# PAYTM BUYBACK – Critical Analysis - Updated

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## Update Post Buyback Announcement:

Paytm, on December 13, 2022, declared a buyback (BB) at a price not exceeding ₹ 810 per share. SES has examined further consequences of BB and price of BB up to ₹ 810.

### Taxation:

Except for share traders, any gain or loss on buying selling is subject to capital gain tax with the exception of BB transaction, as these are exempt from tax in the hands of shareholder but are taxed at source under Section 115QA of the Income Tax Act, with the Company paying the buyback tax at the rate of 20%. Shareholders receive full amount without any tax deduction.

BB transactions are positive for shareholders in case there is underlying capital gains but in capital loss scenario BB transactions are negative.

### Will Post-IPO Shareholders Participate?

In case of Paytm, retail shareholders bought shares at ₹ 2,150 in IPO and today they are sitting at a loss of about ₹ 1600/ share. Given Long term capital gains tax @ 10%, they can book this as capital loss and save tax of ₹ 160/ share. However, if their order is matched against company's order, the sale will be a BB transaction, hence ₹ 160 cannot be saved. Hence, there is absolutely no chance that any informed investor who bought share at a price higher than current market price will tender share in open market as he runs the risk of matching his order against company's order and risks losing tax shield.

However, things are bit different for pre-IPO shareholders, as the Net Asset Value (NAV) per share was ₹ 104 (pre-IPO) and ₹ 227 (post-IPO), with average cost of acquisition for founders being ₹ 0.5 per share. For pre-IPO investors, it is advantageous as they have capital gain and the same gets paid by company.

This effectively shuts doors for post-IPO shareholders to tender in open market, thus achieving a situation where selling pressure on the stock gets a breather till open market BB is open. The Company is achieving two objectives in one stroke - avoiding selling pressure and giving a window to pre-IPO investors to sell and avoid Capital gain as also using the proceeds to buy from market at current rate, thus making their new transaction as tax neutral, having pocketed gains, and creating additional demand.

### Concluding Remarks

SES remains concerned as to misuse of freedom in determining funds being raised in IPO more than required. Probably, it was a wonderful opportunity for selling shareholders to encash at ₹ 2,150, creating a hype and enticing retail shareholders.

## THE TRIGGER

Paytm, *via* a stock exchange announcement on 8th December, 2022, announced a proposal for buyback of its shares citing "*prevailing liquidity/ financial position, a buyback may be beneficial for our shareholders*" after recently completing a year of its listing in November 2022.

## BACKGROUND

**IPO & ITS OBJECTS:** The Company undertook an IPO during November 2021, with the following objects of issue:

> *Growing and strengthening the Company ecosystem, including through acquisition of consumers and merchants and providing them with greater access to technology and financial services; investing in new business initiatives, acquisitions and strategic partnerships; and general corporate purposes.*

### IPO PRICE, COST OF ACQUISITION & MARKET PRICE:

- Pre-IPO average cost of acquisition per equity share of founder shareholder - ₹ 0.5 per share.
- IPO Price: ₹ 2,150 per share
- No. of Shares: Pre-IPO - ~ 6 crores (₹ 10 each), Post-IPO - ~ 64.9 crores (₹ 1 each)
- Cash in Balance Sheet
  As on 31st March, 2021 (Pre-IPO) – ₹ 2,572.6 crores;
  As on 30th September, 2022 (Post-IPO) - ₹ 4,774.7 crores

*Note: During FY 2020-21, there were changes in share capital on account of sub-division of shares, IPO and ESOP issue*

### BREAKING DOWN THE RATIONALE: WHY BUYBACK?

The Company claims that it has excess liquidity, hence it wants to return cash to shareholders. As per news reports, it will not use IPO proceeds for buyback. The logic is simple as IPO proceeds cannot be used for buyback.

The issue is, how has the excess liquidity been created? Did the company declare in its prospectus that its existing liquidity pre-IPO will not be used for its business? Obviously not. Had the company overestimated its funds requirement? Did it raise more money than required? Has it used all proceeds of IPO for its objects? Are the funds not fungible in this case?

SES wonders - Did the company raise more money than required, because of the fancy premium it commanded at that time?

**LEGALITY OF BUYBACK:** As far as Companies Act, 2013 and SEBI Buy Back provisions are concerned, on the face of it, the proposed buyback appears to be in accordance with law. However, the moment one considers that funds are fungible and the Company not having declared any specific objective for pre-IPO funds in balance sheet, both pre-IPO funds and IPO proceeds are co-mingled and form part of the same pool. In that case, any buyback, would amount to using IPO proceeds for buyback, which in opinion of SES is not in accordance with law and the Company cannot do buyback. On the other hand, it will have to follow provisions of law as prescribed in Companies Act and SEBI ICDR Regulations for change in objects of issue related law.

### GOVERNANCE MATTERS AT HAND: THE DOWNTURN OF INVESTMENT FOR IPO INVESTORS?

As on date, one does not know what will the buyback price be. However, for IPO investors, it is a situation of either booking the loss or remain invested in hope. Still, if buyback price is at premium to market price, IPO investors can mitigate their pain by participating in buyback.

Since buyback will be open to all shareholders, as it has no promoter, it will give an opportunity for all shareholders to make a quick buck, especially to those who were pre-IPO investors and were issued shares at deep discount. For example:

The average cost of shares acquisition by the founder shareholder was ₹ 0.5 per share whereas the IPO price stood at ₹ 2,150 per share. The Company is currently trading at a price of ₹ 545 per share. (BSE Price as on December 12, 2022)

The buyback, even if SES takes the statement of the company with a pinch of salt, that only pre-IPO funds will be used, will allow all investors to cash out. IPO investors would be getting almost 25-30% of their cost whereas some pre-IPO investors would be getting more than 1,000 times their investment.

**THE TIMING:** What change has occurred in the Company's strategies within a span of a year that has driven the board to undertake a polar opposite action of returning equity just after raising funds with its November 2021 IPO?

**CRASHING STOCK PRICES:** With stock value crashing more than 70% since its IPO value, the buyback price to be determined will likely lead to losses for the IPO period investors. Why not pump growth to the Company and reward the early investors for their faith and patience? Showing them doors in this period of slump raises a question over the Company's confidence in registering an upward swing. Has the Company changed its plan for growth?

The present instance is technically at the borderline of law. However, with red flags waving over the intent behind an *ab-initio* action of raising funds through IPO and a subsequent contradictory move of the proposed buyback, there exists a requirement for a regulatory scrutiny to identify the factors behind such board room decisions.

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