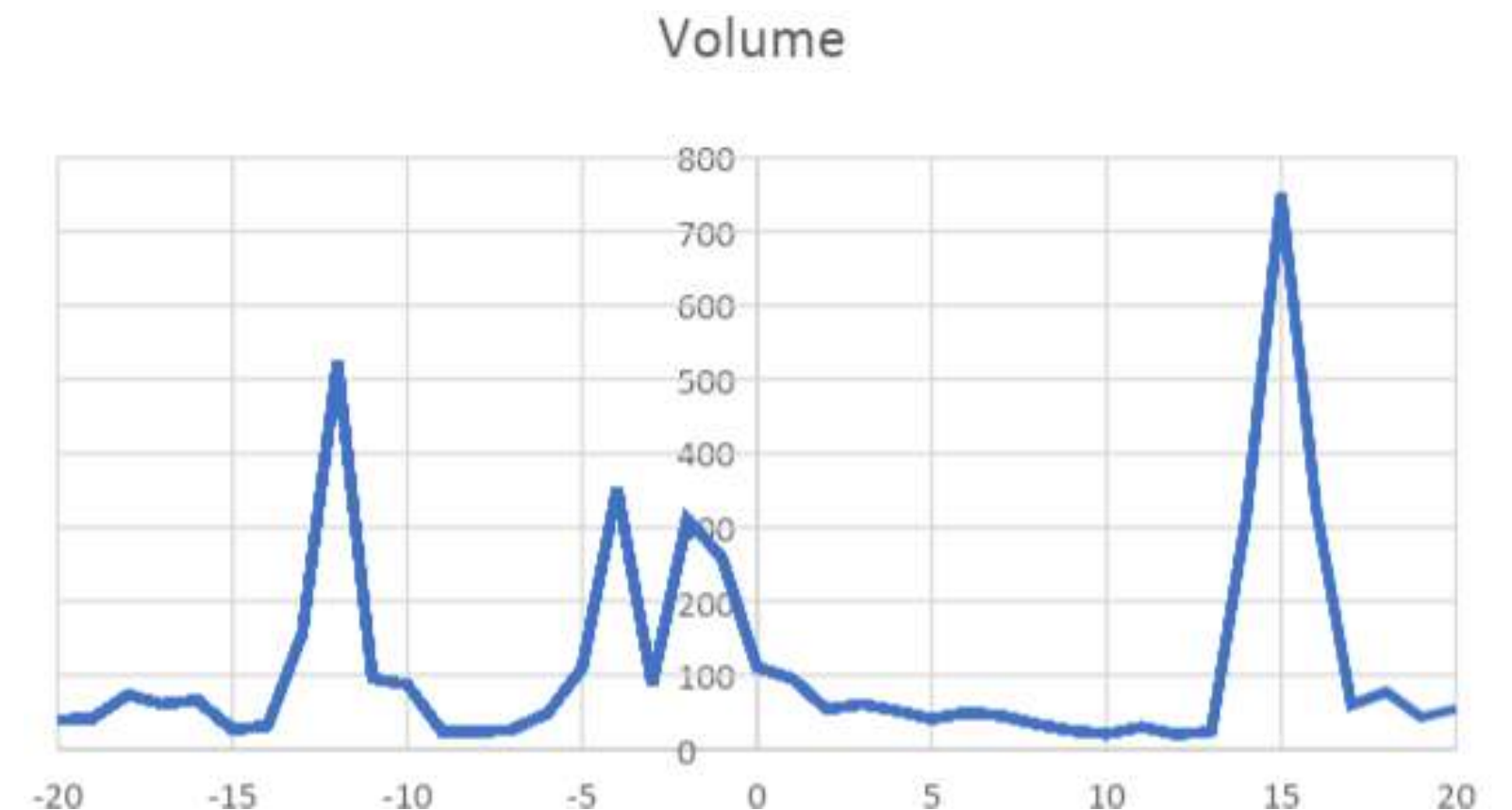
In spite of the increase in net income from FY20, the Dividend per share dropped significantly in FY21. The dividend per share also decreased in FY19, when the company bought back its shares. So it can be observed that buyback were used as an alternative to dividends.

