DIVIDENDS AND SHARE BUYBACKS

Share Buybacks

In the course of a share buyback program, a company buys its own shares more or less regularly or structured in the open market.

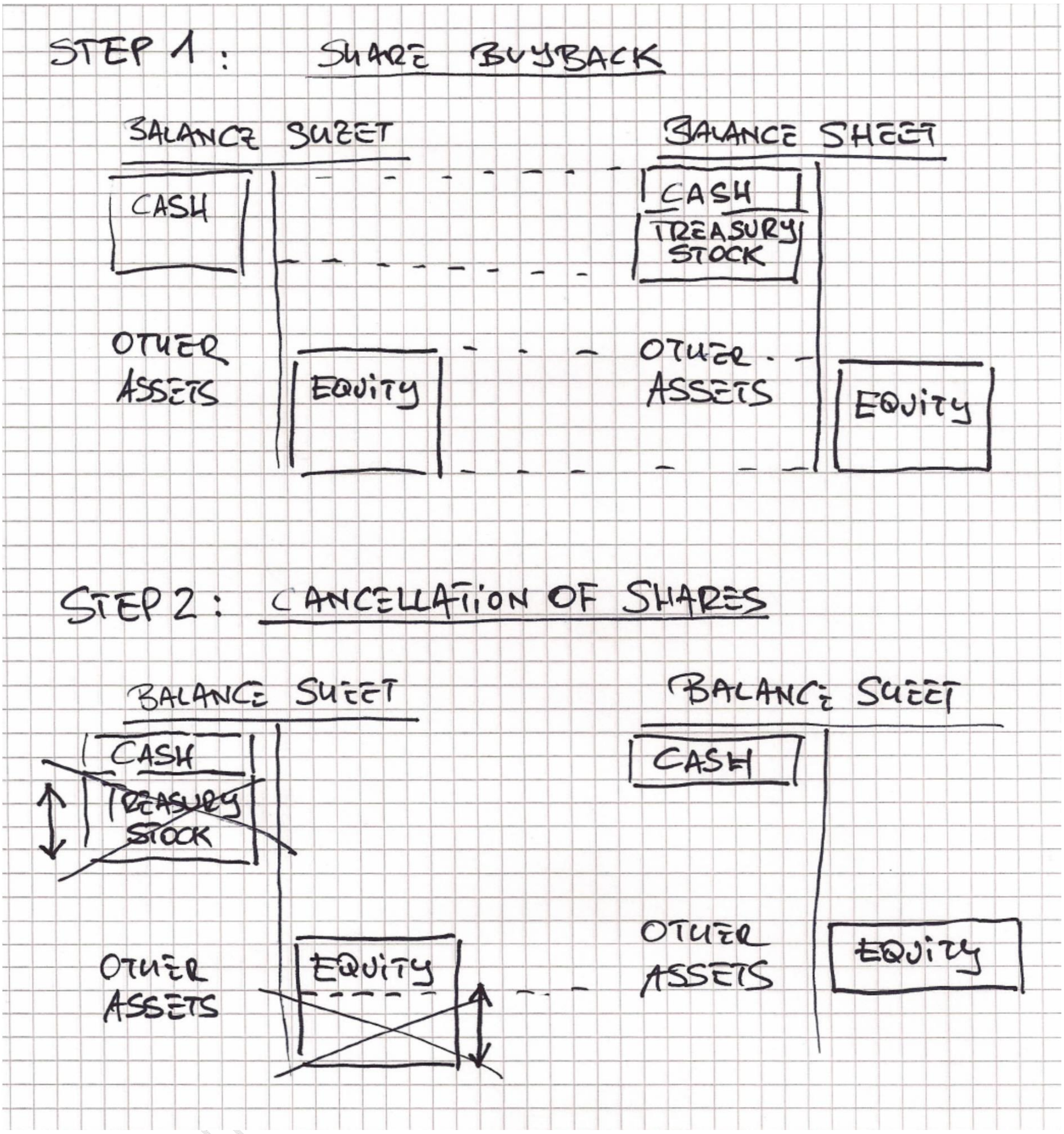
Shares acquired are then parked in the treasury stock position on the active side of the balance sheet. Thereby the number of shares in free float is reduced. However the number of shares outstanding remains still the same. – Corporates usually pursue a share buy-back when they believe that their shares are fundamentally undervalued and that they can at the moment be acquired “for cheap”. Hence, the announcement of a share buyback usually results in the firm´s share price increasing, as investors anticipate firm management to act rationally (not least as firm management can be considered as an insider in regards to such a transaction).

After some time a firm may decide to sell previously acquired shares on the open market again, once the share price has recovered. - Sometimes, though, a firm may decide to use the treasury stock position for other purposes, such as: Meeting obligations from share option schemes offered to senior management; meeting obligations originating from convertible bonds if investors decided to convert such instruments into shares; or acquiring assets for shares, instead of paying in cash.

Alternatively, a firm may also decide to simply cancel the shares held in the treasury stock position: A share cancellation not only reduces the free float of the company, but now also reduces the number of shares outstanding. As a result, the share price for each still remaining outstanding stock will increase subsequent to the transaction, as the value of the firm is now distributed among a reduced number of shares.

The rationale of a share buyback with a subsequent cancellation of shares is basically that the firm does not require as much equity any longer. Frequently, this has to do with the stage in the life cycle the firm has reached. Shareholders seeking growth or yield momentum may then find better alternatives to allocate their capital. - But the rationale of such a transaction may also simply lie in the firm seeking to change its funding structure: The cancellation of shares will eventually result in the firm increasing the leverage of its balance sheet.

Share buybacks are either funded through cash readily available or through debt. Anyhow, a share repurchase will lead to the leverage of a firm increasing which makes sense in a later stage of a firm´s life cycle, when business model and environment have both become more predictable.


STEP 1: SHARE BUYBACK
BALANCE SHEET
CASH
OTHER ASSETS
EQUITY
BALANCE SHEET
CASH
TREASURY STOCK
OTHER ASSETS
EQUITY
STEP 2: CANCELLATION OF SHARES
BALANCE SHEET
CASH
TREASURY STOCK
OTHER ASSETS
EQUITY
BALANCE SHEET
CASH
OTHER ASSETS
EQUITY