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STOCK MARKET REACTION TO BUYBACK ANNOUNCEMENT OF RELIANCE INDUSTRIES LTD. –AN EMPIRICAL STUDY

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Abstract

The Reliance Industries Ltd. announced its third and the biggest ever stock buyback program on 20th January, 2012. The rationale of the buyback of equity program was to signal to the market on perceived undervaluation of the share. The main objective of the paper is to ascertain the market reaction to the announcement of the buyback program by the Reliance Industries Ltd. The present study is undertaken from January, 2012 to July, 2013 and the paper employs 30 day before and 30 day after the announcement day i.e., 61 day as window period. The findings of the study include a) the market reacted positively to the buyback announcement, b) the poor quarterly financial results affected the abnormal returns adversely in the short run and c) the turnover, net profit and earnings per share increased from one quarter to another sequentially in the post buyback period.

Key words: Reliance, buyback period, sequentially, equity, net profit and earnings

Introduction

The stock price of the Reliance Industries Ltd. dipped by 35.66% from January, 2010 to December, 2011. This severe fall in the price within a period of two years would have worsened on the announcement of the poor financial results for the quarter ended December, 2011. Therefore, the company had no option

other than announcing the buyback of equity program on the same day when it announced the decline in the net profit by 21.57% for the Q3 of the financial year 2012 to give support to the dipping share price.

The company after 7 years from the previous buyback on 20th January, 2012 announced that it would buy 12 crore shares with an aggregate amount of Rs. 10,440 crore at a buyback price of Rs 870 which is at a premium of 10% on previous day's closing price through open market operation. However, the announcement of the buyback program by the RIL was accompanied by the poor quarterly financial results. As a result, the news of the announcement of buyback of shares failed to please the market and the stock price fell drastically from Rs. 794.70 to Rs. 772 with a net loss of Rs. 22.70 i.e., by 2.78%.

Rationale of RIL Buyback

The rationale of RIL's share buyback program is to:

- Reward shareholders by returning cash to them in a tax efficient and investor friendly manner.
- .Send a powerful signal to the market on perceived undervaluation of the Reliance share.
- Improve financial parameters such as Return on Equity(ROE) and optimize weighted average cost of capital(WACC) and thereby enhancing global competitiveness

RIL Stock Buyback and Market Expectations

The RIL board approved spending up to Rs.10, 440 crore to buyback of shares at a maximum price of Rs. 870 as it sought to bolster its underperforming stock. The buyback price of Rs. 870 was within the market expectation band of Rs. 850-900. However, the total corpus of Rs.10, 440 crore was at the lower end of the market expectations as RIL had a cash and cash equivalent of Rs. 74,539 crore as on 31st December, 2011. This is quite clear from the opinion of the analysts like Niraj Mansingka, Somshankar Sinha and Vikas Jain.. Niraj Mansingka, oil and gas sector analyst with Edelweiss Securities Ltd., a Mumbai based brokerage firm wrote in a 21st January note that he had expected the total size of the buyback to be around Rs. 16000 crore given the significant amount of cash on RIL's balance sheet. While Somshankar Sinha and Vikas Jain, analysts at CLSA Asia-Pacific markets said in a report released on Monday, 20th January, 2011 that, while the buyback size was lower than Rs. 14000 crore limit that they had expected, it was still a 'constructive use' of its cash in the context of rising salience on non-core investments. However, the buyback of shares worth up to Rs.10, 440 crore from the open market will help the company to support its stock. The shares bought back would be cancelled; assuming that the whole amount is bought back, as much as 3.7% of capital could be cancelled. This could be EPS and ROE accretive in the long run for the benefit of the existing shareholders.

RIL Stock Buyback and grading by Market Agencies

- Morgan Stanley maintains 'Underweight' on RIL; raises target price from Rs.650 per share to Rs. 703 per share to factor in buyback of shares.
- Emkay downgrades RIL to 'Accumulate' cuts target price downwards to Rs. 913 on disappointing quarterly results.
- Motilal Oswal 'Neutral' on RIL; buyback to provide some support to the stock price in the near term.
- HSBC Global Research indicated a neutral view on the stock stating that the weakness in price will continue ahead of a ramp up in gas production.