Buyback Results For Infobeans

Volume(in thousands)

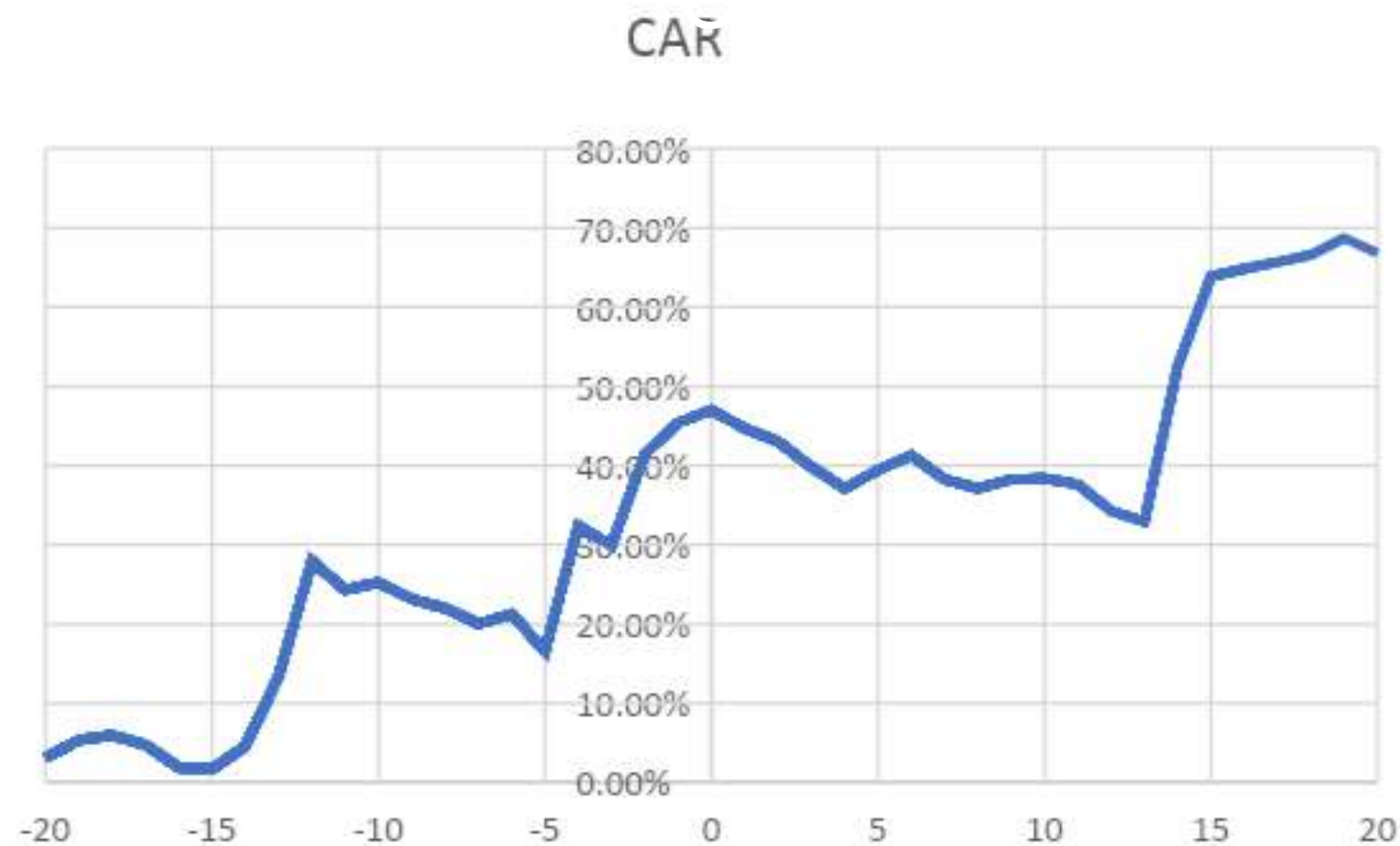
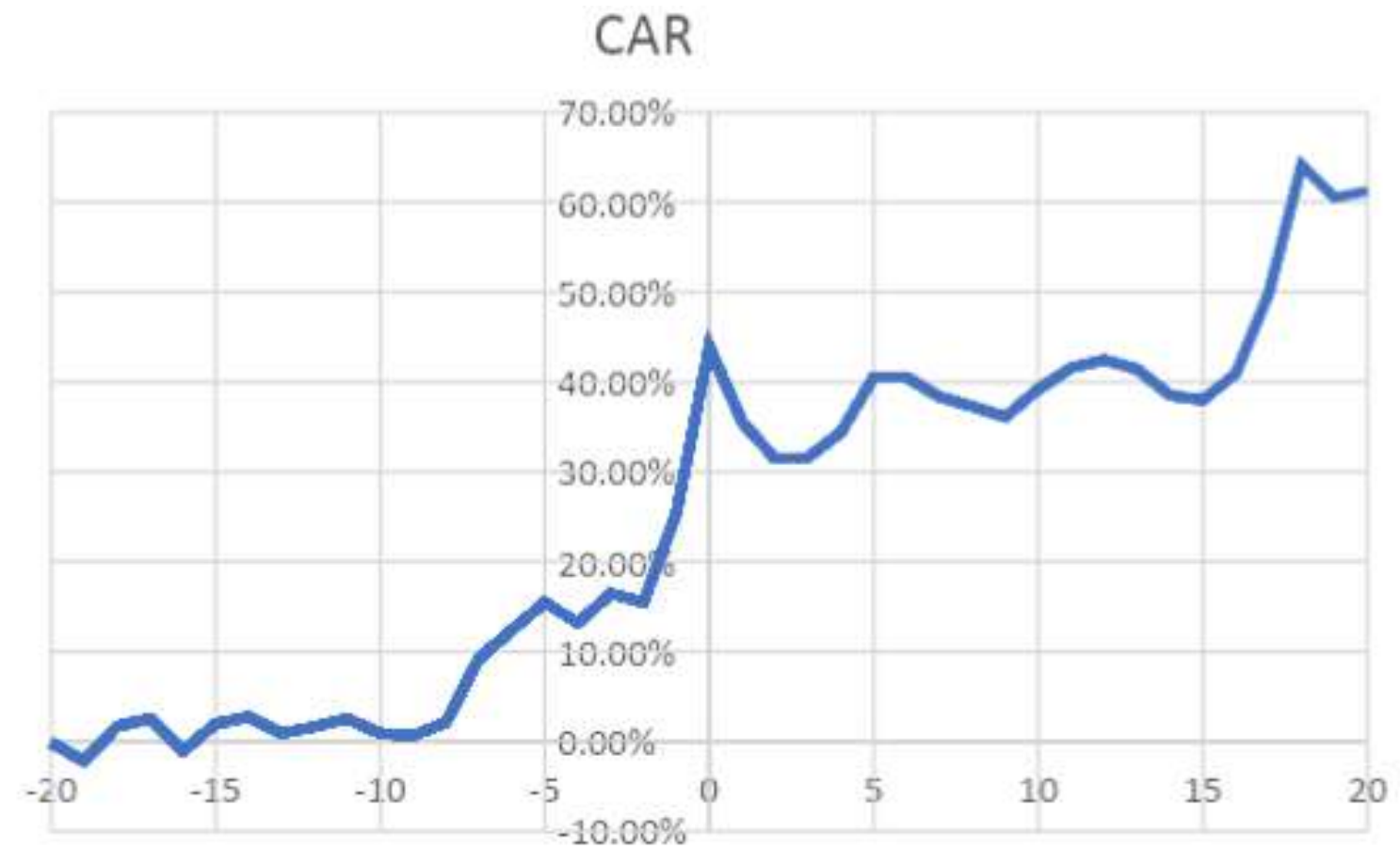


