Should Infosys Go Ahead With the Share Buyback

TEACHING NOTE

CASE SYNOPSIS

In July 2014, former top executives of Infosys, T V Mohandas Pai, V Balakrishnan and D N Prahlad had demanded a buyback of shares immediately to the tune of US$1.83 billion at the 52-week high share price of Rs.3850 per share. They had also suggested the management to announce an ongoing buyback programme to the extent of 40% of the previous year’s net profit on a consistent basis. In a letter to the board dated July 29th, they had said that Infosys shares are undervalued and an immediate buyback would correct the situation by improving investors’ confidence, by reducing idle cash. They claimed to have investors support to buyback. This was a big challenge for Infosys specifically as the company was going through major leadership transition at the time. The demand had come just one day before Dr Vishal Sikka (Sikka) the former executive board member of SAP AG, formally appointed as the first non-founder CEO of the company. One month before in June, Narayana Murthy had retired as executive chairman of the board.

Infosys Ltd, the software giant of India was started in 1981 under the leadership of Murthy. In thirty years (1981-2014), it had grown to become a US$ 8.53billion turnover company with a market capitalisation of US$ 31.87 billion, giving employment to 1, 60,405 people, serving clients in more than 50 countries. The market price of Infosys share had appreciated from Rs 95 in 1993 to Rs.3428 in 2010. Infosys was an ethical and much respected company. But from 2011 onwards the growth of Infosys became very slow. Peers like TCS, HCL, and Cognizant outperformed Infosys. Investors criticised the company for its conservative strategy in the use of cash and demanded share buyback. The huge amount of cash and cash equivalents in the Balance sheet was criticised to destroy shareholders wealth. The buyback demand first came in the year 2012. With demand again surfacing in 2014 from former top executives added to the pressure for Infosys management. The analyst and investor community were divided on their opinion about whether Infosys should go ahead with Buyback or not.

TARGET AUDIENCE

The case is designed for use for a course on Corporate Finance, Financial Markets or Business Strategy for an MBA programme, MFC programme, Certificate programmes in Financial markets or Management Development Programmes. The case can also serve a good example for business houses for understanding, evaluating & choosing buyback strategies.

TEACHING OBJECTIVES

The case can be used to teach various aspects of the share buyback strategy. The specific teaching objectives for the case are as under

1. To understand the concept of Buyback of shares.
2. To discuss the factors that needs to be considered before going for buyback.
3. To learn the implications of a share buyback both short term and long term
4. To explore and evaluate company strategies for effective use of cash.
5. To understand the buyback developments in India.
6. To discuss the present buyback scenario in India and abroad
MAJOR ISSUES/CONCEPTS

The major issues or concepts that are to be covered in the class are

1. Introduction of the Share Buyback concept through Infosys Dilemma.
2. Share Buyback implications (for the company/for the shareholders/for the economy) both short and long term
3. Pros and Cons of buyback.
4. Factors to be considered before going for buyback
5. Understanding the buyback developments in India.
6. Understanding the present buyback scenario in India and abroad

STUDENT PREPARATION REQUIRED FOR THE CASE

Students are expected to read the case thoroughly before coming to the class. Students are expected to come with their decision sheet to the class. They are assumed to have sound knowledge in Accounting. Knowledge of Excel will help them in calculations and analysis of different situations. It is recommended to supply some of the additional reading material along with the case study. The additional readings will enable better case analysis and a better understanding of the concept of buyback.

ADDITIONAL READINGS


SUGGESTED SEQUENCE FOR CLASS DISCUSSION

This case is designed for a 1hr and 30 minutes class. The sequence that would be helpful in the case discussion is as under.

Step 1: Select randomly a student to be the protagonist and ask for his/her decision on the dilemma. The instructor can write down the solution from the first participant on board. Ask clarifying questions based on what, why and how on the solution suggested by him/her.

Step 2: The instructor can ask the class if all agree to the solution or any difference of opinion on the solution or addition or deletion of different points etc. A second participant may be allowed to give his or her solution and defend it.

Step 3: Open the class for a debate on the dilemma, jot down different points on the board. The points can be grouped under different alternatives.

Step 4: Introduce the topic of Share buyback by referring to the case.
Step 5: From the points discussed try to assimilate what factors should be taken into consideration for a buyback, the implications, pros and cons of the strategy.

Step 6: Discuss the buyback scenario in India and abroad.

Step 7: Calculate the impact on the key financials of Infosys of the proposed buyback preferably using Excel,

Step 8: Once again go back to the dilemma, to the most logical alternative.

Step 9: Discuss the actual action taken by the company and its implications.

