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Portfolio

Telstra buyback a bargain in hindsight

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Telstra referred to it as an exercise in "enhancing shareholder value", but given the recent fall in the share price, investors who sold into the $750 million share buyback last year have every reason to be feeling quite pleased with themselves.

Whether they accepted the offer on behalf of their do-it-yourself super fund or as individuals, they should be a nose in front of shareholders who stuck it out, or who might be thinking of abandoning ship now.

Although it may seem that selling now would be rash, given the plunge in the Telstra share price, it is far from clear where the shares are headed from here. An important test is due next month when new chief executive Sol Trujillo is scheduled to unveil his strategic review.

With Telstra trading in a range of $3.99 to $4.11 since the shares went ex-dividend last week, shareholders who took the buyback money last year and invested the funds elsewhere would no doubt have felt like they made the right decision, said chartered accountant and do-it-yourself superannuation administrator Phil Jaquillard, of Adelaide-based SuperGuardian.

Under the terms of the buyback, investors received a fully franked dividend of $2.55 and a capital return of $1.50, giving a total of $4.05. That did not seem much at the time, with Telstra trading at about $4.80.

Drowning or waving? Sol Trujillo will reveal his plan next month. Photo: JOHN WOUDSTRA

But if the shareholders were DIY funds, the after-tax bottom line should have been more attractive, depending on the price they paid for the shares, Mr Jaquillard said.

Furthermore, had DIY funds sold their shares to Telstra last year and reinvested the proceeds into the sharemarket — which has since risen 20 per cent while Telstra has gone backwards — they would have come out well ahead.

Even if shareholders failed to make spectacular investments with the buyback money, DIY fund shareholders who originally bought the shares for $5 should have received about $4.87, including extra benefits such as franking credits.

On top of this, they should have achieved additional returns after reinvesting the buyback funds.

But if they had held on to the shares and sold at Monday's market price of $4.11 — to which they could add 53¢ of dividends and an 11¢ franking credit tax refund benefit — their DIY fund Telstra investment would have been worth about $4.75. And they would not have had the opportunity to re-invest the funds elsewhere.

Mr Jaquillard said it was difficult to draw general conclusions about the merits of share buybacks based on the Telstra exercise, other than the fact that in hindsight accepting the offer proved to be a good idea.

That said, it is worth asking why companies conduct share buybacks in the first place. One reason is that they think they are better off giving the money back to shareholders because they are unable to generate attractive returns for investors. That has so far proved to be the case with Telstra, Mr Jaquillard said.

Another reason given for buybacks is that by reducing the number of shares in circulation, the amount of profit generated per share should improve, assuming profits are unchanged.

A logical conclusion is that share buybacks will lift the value of the remaining shares, but this logic does not always stack up. If shareholders take the view that the company is heading in the wrong direction, buybacks are a handy escape route.