Significant volume increases were observed on announcement date. Volume increase on Day t_0+18 (21 May 2021) can be observed. No specific reason for this anomaly was discovered and even the stock exchange raised its concern about the abnormal price movement.



Significant volume increase as observed on Day $t+15$ corresponding to the finalization of the buyback acceptance date. Volume increase on Day t_1-12 corresponds to 21 May 2021.

Cumulative Abnormal Returns



Future growth prospects or Undervalued Firm

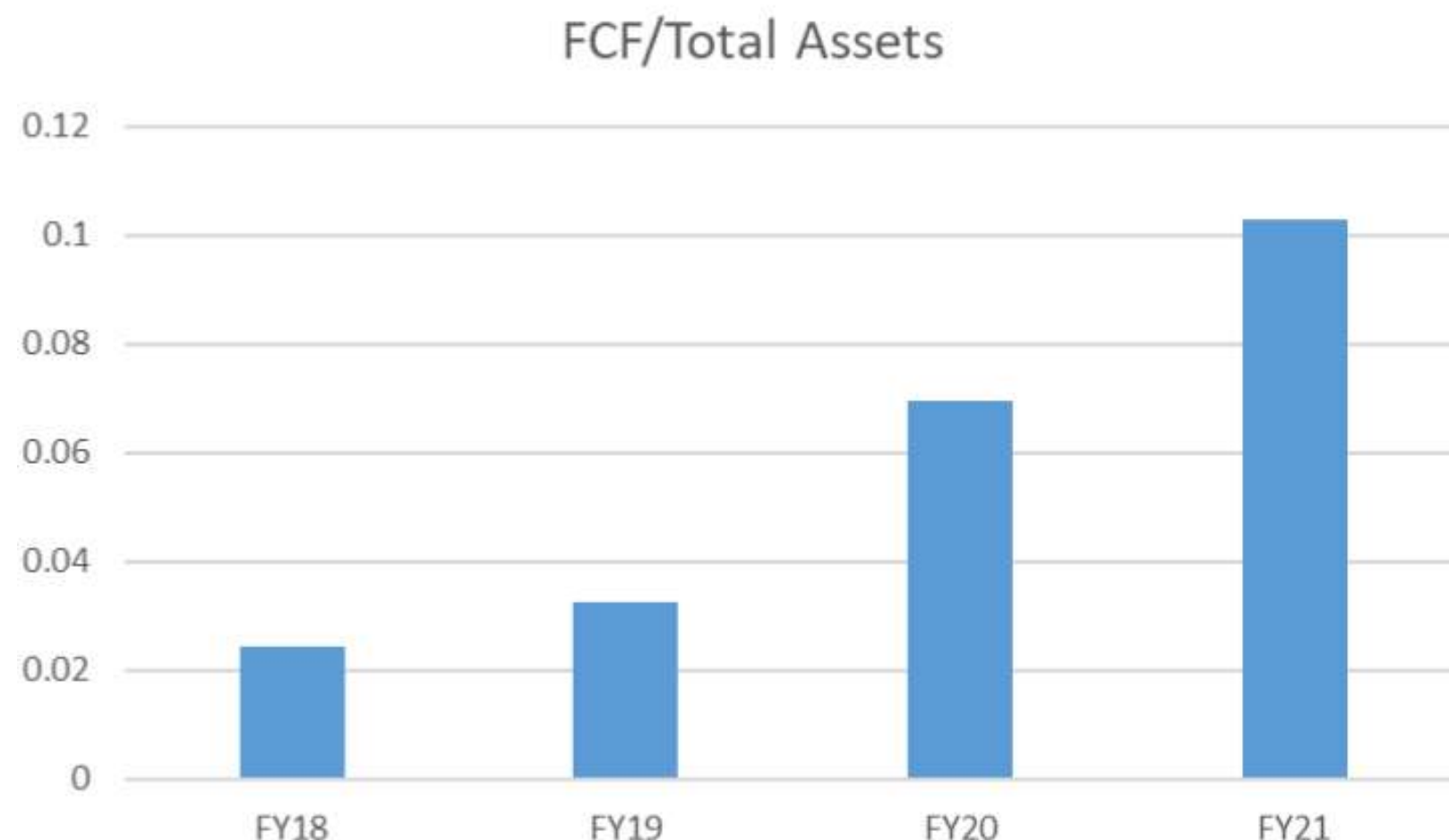
On the announcement date, Infobeans had a P/E and P/B ratio of 18.71 and 3.58 respectively. Both of these were considerably lower than the industry P/E of 27.59 and P/B of 8.21. We can infer that the company was undervalued.

Quarter	Dec-21	Sep-21	Jun-21	Mar-21	Dec-20
Promoter	74.55	74.66	74.69	74.97	74.97