Buyback of RIL in 2012 vis-à-vis Buybacks in 2000 and 2004

The following table depicts the buyback program of RIL in 2012 as compared to the buybacks in 2000 and 2004,

Table No.1

Year	MOP	BP	Buyback size (crore)	No. of shares purchased	Amount spent on Buyback (crores)	PAD Rs.	PND Rs.	% change in Price AD to ND
2000	OMP	Rs 303	Rs.1100	-----	-----	336.90	324.95	(3.55)
2004	OMP	Rs.570	Rs.2999	28,69,495	Rs.149	516.95	531.50	2.81
2012	OMP	Rs.870	Rs.10440	3,90,00,000	Rs.3,198	794.70	772.00	(2.78)

Source: Reliance Industries Ltd. Website

MOP: Method of purchase

BP: Buyback price

PAD: Price on Announcement Day.

PND: Price on Next Day.

From the above table, it is clear that the buyback price of the buyback program of RIL in 2000 was below the market price which was against the general rule of the stock buyback and the company did not buy a single share during the buyback period while the buyback programme by RIL on 28th December, 2004 was well accepted as an incentive by the market as everything was fine around the buyback announcement. As a result, the stock price rose by 2.81%. In contrast, notwithstanding the stock buyback of 2004, the market reacted negatively to the buyback announcement of RIL on 20th January, 2012 as the announcement of the buyback by the company was accompanied by the poor quarterly financial results. The news of the announcement of buyback of equity failed to please the market and the share price fell drastically by 2.78%.

Objectives and Methodology

The main objective of the paper is to ascertain the market reaction to the buyback announcement of Reliance Industries Ltd in 2012. The further efforts have been made to analyze and interpret a) quarterly financial results i.e., turnover, net profit and earnings per share before and after the buyback, b) effects of poor quarterly financial results on abnormal returns, c) daily abnormal returns and d) abnormal returns for different window periods.

The present study is undertaken from January, 2012 to July, 2013 for a period of two and half years. The paper employs 30 day before and 30 day after the announcement day i.e., 61 day as window period. The window period of 61 day has been further divided into 1-day, 5-day, 10-day, 15-day, 20-day, 25-day and 30-day. The study uses Sensex a well diversified 30 stock index accounting for a wide variety of sectors of the Indian economy as a surrogate for the market portfolio. The average market return for the estimation period of 61 days corresponding to the period of buyback announcement has been considered as a normal market return. Therefore, the abnormal return has been calculated by deducting average normal market return from the actual return from the stock (Abnormal return=Actual return-Average market return). The entire negative actual return from the stock has been considered as negative abnormal return if the average market return is positive

Quarterly Financial Results of RIL before Buyback

The poor quarterly financial results of the RIL from Q1 to Q3 is one of the reasons why the RIL has gone for the buyback of equity. The table no. 2 indicates the Quarterly financial results of the RIL before buyback.

Table No.2

	Turnover In crore	% change from Q1	Net Profit	% change from Q1	EPS	% change from Q1	PAD Rs.	PND Rs.	% change
Q1	83,689	--	5661	--	17.30	--	881.60	870.35	(1.28)
Q2	80,790	(3.46)	5703	0.74	17.40	0.58	865.00	833.05	(3.69)
Q3	87,480	4.53	4440	(21.57)	13.60	(21.84)	794.10	772.00	(2.78)

Source: Reliance Industries Ltd. Website

The table no 2 shows that the Reliance Industries Ltd. has reported poor financial results sequentially (quarter on quarter) for the first time in the last three quarters. The quarterly turnover of RIL decreased from Rs. 83,689 crore in the Q1 to Rs. 80,790 in the Q2. However, it increased from Rs. 80,790 in the Q2 to Rs. 87,480 in the Q3. While, the net profit declined severally from Rs. 5,661 crore in the Q1 to Rs. 4,440 crore in the Q3 i.e., by 21.57%. At the same time, the earnings per share decreased from Rs.17.30 in the Q1 to Rs. 13.60 in the Q3 i.e., by 21.84%. Thus, the turnover of RIL increased by Rs.3791 crore i.e., by 4.53% and the net profit and the earnings per share declined by Rs. 1,221 crore and Rs.3.70 per share i.e., by 21.39% and 21.57% respectively within a period of nine months. Similarly, the stock price of RIL fell respectively by 1.28%, 3.69% and 2.78% on the next day of the announcement of the Q1, Q2 and Q3 results. This may be due to the decline in the net profit and earnings per share of more than 21% which is perhaps beyond the expectations of the market

