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THE TAO OF EQUITY CAPITAL

Finding a balance between dividend reinvestment plans and share buybacks. By NASTASCHA HARDUTH, head of Corporate Debt, Turnaround & Restructuring and designate – Dispute Resolution, YANIV KLEITMAN, director – Corporate & Commercial, and ZACHARY KOKOSIOULIS, associate designate – Dispute Resolution, at Cliffe Dekker Hofmeyr

Dividend reinvestment plans (DRIPs) are a popular option listed companies offer to their shareholders. A DRIP involves shareholders choosing to reinvest their cash dividends and receive additional shares instead of retaining the entire cash portion of their dividend. A DRIP is similar to a capitalisation share issue, with some technical differences that are not important for present purposes. From a company perspective, offering this structure has some material advantages.

1. **Increased capital retention:** when shareholders reinvest dividends through DRIPs in a company, the company retains more capital within the business that can be used for growth initiatives, research and development or debt reduction.
2. **Potential for lower cost of capital:** if a company consistently reinvests dividends through DRIPs into its operations, it may reduce its reliance on external financing. This can lead to a lower overall cost of capital.
3. **Stability and retention of shareholders:** offering DRIPs demonstrates a commitment to shareholders and encourages long-term investment by allowing shareholders to reinvest dividends directly into a company, and this stability reduces the likelihood of sudden sell-offs during market downturns.
4. **Lower transaction costs:** by bypassing traditional brokerage channels, companies can save on transaction fees associated with dividend payments. This cost reduction benefits both the company and its shareholders.
5. **Protection:** DRIPs can protect a company against hostile takeovers. If a hostile acquirer tries to gain control by purchasing shares on the open market, the company can counteract that by issuing additional shares through the DRIP. This makes it harder for the acquirer to achieve a controlling stake.

While DRIPs have their advantages, a downside is that they dilute issued shares, which can, in turn, result in a drop in share price. To counteract this effect, companies may want to take a closer look at their capital management plan and consider a repurchasing programme where they buy back a portion of their shares from shareholders.

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Nastascha Harduth

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SUBSTANTIAL BUYBACKS HAVE BEEN GREATLY SIMPLIFIED, ESPECIALLY FOR A LISTED COMPANY.

In this regard, Apple appears to be a strong proponent of share buybacks as a means of neutralising the dilution of shares made available through a DRIP. In May 2024, it announced a share repurchase programme of over a hundred billion dollars. On the same day of announcing this, its shares saw an increase of six per cent. But, this is not a new trend. For example, the stated purpose of the repurchasing programme by ANZ Group Holdings Limited, a listed bank in New Zealand, was to neutralise the impact of its DRIP; and Barclays plans to return at least £10-billion of capital to shareholders between 2024 and 2026 through dividends and share buybacks, with a continued preference for buybacks.

Closer to home, almost three years ago, on 27 June 2022, Naspers issued an announcement that it was launching an open-ended, repurchase programme in respect of certain ordinary shares held by free-float shareholders. On 7 January 2025, Naspers reported that for the period between 30 December 2024 and 3 January 2025, the Group purchased 141 071 Naspers shares for a total consideration of ZAR587 437 300 (US$31 293 961).

There are three major benefits of share repurchase programmes, particularly in relation to DRIPs.

1. **Capital allocation:** share buybacks allow companies to allocate excess capital efficiently. That is, instead of hoarding cash or paying a special dividend (a one-time payment), companies can repurchase their own shares, signalling confidence in their future prospects and creating greater and sustainable value for the remaining shareholders.
2. **Flexibility:** unlike dividends, which commit companies to regular payouts, share buybacks offer flexibility. Companies can adjust the timing and amount based on market conditions. As Poole College of Management puts it: "[by] choosing big annual buybacks over larger dividends, Apple keeps things flexible – it's like having an option open rather than committing to ongoing payments that don't respond to how well the business does each year."
3. **Protection:** because the effect share buybacks have on the price of a company's shares, hostile takeovers are less likely due to these companies' valuations increasing significantly and quickly.

Before 27 December 2024, when the Companies Amendment Act 16 of 2024 (Amendment Act) partially took effect, when considering a share repurchase programme in South Africa it had to be borne in mind that section 48(8)(b) of the Companies Act 71 of 2008 (Companies Act) applied, and a buyback of more than five per cent in a transaction or "integrated series" (which was not always a fully understood concept) would qualify as a "*fundamental transaction*", which raised all kinds of technical issues. If the five per cent threshold was crossed, the rules on schemes of arrangement would apply, a special resolution of shareholders and an expert's report was required, dissenting shareholders had the ability to review the special resolution and/or exercise appraisal rights (namely the right to compel the company to buy their shares at fair value), and takeover law applied to the buyback as well – all in all it was a cumbersome regime.

However, the Amendment Act has altered this position and the highest requirement now for a buyback is a special resolution of shareholders, which itself is not even required if the buyback is pursuant to a pro-rata offer by the company (whether listed or unlisted) to all its shareholders or to a class of its shareholders, or, in the case of a listed company, the shares are bought back through the exchange. In other words, substantial buybacks have been greatly simplified, especially for a listed company. The JSE Listings Requirements will still need to be complied with by those companies, but at least they have comfort now that the scheme of arrangement debate ended with the December 2024 amendments.

It is clear that finding the Tao (the way) between the yin and yang of DRIPs and share repurchase programmes can be a fine line – one that should be considered carefully with trusted advisors to achieve a balance in the company's capital structure.

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Zachary Kokosioulis

Yaniv Kleitman

CDH

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