The Effect of Share Repurchase Announcements on the Underlying Share Prices

Bachelor Thesis

University of Zurich

Department of Banking and Finance

Corporate Finance

Prof. Dr. Michel Habib

Assistant: Jakub Rojcek

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Silvan Scheerer

Talstrasse 13

8214 Gächlingen

10745104

silvan.scheerer@bluewin.ch

079 407 56 66

Executive Summary

A company may choose to distribute its net profit to shareholders either in the form of dividends or the repurchase of its shares.

During the last decade, the repurchase of shares has gained more and more popularity in the corporate finance community. Also the volume of share repurchase programs by Swiss corporates has increased significantly since 1997 (Welti, (2001)).

This study analyses the impact of buyback announcements by Swiss corporates (listed on the SIX) on their share price during the last 5 years. Event study methodology and a market model will be used to compare expected returns with actual returns. Many studies completed in various countries, such as US, UK, Canada, Hong Kong and Thailand, report significant abnormal positive returns of the shares around the repurchase announcement date of that company.

Shares can be repurchased by many methods of which the 2nd trading line and the open market repurchase are the most widely used methods in Switzerland.

The buyback of shares may have significant impacts on the financial positions of the company and its shareholders, depending on the method employed by the company. In order to protect the interests of the company's stakeholders, a comprehensive legal framework was established over time by regulators and is still developing.

When analysing the effects of announcements of share-buyback programs on the behaviour of share prices the repurchasing methods used and the regulatory framework must be taken into consideration.

This study is organised as follows: the fundamentals (methods, regulatory frameworks) are described in detail, followed by an overview of the motivation for conducting share buybacks. The effect of a stock repurchase program will be analysed in theory and various hypothesis, will be discussed, which might explain the positive announcement returns. Thereafter, the data and methodology used in this study will be presented. In the final sections the results and conclusions will be reported.

The event study completed with data of the Swiss market reports that positive cumulative average abnormal returns (CAARs) were found around repurchase announcements. It takes about 10 days till the price increases are completed. Therefore, Swiss market participants are

able to process new information about share buybacks in a short period of time. Studies of other markets report, that the price reaction for fixed price offers (including put options) caused the highest observed reactions. In the Swiss market, however, only the CAARs from day 0 till 10 days after the announcement for the 2^{nd} trading line are significant at the 5% level. All other CAARs are not significant in a statistical sense. Moreover it seems, that open market repurchases in the available sample have no systematic effect at all. Since 2^{nd} trading line transactions are for capital reductions and open market repurchases are conducted for treasury shares, the impact on the capital structure of the latter is minimal, which investors also take into consideration. Therefore the corporate taxation hypothesis might explain some of the positive announcement effects.

Another interesting observation is, that managers tend to announce buyback programs after abnormal drops in stock prices. This might be the case because managers try to take advantage of undervalued stock. If undervaluation is the motivation, managers have no incentive to actually buy back stock if the market adjusts fully to the new information. However, the completion rate of share buybacks is with 75% on average very high.

Generally, the study reports, that the market behaviour is similar to other international peer markets.