RIL and SENSEX before Buyback

Another reason perhaps for the buyback of equity by RIL is poor performance of the stock as compared to the market benchmark index Sensex. The following table gives the clear picture of the RIL stock price and the Sensex before the buyback,

Table No.3

	RIL	SENSEX
4/1/10	1077.30	17558.70
31/12/10	1058.00	20509.10
% change	(01.79)	16.80
High/Low	1149.90 / 915.00	20984.10 / 151652.00
3/1/11	1054.40	20561.10
30/12/11	693.10	15454.90
% change	(34.27)	(24.83)
High/Low	1091.40 / 689	20664.80 / 15135.90
% change from 04/01/10 to 31/12/10	(35.66)	(11.98)

Source: BSE website

The above table depicts that the stock price of Reliance Industries Ltd. during the year 2010 fell by 1.79% to Rs. 1058 with a high of Rs.1149.90 and a low of Rs. 915 while the Sensex surged by 16.80% to cross the 20,000 points mark with a high of 20984.10 points and a low of 15652 points. This bearish trend in the scrip of Reliance Industries Ltd. continued further severely during the year 2011. It dipped from Rs.1054.40 to Rs.693.10 to record a panic fall of 34.27% with a high of Rs.1091.40 to a low of Rs. 689. But, the Sensex during the same period witnessed a net fall of 24.82% with a yearly high of 20664.80 points and a low of 15135.90 points. Thus, the RIL stock and the Sensex lost by 35.66% and 11.95% respectively from January, 2010 to December, 2011. This trend clearly indicates that the Sensex outperformed the scrip of Reliance Industries Ltd. This may be the crucial reason for the announcement of the buyback program by the RIL in 2012.

RIL and SENSEX after Buyback

The table no. 4 exhibits the stock price of the RIL and the Sensex after buyback for a period of one and half year,

Table No.4

Period	RIL	% change from AD	SENSEX	% change from AD
Announcement day (20/01/2012)	794.10	---	16739.01	----
After one month (21/02/2012)	840.40	5.83	18428.61	10.09
After three months (19/04/2012)	741.65	(6.60)	17503.71	4.57
After six months (19/07/2012)	727.80	(8.35)	17278.85	3.23
After nine months (19/10/2012)	802.80	1.10	18682.31	11.61
After one year (21/01/2013)	919.00	15.85	20101.82	20.09
After one & half year (19/07/2013)	923.70	16.32	20149.85	20.38

Source: BSE website

The table no.4 shows that the Share price of the RIL rose from Rs. 794.10 on the announcement day to Rs.923.70 on 19th July, 2013 with a net rise of Rs. 129.60 i.e., by 16.32% after one and half year from the announcement of the buyback as compared to the fall in the price from Rs. 1054.40 on 3rd January 2011 to Rs. 693.10 on 31st December 2011 with a net fall of Rs. 361.30 i.e., by 34.27% one year before the buyback announcement. But the Sensex for the corresponding period though outnumbered the stock price of the RIL yet the performance of the stock price of the RIL in the post announcement period is much better than in the pre announcement period. This indicates that the share price of the RIL after buyback announcement has performed much better than before the announcement with a capital gain of Rs. 129.60.

Quarterly Results and Stock Price Movement after Buyback

The table no.5 deals with quarterly financial results of RIL after buyback from Q3 of the FY 12 to Q1 of the FY 14.

Table No. 5

Period	Turnover	% change after BB from Q3	Net profit	% change after BB from Q3	PAD	PND	% change from PAD to PND
FY12							
Q3	87480	---	4440	---	794	772	(2.78)
Q4	87833	0.40	4236	(4.59)	730	736	0.74
FY13							
Q1	94926	8.51	4473	0.74	722	719	(0.50)
Q2	93265	6.61	5376	21.08	823	812	(1.29)
Q3	96307	10.09	5502	23.92	900	919	2.19
Q4	86618	(0.99)	5589	25.88	804	773	(3.88)
FY14							
Q1	90589	3.55	5352	20.54	923	909	1.52

Source: Reliance Industries Ltd. Website

The table no. 5 indicates that the turnover of the RIL has increased sequentially from one quarter to another for the last one and half year in the post buyback period. Similarly, the net profit in the post announcement period has gone up from Rs 4440 crore for the Q3 of the FY 12 to Rs 5352 crore for the Q1 of the FY 14 with a net rise of Rs 912 crore i.e., by 20.54%. Besides, the stock price on the announcement day and the next day of the announcement of the quarterly financial results rose on an average considerably with an all time high of Rs.923 in the post announcement period which is higher than the buyback price of Rs. 870. The rise in the turnover, net profit and stock price in the post buyback period supports the signal sent by the buyback program on better prospects for the company in the future.