ROLE PLAY (ALTERNATIVE PEDAGOGICAL TOOL)

The case can also be handled through a role play. The class can be divided into four groups. One group will represent the management of Infosys, the second group will represent analysts and investors supporting the buyback idea, the third group can represent the analysts who opposes buyback, there can be the fourth group representing media who will give the news, connect to the management, analyst groups, give information on buyback developments in India, the buyback scenario in India and abroad, also they will give the final company response. The entire case can be discussed through them, while the class listens to their discussion, the instructor should facilitate the smooth flow of discussions, correct or add to the points where needed, jot down points on the board. The role play can continue for 50 minutes, after which the whole class can debate over the dilemma facilitated by the instructor. The students may be informed and guided about their role and the entire plan in advance to come better prepared for the class. This tool will be more successful where the students are hardworking and more participative, good communication skills, an added advantage.

PROPOSED TEACHING QUESTIONS AND ITS ANALYSIS

Q.1. Do you think Infosys should go ahead with the suggested share buyback?

Answer: Debate should be done over the pros and cons of buyback

For example the following points can be discussed in favour of buyback

1) signalling effect may improve share price
2) since number of shares and capital will be reduced the EPS, ROA, ROE likely to improve
3) cash will be returned to the owners.
4) Cash will not lie idle yielding very low returns.
5) No big acquisitions only one in 33 years, so no use for cash
6) No history of paying high cash dividend
7) Infosys 3.0 strategy didn’t do well
8) Low performance in the 2011-2014 period, low growth in stock, revenue, profit
9) Peers outperforming

Likewise the following points can be discussed against buyback

1) company will not have enough cash for funding acquisitions.
2) Company cannot take advantage of the able leadership of Sikka
3) Sikka has the expertise and required skill for identifying good acquisitions
4) Future revenue and profit growth will be adversely affected for lack of funds.
5) Not the right time to take a strategic decision
6) The outgoing shareholders may be benefited at the cost of existing ones.
7) The ex-infoscions who now demand buyback were not supportive of it when they are in the management.
8) The investors who are losing confidence can leave the company through market.
9) Buyback should be the last resort when the management lacks imagination and is not capable of creating value through investment.

Q.No.2. What would be the implications of share buy back on the share price, EPS, ROE and other key financials of the firm?

Answer:
Through excel two scenarios can be created one before buyback and one after. The two can be compared to demonstrate the impact on financial numbers as follows.

As suggested by the shareholders if the buyback will be done at the 52-week high price of Rs 3,850 share and for shares worth Rs 11,200 crore then the number of shares will be reduced by approximately 291 lacs (2, 90, 909,090) . Here two/three alternate offer price can also be compared. To calculate the P/E ratio, the post buyback price has to be assumed. As buyback news caused the share price to rise upto Rs.3557.95, the post buyback price may be assumed as Rs.3500.

Using What-if analysis in Excel the effects of different offer price /different post buyback market price can be analysed. As shown in table 1 there is improvement in the key ratios such as EPS, ROA and ROE.

<table>
<thead>
<tr>
<th>Effect of Buyback on key Financials</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Before Buyback</strong></td>
</tr>
<tr>
<td>No of shares</td>
</tr>
<tr>
<td>Total Assets (in millions)</td>
</tr>
<tr>
<td>Share price (in Rs.)</td>
</tr>
<tr>
<td>PAT (in millions)</td>
</tr>
<tr>
<td>EPS (PAT/No of shares)</td>
</tr>
<tr>
<td>PE ratio</td>
</tr>
<tr>
<td>ROA (PAT as % of total assets)</td>
</tr>
<tr>
<td>Net worth (in millions)</td>
</tr>
<tr>
<td>ROE (PAT as % of net worth)</td>
</tr>
</tbody>
</table>
Q.3. Which option is better for Infosys, capital investment, distribution of cash dividends or buy back of shares.

**Answer:** Though there is no exactly one correct answer but the most logical one is to go for capital investment under the leadership of Sikka and it can also go for some high cash dividends. Sikka is considered to be instrumental behind the success of SAP AG. He has creative mind He is an expert in big data analytics that is likely to change the future of tomorrows IT landscape. Sikka should be given some time to exercise his expertise. This is not the right time to go for buyback.

Q.4. What factors Infosys should take into consideration before deciding to go for a buyback.

**Answer:** All the factors that are discussed in the Q.1 and Q.2 can be considered here. With that the other implications like impact on all the shareholders, the economy etc can be taken into consideration.

Q.5. Why Buyback was prohibited in India? Discuss the present buyback scenario in India and abroad.

