

Case Study 4: 1st Tranche of BNP Paribas's 2023 share buy-back

Introduction

This case study examines the implementation of the 1st tranche of BNP Paribas's 2023 share buy-back. We question if the company's stated buy-back objective and the execution strategy employed were aligned with BNP's shareholders' interests. This case study is part of a series of recent work by Candor Partners, and at times in collaboration with Prof. Osterrieder, which is attempting to shine the light on the broader topic of the execution of share buy-backs, and a specific family of execution products. We believe that these products can have terrible outcomes for shareholders of the issuers that use them. We are highlighting a product problem, not an issuer problem.

We understand that the trading and execution of a share buy-back might seem too micro for the shareholder and investor governance community. However, we ask for your attention because of the sheer scale and longevity of this problem. The compounding effect of damage to shareholder value over time is truly staggering.

To give an idea of the scale of the potential issues, note that currently [29%](#) of companies globally are buying back their own shares. In the US/EU and UK, over the last 5 years this amounted to approx. \$5.6 trillion. We believe that for at least the last 25 years a significant portion of these share buy-backs have been implemented using a family of execution products whose design and fee structure are at times in direct conflict with the issuer's shareholder interests.

We think that this case study is both timely and of particular interest from a governance perspective. On the one hand BNP Paribas are part of the way through their own €5bn share buy-back. On the other we also understand that BNP Paribas also sell these "problem products" to their corporate clients. We think that this makes for a very interesting set of governance questions to consider.

Issuer Governance: Align the Company Objectives with the Shareholders' Interests

BNP's [stated objectives](#) for undertaking this share buy-back are clear. They state the reason is "for the intent of compensating for the effect of the dilution of net earnings per share relating to...". From an execution perspective, the goal is therefore to buy as many shares as possible, which can then be cancelled. The greater the reduction in the total outstanding share count of BNP the greater the reduction in the mentioned dilution effect to net earnings per share. The shareholders rely on the company's governance process look after their interests for several reasons. These reasons include the fact that shareholders have no control on how a buy-back will get executed and have imperfect transparency on the relevant components that need to be controlled, often for good reason. The process of evaluating the implementation of the share buy-back should include an understanding of the expected costs and risks as they relate to trying to purchase as many shares as possible

for the €5bn of company capital. After the share buy-back is complete the number of shares purchased, and the associate transaction costs should be evaluated. This process, called transaction cost and post trade analysis, is commonplace in almost all institutional equity execution businesses. There are standard benchmarks and techniques for estimating these risks and costs for different execution goals and the associated processes against which to evaluate the outcomes.

Information for Post Trade Analysis

To attempt to carry out a fair post trade analysis for BNP’s 1st buy-back tranche we need to know all the facts, and for very good reasons only some of these facts are in the public domain. For example, we do not know if there are share price limits or average purchase price caps. There may have been a minimum date before which the share buy-back could not be complete, nor do we know the terms and quantity of remuneration for the broker and many other details.

There are however some bits of useful data that are available in the public domain:

- i) The target value of €2.5bn to be purchased
- ii) The objective: the greater the quantity of shares purchased the better
- iii) Maximum time frame: completion no later than 3Rd Aug ‘23
- iv) 7th Feb ‘23 results BNP said they will pay a [€3.90 dividend](#), ex div on 22nd May ‘23
- v) [Daily trading](#) activity released weekly

There is not enough information to do a full and fair evaluation, however there is enough to ask some questions.