EPS before and after Buyback

The following table depicts the earnings per share in the post buyback period from the FY 12 to FY 14,

Table No. 6

Period	Quarterly EPS before BB	% change from Q1 EPS BB	Quarterly EPS after BB	% change from Q3 EPS BB	Yearly EPS	% change from FY12 to FY13
FY12						
Q3	13.60	(21.38)				
Q4			12.90	(5.15)		
					61.20	
FY13						
Q1			13.70	0.74		
Q2			16.60	22.06		
Q3			17.00	25.00		
Q4			17.30	27.21		
					64.80	5.88
FY14						
Q1			16.60	22.06		

Source: Reliance Industries Ltd. Website

The above table exhibits that the earnings per share in the post announcement period increased from Rs.13.60 for the Q3 of the FY 12 to Rs.16.60 for the Q1 of the FY 14. Similarly, the earnings per share rose from Rs. 16.20 for the FY 12 to Rs. 64.80 for the FY 13 i.e., by 5.88%. In addition to this, the important point to be noted here is that the earnings per share consecutively increased from one quarter to another. Thus, the buyback program of the RIL enhanced the value of the shareholder by increasing the earnings per share in the post buyback period.

Abnormal Returns and Cumulative Abnormal Returns from RIL Stock Buyback

The ARs and CARs from RIL stock buyback announcement in 2012 are shown in the following table,

ARs and CAARs for 30 Days before and 30 Days after the Announcement of Stock Buyback**Table No.7**

2012					
Day	ARs (%)	CARs (%)	Day	ARs (%)	CARs (%)
-30	-0.5257	-0.5257	01	-2.7830	-4.1662
-29	-3.3640	-3.8897	02	1.1878	-2.9784
-28	-3.0435	-6.9332	03	1.1729	-1.8055
-27	-3.5306	-10.4638	04	3.2442	1.4387
-26	2.2756	-8.1882	05	-2.7845	-1.3458
-25	-0.5311	-8.7193	06	2.8845	1.5387
-24	1.4646	-7.2547	07	1.8900	3.4287
-23	-4.1086	-11.3633	08	-0.8580	2.5707
-22	2.1795	-9.1838	09	1.1495	3.7202
-21	-3.2948	-12.4786	10	-0.4306	3.2896
-20	5.7598	-6.7188	11	1.5010	4.7906
-19	0.6544	-6.0644	12	1.7023	6.4929
-18	-1.6879	-7.7523	13	-0.5813	5.9116
-17	1.1041	-6.6482	14	-1.3157	4.5959
-16	-2.3804	-9.0286	15	0.4017	4.9976
-15	-3.5864	-12.6150	16	0.2640	5.2616
-14	-2.3390	-14.9540	17	-1.370	3.8912
-13	1.9772	-12.9768	18	-3.2738	0.6174
-12	2.2837	-10.6931	19	0.5676	1.1850
-11	-1.2093	-11.9023	20	2.9538	4.1388
-10	-1.7907	-13.6931	21	-0.7615	3.3773
-09	2.2578	-11.4353	22	-0.1678	3.2095
-08	2.2130	-9.2223	23	-1.5313	1.6782
-07	1.7956	-7.4267	24	-4.9826	-3.3044
-06	-1.0496	-8.4763	25	2.1267	-1.1777
-05	-1.0878	-9.5641	26	2.3445	1.1668
-04	-2.2815	-11.8456	27	-0.5460	0.6208
-03	3.4595	-8.3861	28	0.3953	1.0161
-02	4.4622	-3.9239	29	-1.9656	-0.9495
-01	1.3468	-2.5771	30	-2.8258	-3.7753
00	1.1939	-1.3832	Average	-0.0618	

The table no.7 denotes that the buyback announcement recorded an announcement day returns of 1.1939 %. While on very next day the returns fell drastically to - 2.7830%. However, the returns recovered on + 2 day, + 3 day and + 4 day to 3.2442%. But the Abnormal Returns were negative not only for - 30 day (- 0.0859%) and + 30 day (-0.0797%) but also for the entire window period of 61 day (- 0.0618%). Whereas, the CARs showed a negative trend from - 30 day to + 5 day and thereafter turned to positive till the end of the window period. This showed a mixed trend indicating that the market took almost a month's time to react to the buyback announcement.