**Answer:** In this question the history of buyback in India, the developments 1998 onwards, the buyback procedure, SEBI Buyback guidelines, the national and international buyback scenario can be discussed.

This question can also be given as an assignment. The students can be divided into groups. They can be asked to prepare reports on any of the following topics

1) Buyback developments in India
2) Indian buyback scenario (5 years/10 years)
3) International buyback scenario
4) Buyback Analysis of a particular company e.g. Apple Buyback, Reliance buyback, HP buyback
5) Buyback process in India
6) SEBI Buyback Guidelines

The question can be analysed in the following lines.

Buyback was prohibited in India to protect manipulation by the company management and to protect the real interest of the company, of the shareholders and the economy.

As situations changed, in 1998, Section 77A, 77AA and 77B were inserted by the Companies (Amendment) Act, 1999 to allow buyback in India. The Securities and Exchange Board of India (SEBI) framed the SEBI(Buy Back of Securities) Regulations, 1999 and the Department of Company Affairs framed the Private Limited Company and Unlisted Public company (Buy Back of Securities) rules, 1999 pursuant to Section 77A(2)(f) and (g) respectively that governed the buyback of companies’ shares. The Securities and Exchange Board of India (Buyback of Securities) Regulations, 1999 became the main governing law for regulation of procedures related to buyback in India.

By 2014 share buy backs had become common phenomena in the Indian Capital Markets. In the year 2013-14, 31 buyback offers were concluded with a total acquired sum of Rs 4,426 crore. The largest buyback was by NHPC for Rs 2,368 crore. Out of 31 buyback offers, 24 were through the stock exchange route, while the rest were via the tender offer. In 2012-13, 26 buyback offers were completed with a total acquired amount of Rs 4,746 crore. (Refer to Exhibit 1 for India Incorporation Buyback Data from 2008-09 to 2014-15).
Similarly the buyback abroad can also be discussed with some data, expert’s opinions and company examples.

**Additional questions that can be asked to the participant**

1. What are the modes of share buyback in India?

The company can buy back its shares in any of the following manners:

   i. From the shareholders on a proportionate basis through the tender offer;
   ii. From open market through: Book building process and Stock exchange,

2. What is buyback?

3. Why buyback was earlier prohibited in India?

4. When a company can be benefited from buyback?

5. What is the difference between a tender offer and open market offer.


6. What process a company goes through in India to announce the buyback.

7. In India which acts regulate the buyback of companies.

**ACTUAL COMPANY ACTION**

The company decided not to go for buyback. It earmarked some fund for the start-ups and went ahead with a merger spree aiming at future growth. In February 2015, Infosys acquired the US-based automation technology company Panaya for US$200 million. Panaya had a strong SAP connection and had clients such as Apple, Coca-Cola and Mercedes Benz. In April 2015, the company acquired US-based Kallidus for US$120 million in an all cash deal. Kallidus is a leading provider of digital experience solutions including mobile commerce and in-store shopping experiences to large retail clients. The market analysts again started believing in the growth of the company. Technology research firm Gartner said, “Infosys is poised to win significant market share over the next two years and that the software major may be on course to reach its goal to become a $20-billion company by 2020”.

---


## Exhibit 1
India Incorporation Buyback Data from 2008-09 to 2014-15

<table>
<thead>
<tr>
<th>Year</th>
<th>No of Offers</th>
<th>Offer Amount (Rs. In crore)</th>
<th>Acquired Amount (Rs. In crore)</th>
<th>Percentage of offered amount acquired</th>
</tr>
</thead>
<tbody>
<tr>
<td>2008-09</td>
<td>19</td>
<td>1,891</td>
<td>1,763</td>
<td>93</td>
</tr>
<tr>
<td>2009-10</td>
<td>44</td>
<td>4,146</td>
<td>1,192</td>
<td>29</td>
</tr>
<tr>
<td>2010-11</td>
<td>23</td>
<td>4,181</td>
<td>4,008</td>
<td>96</td>
</tr>
<tr>
<td>2011-12</td>
<td>19</td>
<td>2,582</td>
<td>1,152</td>
<td>45</td>
</tr>
<tr>
<td>2012-13</td>
<td>26</td>
<td>12,532</td>
<td>4,746</td>
<td>38</td>
</tr>
<tr>
<td>2013-14</td>
<td>31</td>
<td>5,704</td>
<td>4,426</td>
<td>78</td>
</tr>
</tbody>
</table>

*Source: Prime Database*
References

1. www.infosys.com
2. www.sebi.gov.in
3. www.legalserviceindia.com
4. www.mca.gov.in
5. www.icai.org
6. www.economist.com
7. www.hbr.org
8. www.profit.ndtv.com