IHS Markit Perspectives VII (August 11th, 2020)

Preference for share repurchases amidst global uncertainty

IHS Markit's Perception Analytics team engages in in-depth discussions with investors and analysts daily. Considering market volatility and economic uncertainty, IHS Markit is speaking to investors and analysts on a regular basis to assess how the current situation with COVID-19 is impacting their evaluations of and engagement with corporate issuers.

As companies look to align shareholder returns with the current market environment, we revisit the topic of capital allocation during a pandemic. With many companies experiencing severely depressed valuations, opportunistic buybacks would seem like an appropriate use of cash. However, there are obvious concerns around boosting shareholder returns when the economy is struggling and the capital markets are being supported by government bailouts. **Thus, the seventh topic we gathered feedback on is whether the recent market uncertainty has impacted investors' and analysts' views on share repurchases.**

Many investors view share repurchases negatively in the current environment and caution against using state aid or going to debt markets for funding buybacks. Instead, they prefer companies to preserve liquidity given the lack of visibility in the short term.

- "**I would not take a buyback positively because at this point in time I would prefer companies to be preserving liquidity rather than using it for buybacks.** There is a lot of uncertainty as to whether there will be a second wave and another lockdown. There may be opportunities down the track to do buybacks, but I think companies should be preserving liquidity given the lack of visibility in the short term. That means excluding buybacks and being cautious on dividends at this point in time." *Analyst, UK investment manager ($9B EAUM)*
- "The current situation has changed my view, but it depends on the situation and the COVID-19 headwind a company is facing. For example, some media companies would be ill-advised to launch their buyback program in the current environment just because they would get a lot of negative press as a lot of employees are being furloughed. **Any company that is using state**

aid, laying off, and cutting costs should be a bit more cautious." *Analyst, UK investment manager ($6B EAUM)*

- "My view on share repurchases is generally going down because I want companies to preserve liquidity in this crisis, but it depends on the business. If it is a more cyclical business with liquidity issues, I want them to preserve cash. **The right thing for shareholders is to preserve cash if they are in a liquidity crunch.**" *Analyst, US hedge fund ($65B EAUM)*

- "For many companies, repurchases are still the last thing you should be thinking of in terms of capital allocation. Generally speaking, buybacks have always been funded by companies typically borrowing in the debt markets. It is much more a US phenomenon than a European one I would say. It is a huge part of most US companies' thought process and they have been huge buyers of equities generally. **In the sense that most US companies turn to the debt markets to fund buybacks, then it is probably not a great idea to do that right now."** *Analyst, UK investment manager (>$2B EAUM)*

- "One trend we have seen since the COVID-19 crisis is that we generally want companies to have sustainable balance sheets and to be thinking about their long-term success. So, if companies feel that they need to be cautious around returns to shareholders to do the right thing and preserve the company's long-term future, then clearly that is what they should do. There are other cases where, for instance, **the application for government supports may not be seen as compatible with paying out dividends or continuing to do distributions to shareholders.** *Corporate Governance Analyst, UK investment manager (>$20B EAUM)*

- "A lot of companies put share buybacks on hold when there was a lot of uncertainty about what the world will look like going forward, but now that uncertainty is starting to narrow. Even high-quality companies, with minimal leverage, questioned whether doing share buybacks in March was a good idea. **Going forward, companies that generate a lot of free cash flow and have low leverage may resume buybacks, but those who do not will have to wait because you cannot threaten the solvency and liquidity of the company.** However, we are at a stage in the world where we have to preserve cash." *Analyst, US hedge fund (>$16B EAUM)*

However, a group of investors have appetite for share repurchases citing that it signals a healthy balance sheet and instills much needed market confidence during periods of uncertainty, provided that it does not risk the financial position of the company.

- "Companies that have enough cash and are able to engage in share repurchases restore confidence more in these uncertain times. Companies should continue to buy back shares when they think it makes sense. They should not worry too much about the perception of doing so**. If it is a signal of strength and they have the cash to do so, buying back shares unlocks shareholder value in a rational way at that moment in time.** Companies cannot control what externalities may happen in the future that would change the situation. As long as it makes rational sense at that moment in time, companies should continue repurchasing shares." *Analyst, US investment manager (>$30B EAUM)*

- "**I continue to see share repurchases as a very useful tool to make the capital utilization of the company much more efficient. It is also a strong signal of confidence to the market, especially in this tumultuous and very uncertain environment**. Share repurchases really help to show management's confidence in the business and balance sheet, so it is a useful tool. With that being said, it is a challenging environment, so as an investor, we want to weigh up whether it is a prudent use of capital to be returning it in volatile times. It seems like regulators are generally a bit cautious of financial institutions giving back capital, especially if there is a risk that they could need support from the government in future. It seems like there is a push from stakeholders to push these companies to be more prudent in terms of managing their balance sheet and distributing capital back to shareholders through share repurchases. As an investor, my view is that buybacks would not hurt unless the impact on the balance sheet is really big. If not, then I think there is still a good reception to share repurchases." *Analyst, Asian hedge fund*

- "My view on buybacks depends on the unique situation of a specific company. The questions you need to ask are how much cash does the company have and what kind of business is it in? It is understandable for some companies to stop share repurchases as they may be in a situation of a cash squeeze. **However, companies that continue to do buybacks without being affected will benefit in the long term as they will be seen as more trustworthy**." *Portfolio manager, European investment manager (>$3B EAUM)*

- "March was the time to be buying back shares more aggressively than ever, yet it seems that most companies have decided to cancel or pause their buybacks. This is incredibly backwards to us. The biggest mitigating factor through all of this is the balance sheet. If you do not have a healthy balance sheet, you cannot buy back shares. You should not buy back shares if you are already highly levered. Downturns cause companies to think about their leverage. You should buy back shares more than you ever have, but it does not seem to be the case. If you are over-levered, you should not buy back stock even outside of COVID-19. **If you have the balance sheet to withstand buybacks, you should absolutely buy back shares. Why would you not buy back shares if your shares have gone down 25%?"** *Analyst, US investment manager (>$75B EAUM)*

- "The current market environment has not changed my view of companies' share buyback strategies. We understand that if you are seeking a government loan, you cannot reward shareholders at the same time through using that loan to do buybacks. You cannot be aggressive in anyway with shareholder returns during a situation like we are in now**. But, for companies that are not in a situation where they need to borrow money from States, they should continue to create value for their shareholders just as they did previously.** Therefore, companies that are not getting bailouts should be focused on creating value for all stakeholders, which includes shareholders. If you are self-sufficient, you can do whatever you like, which would show a lot of responsibility. But, if you are needing to access liquidity, you have to be very mindful that you cannot reward shareholders at the same. Although shares might be undervalued, buybacks would not be the appropriate way to use the money for companies that are taking state loans." *Analyst, US investment manager (>$150B EAUM)*

- **"If it is a very stable business that is trading way below its intrinsic value, management should very aggressively be buying back the stock if they have enough cash on the balance sheet.** Companies should not worry about being scrutinized for buying back stock. As a shareholder, I do not care about the public view because the only thing that matters is if the company is doing the right thing for shareholders.” *Analyst, US hedge fund ($65B EAUM)*