The Execution Details

Fig 1

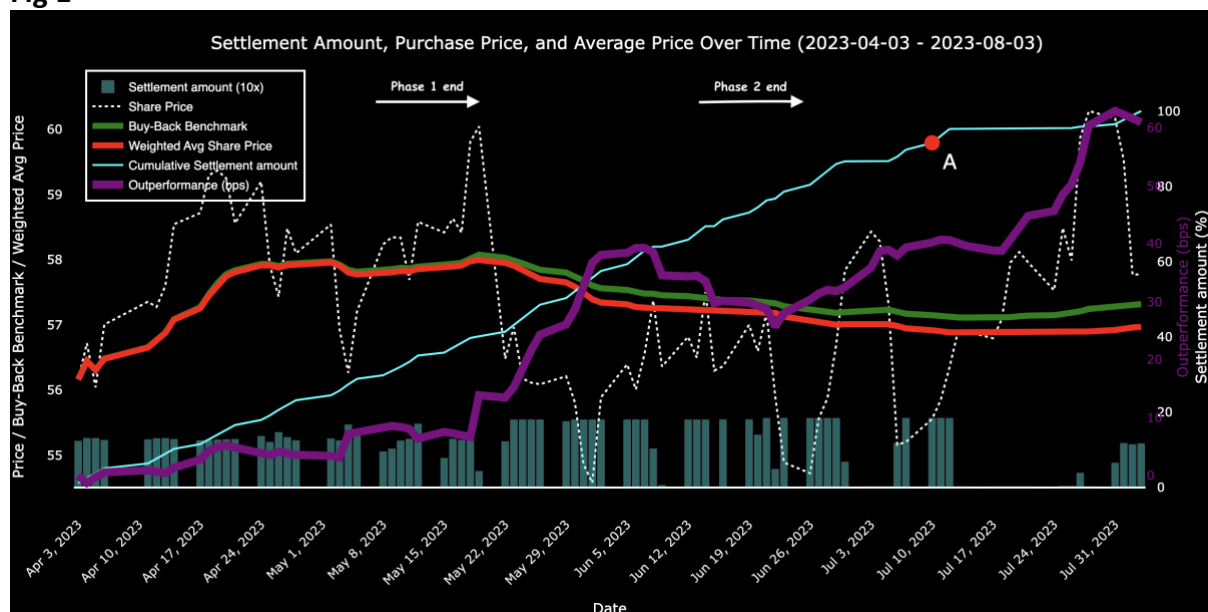


Fig 1. is not precise, however it is based on BNP’s regulatory reporting of the daily trading activity (point v above). For example, the green line called “benchmark” is not measured

correctly, however it is a good enough approximation for the points we want to illustrate. The “benchmark” in this illustration is the simple average of the daily share prices. This is a proxy for a commonly used benchmark for some share buy-back execution products, the arithmetic average of the daily VWAP (volume weighted average price) of the days the broker purchases shares (or trade life). For a better understanding of these terms and what they mean please see section 3 and appendix 4 of [“The Great Deception”](#). Note that in this paper the authors refer to this as the “Bogus Benchmark”.

To explain what we see in fig 1 we are going to split the share buy-back into three phases.

Phase 1 is the first €1bn spent between dates 3rd April and 19th May.

Phase 2 is the second €1bn spent between the 22nd May and the 26th Jun.

Phase 3 is the last €500m spent between the 27th Jun and the last allowable day of the program on the 3rd Aug.

The calculations below are for illustrative purposes only and may have errors, so please do not take any of this as fact, but we have done our best to be as accurate as we can with the available information.

Phase 1

What appear to be the facts: In phase 1 the broker bought 17.3m shares at an average price of €58.00 per share.

The average value spent on each of the 32 trading days was €31.4m.

Candor’s comments: For the first 20 days, until 3rd May the value spent each day was fairly constant at €32m (turquoise bars in chart, value is indexed so just look at the variations in height), with a min of €30m and a max of €36m on any given day. Between the 3rd of May and the 19th of May, on days when the share price (white dotted line) dipped below the “buy-back benchmark” (green line) they spent more (e.g. 12th May, €42m) and when it was above they spent less (e.g. 19th May, €11m). Nothing particularly interesting or unusual.

Phase 2

What appear to be the facts: In phase 2 the broker bought 17.9m shares at an average price of €56.18 per share, a price that is 3.1% lower than phase 1.

The average value spent on each of the 27 trading days was €39mil.

The stock price went ex-dividend on May 22nd. The dividend was €3.9 a share.

Candor’s comments: On the first day of this phase the broker spent €30.5m, and then increased the rate of spending by approximately 50%, spending €45m to 46m on 20 of the subsequent 26 days. On the other 6 days the value spent ranged from two days which were €0.5 and 1.5m and two days as high as €35 and 34m.

