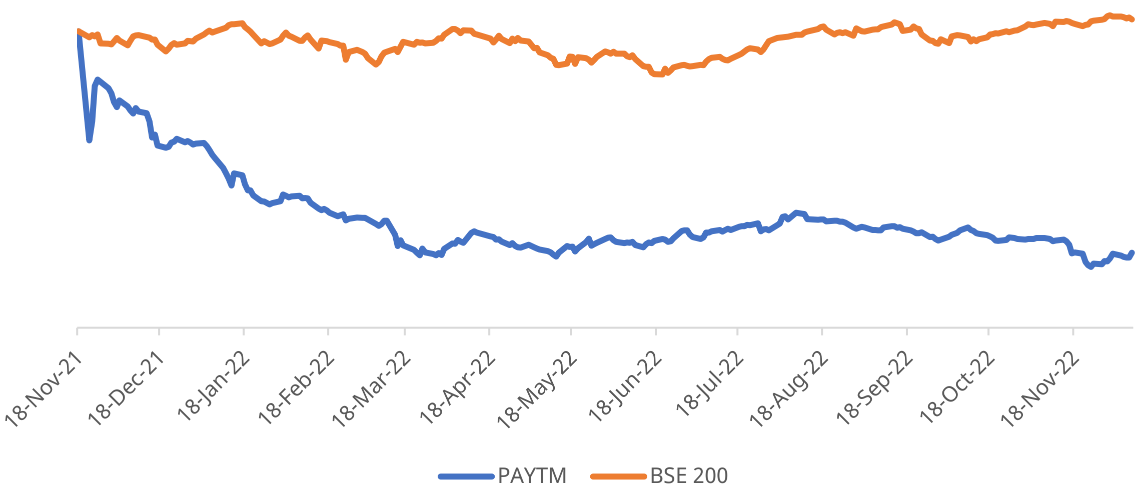
Should Paytm's board approve a buyback?

Paytm has had several missteps since its listing on the exchanges in November 2021. While it was one of India's largest IPOs, it also seems to have the largest set of disgruntled IPO shareholders.

One 97 Communications Limited (Paytm) listed itself at an IPO price of Rs. 2150. Since then, investors in the IPO have lost almost 75% of their investment.

The markets expectations of listed companies are widely different from unlisted ones, and Paytm's board appears to be still learning some of these harsh realities. Despite being one of the largest IPOs in India, the company has not been able to win investor confidence.

Exhibit 1: Paytm's stock price movement since its listing – issue price of Rs. 2150 (normalized)



Take the case of the company's recent announcement regarding a proposed buyback. The board is set to meet on 13 December 2022 to decide the contours of the buyback.

Buybacks are generally used as tax-efficient instruments to return excess cash to shareholders. They signal that the company has strong cash flow generation, which is more than required to maintain the company's growth trajectory. In Paytm's case, the company continues to report cash losses annually. Therefore, the buyback is essentially a return of equity capital to its shareholders.

Exhibit 2: Paytm's cash position

Particulars	Rs. Bn.
Cash on 30 June 2021[3] (pre-IPO) (A)	30.64
Less: estimated cash burn during 3Q22 (IiAS estimates) (B)	4.69
Cash with Paytm just before the IPO (IiAS estimates); (C) = (A) - (B)	25.95
Fresh equity issued during the November 2021 IPO (net proceeds)	81.13
Total cash after the close of the IPO in mid-November 2021 (IiAS estimates)	107.08
Cash and cash equivalents on 30 September 2022	91.86

Source: Prospectus, stock exchange filings, IiAS research

Note:

1. *Paytm reported a cash loss of Rs. 12.5 bn for FY22. Our estimate of cash burn from 1 July 2021 to the IPO is proportionately adjusted.*
2. *The cash and cash equivalents on 30 September 2022 are high because of an increase in its other financial liabilities. For 1H23, Paytm has reported negative cash from operations before working capital adjustments. Because of the increase in other financial liabilities, the release of working capital has resulted in the company reporting a positive cash from operations after working capital. This is largely similar to the company's financial position in FY22 – where the 1H22 cash flow from operations was positive, but at the end of the year, the company reported a Rs. 12.5 bn cash loss.*
3. *We have included non-current other financial assets, cash and cash equivalent and bank balances.*

Since inception Paytm has been burning cash. We believe that the pre-IPO cash on the books is also likely to be from an equity raise from its pre-IPO investors. It is possible that this is the pool from which the board will attempt to demarcate its buyback pool, since proceeds raised during the IPO must be used towards the objects of the IPO (any change will need shareholder approval). Of the Rs. 81.13 bn net proceeds raised during the IPO, the company had utilized only Rs. 25.14 bn on 30 September 2022 – Rs. 56.0 bn remains unutilized (Exhibit 3). Whichever way the board articulates it – Paytm is returning equity capital to its shareholders, those who came in pre-IPO, and during and since the IPO. But there is little merit in bucketing cash this way.

Exhibit 3: Utilization of IPO proceeds as on 30 September 2022

#		Objects of the issue	Amount proposed in the offer document	Amount utilized upto 30 September 2022	Amount unutilized on 30 September 2022
1		Growing and strengthening the Paytm ecosystem, including through acquisition and retention of consumers and merchants and providing them with greater access to technology and financial services	43.00		22.69
	i	Marketing and promotional expenses		3.98	
	ii	Expanding the merchant base and deepening partnerships with merchants		8.04	
	iii	Strengthening and expanding technology powered payments platform		8.31	
		Total (A)	43.00	20.32	22.69
2		Investing in new business initiatives, acquisitions and strategic partnerships	20.00		20.00
	i	Investing in new business initiatives		-	
		(a) Payment services		-	
		(b) Commerce and cloud services		-	
		(c) Financial services		-	
	ii	Investments in acquisitions and strategic partnerships		-	
		Total (B)	20.00	-	20.00
3		General corporate purposes (C)	18.13	4.82	13.31
		Total (A + B + C)	**81.13**	**25.14**	**56.00**

Source: *Stock exchange filings*

Unless the buyback price is higher than the issue price of Rs. 2150, the buyback will favour Paytm's pre-IPO shareholders and employees. Employees have been issued stock options at a significant discount to market price; Vijay Shekhar Sharma was granted 21 mn stock options at Rs. 9 in FY22 alone. IPO shareholders are unlikely to see the buyback positively, unless they entered the stock at a price lower than the to-be-announced buyback price. It is unclear if the size of the buyback will be sufficiently meaningful to move the needle.

Should the board decide to undertake the buyback, it must address the following questions:

- Why is the board considering a buyback at this stage? The company is yet to generate positive cash from operations. It is also yet to report profits – by traditional measures and not based on the companies proposed profitability measures that exclude ESOP charges.
- We expect that the board raised Rs. 81.13 bn in net IPO proceeds after factoring its existing cash. Therefore, its growth strategy a year ago required funding support that was in excess of the IPO proceeds. What has changed for the board to believe that its current liquidity is sufficiently in excess that it can be returned to shareholders?
- At the time of its IPO, the company had announced its plans to undertake new initiatives. It is only once these initiatives are rolled out that the board can satisfy itself that the war chest is sufficient. Therefore, the board must articulate how it has determined that the post-buyback liquidity will be sufficient to meet the unexpected investments in these new initiatives.

These are the questions that shareholders will want answers to when the buyback proposal is put to them to vote.

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