Average Abnormal Returns and Cumulative Average Abnormal Returns for different Window Periods

The AARs and CAARs have been calculated for different window periods to ascertain whether the market reacted specifically during a particular window period of RIL stock buyback announcement. The following table exhibits the AARs and CAARs for different window periods

Table No.8

	2012	
Window Period	AARs %	CAARs %
-30	-0.0859	2.5771
-25	0.2244	5.6111
-20	0.4950	9.9015
-15	0.4301	6.4515
-10	0.9325	9.3253
-05	1.1798	5.8992
00	1.1939	1.1939
05	0.0074	0.0374
10	0.4672	4.6728
15	0.4253	6.3808
20	0.2761	5.5220
25	0.0082	0.2055
30	-0.0797	-2.3921

The above table indicates that the AARs and CAARs decreased from 1.1798% and 5.8992% for - 5 day to - 0.0859% and - 2.5771% for - 30 day respectively. This is the clear indication of the fact that the market was unaware of the likely announcement of the buyback. Similarly, the AARs and CAARs decreased from + 5 day to + 30 day. Moreover, the AARs and CAARs increased respectively from 0.0074% and 0.0374% for + 5 day to 0.4672% and 4.6728% for + 10 day. This means that the share price does not rise as expected on the buyback announcement. Therefore, one can conclude that the market reacted aggressively to the - 5 day, - 10 day, + 5 day and +10 day as the rumor of the stock buyback announcement spread around

Difference in AARs for different Window Periods

The AARs have been further analyzed by calculating the difference in the AARs for different window periods to find out the net AARs from the pre-buyback period to the post- buyback period. The table given below depicts the difference in the AARs for different window periods,

Table No.9

Window Period	2012
-01 to +01	-1.4362
-05 to +05	1.1724
-10 to +10	0.4653
-15 to +15	0.0048
-20 to +20	0.2189
-25 to +25	0.2122
-30 to +30	-0.0062

From the above table, it is clear that the difference in the AARs for -1 day to +1 day (-1.4362%) and -30 day to +30 day (-0.0062%) was negative. However, it was positive from -5 day to +5 day (1.1724%) to -25 day to +25 day (0.2122%). The positive but rather declining returns give clear signal that the market reacted slowly to the buyback announcement due to the bad news of the poor quarterly financial results. Thus, the difference in the AARs from the pre announcement period to the post announcement period on an average was more for shorter window periods than the longer window periods.

Summary and Conclusion

The Reliance Industries Ltd. announced its third and the biggest ever buyback program of 12 crore shares with an aggregate amount of Rs. 10,440 crore at a buyback price of Rs.870 through open market operation on 20th January, 2012. However, it spent an amount to the tune of Rs.3, 198 crore for buying 3.9 crore equity shares which is just 30.63% of the total buyback corpus.

The analysis indicates that a) the market reacted positively to the buyback announcement, b) the poor quarterly financial results affected the abnormal returns adversely in the short run, c) the turnover, net profit and earnings per share increased from one quarter to another sequentially in the post buyback period, d) the AARs for -30 day, +30 day and 61 day window periods was negative and the CAARs were positive on an average for the entire window period indicating that the market reacted to the buyback slowly due to the poor quarterly financial results and e) the shorter window periods were more sensitive than the longer window periods.

The paper concludes that the stock buyback program of RIL in 2012 met all the expectations of the company in particular and the market as a whole in general. At the same time, it benefitted both the participating and non-participating shareholders by distributing quite a sizable amount of surplus cash to the tune of Rs.3, 198 crore and rallying the share price to Rs.923.70 which is higher than the announced buyback price respectively. The further research can be carried out on the effects of the stock buyback program of the RIL on its capital structure, return on investment and other financial variables.

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