Antitakeover measures

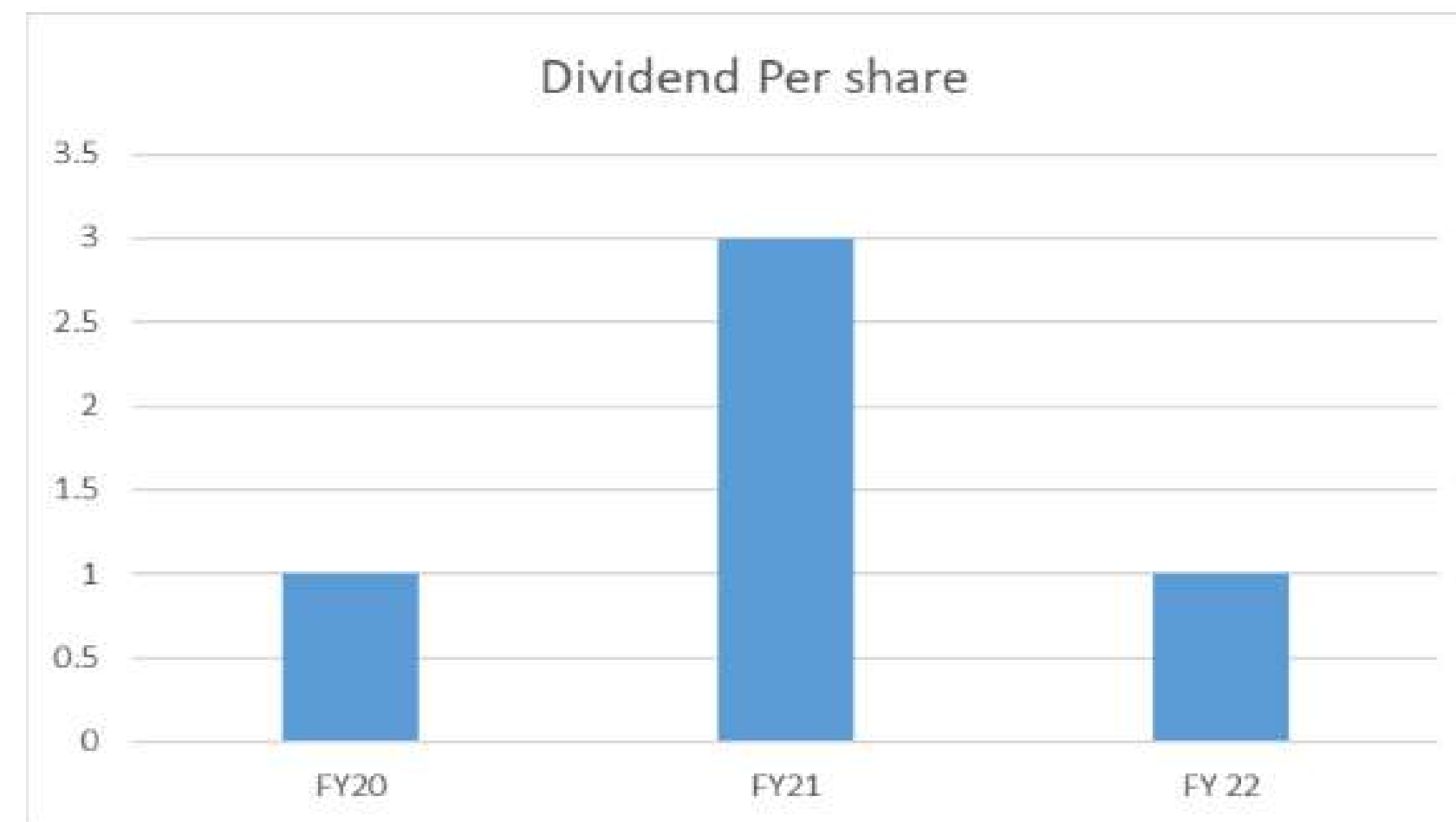
Closing date of 21 June 2021. There was not a significant change in the shareholding of promoters and just a slight decrease is observed.

Excess Cash Flows



We can observe the ratio of Free cash flows to Total assets increasing year by year. The buyback was announced on 26 April 2021 just after the end of FY21. There was a significant increase from FY20 to FY21. Thus it can be deduced that increased Free cash flows had a positive impact on the tendency of the company to buy back its share.

An Alternative source of payout



Inspite of the net income rising from FY20 to FY21, the dividend per share didn't increase. The total payout (Rs. 5 per share) increased from FY21 to FY22 but the method was buyback along with dividends in FY22.

Limitations

- The study was conducted when FED was continuously increasing Interest rates. This affected the Indian market severely. There was an abnormal movement in stock prices during this period.
- The event window of our study coincided with other corporate events happening in the company. Quarterly Result announcements may also have affected the results of the study.
- There was an ongoing Russia-Ukraine war during the period of the study. China was affected by the COVID-19 pandemic during this period. These two factors made metal prices extremely volatile.
- Since the stock split happened recently for both the company, the long-term impact of the corporate action could not be studied.
- The data for the number of investors is released quarterly. Consequently, the immediate effect of the split could not be studied.

Conclusion

1. It was observed that the impact of Stock Splits and Buybacks on the price are not always positive, unlike concluded in previous studies.
2. They are particularly beneficial for small-cap companies which are undervalued.
3. Instances of Insider Trading / Information leak and Price of security rising above that offered by the company are also not uncommon.
4. Corporate Actions attract retail investors, and increased no. of investors after the event was observed in all the cases

Link to the Report: <https://t.ly/W5fe>