Candor’s Questions: Is it worth looking that the “out-performance” line (purple line, the difference between the green line (benchmark) and the red line (weighted average price of the share bought so far)? The purple line raises steeply when the broker spends more on days when the stocks share price is trading below the “benchmark” and also raises when they spend a lot less value if the stocks share prices are above.

Is this behaviour because the broker's fee is derived from some portion of this "out-performance"? "VWAP" guarantee and "VWAP" discount products (some of the "problem products") are frequently designed so that the brokers fee increases as the out-performance increases.

Does the execution contract that BNP referred to in their 31st Mar 2023 [press release](#) guarantee completion and performance versus the arithmetic average of daily VWAPs over the execution period (Bogus Benchmark)?

Does this explain why the broker increased the daily average value spent right after the stock goes ex-dividend? Logically this would only seem to make sense to the shareholder if the cost of buying the shares was cheaper, as it optically looks like it is. However, is it cheaper for the company to buy these shares after the stock price went ex-div or when the stock was cum-div?

In the case of a company buying its own shares how should we think about this price differential? Does the company pay any dividend on shares that they hold in treasury or have cancelled? If they do not, then doesn't this mean that the cum-div shares are effectively €3.9 per share cheaper for the company to buy than buying the same shares once the stock price has gone ex-div? If we adjust the share price of phase 1 down by the dividend amount, are the shares that were bought in the 2nd phase 3.8% more expensive for the company to buy than those bought in phase 1? If the objective of the buy-back is to buy as many shares as possible, then why did the broker increase the pace of spending so dramatically when the total cost to the company appears to be higher for these ex-div shares?

If the broker's fee relates to the magnitude of the out-performance of the average purchase price for the shares versus the "benchmark", then does the benchmark adjust for the dividend? If it does, then why did the broker speed up the pace so suddenly right after the ex-date at what appears to be a higher total cost per share for the company? If the "benchmark" does not adjust, then why not? All the dividend information was available well before the share buy-back started.

Phase 3

What appear to be the facts: In phase 3 the broker bought 8.6m shares at an average price of €56.56 per share (4.5% higher than the div adjusted phase 1 price, and 0.7% higher than phase 2)

The average value spent on each of the 28 trading days was €17mil.

Candor's Comments: The broker spends an increasingly binary value each day. By this we mean that it looks like when the share price is below the red line (the average purchase price) the the broker spends about €45m a day. When the share price is above, such as in the 10 days from the 13th to the 27th Jul the broker spends an average of €0.6m a day. The broker then changes strategy in the last 6 days and completes the program when the daily share price is above both the "benchmark" and the average purchase price, spending on average €19m a day for these 6 days. Note the purple line ("out-performance") ends at

close to its high point of about 60bps, and that the buy-back is completed on the last possible day.

In our analysis of many share buy-backs we have come to recognise certain “footprints” of programs that are implemented using these problematic “Bogus Benchmarked” products. One of these footprints is seen by looking at the brokers trading patterns after the 90% of value completion mark, marked as point A on the chart. If the share price remains above the “bogus benchmark” after this point A, programs typically run all the way until the very last day, in this case Aug 3rd. If the share price is significantly below, the broker typically completes very quickly.

Candor’s Questions: Why did the broker slow down so much between the 13th and the 27th of Jul? We don’t expect the broker to know the future share price path of a stock. However, what was the broker’s logic behind the decision to not complete the program when they could have done at share prices in the region of €56.92 around Jul 13th. If you look back to the broker’s trading pattern in April and May, when they were spending a lot more value at these and even higher prices than the period just after Jul 13th. Granted the stock was cum-div back then but our point is there was plenty of time and price opportunities to buy cheaper shares. What then changed that made them happy to spend €113m at much higher prices around the €58.74 in the final 6 days?

One possible explanation is that the broker was incentivised by trying to maximise the out-performance to the benchmark. In our illustrative chart the out-performance increases 50% from about 40bps to about 60bps in this period.

If the share buy-back is being executed using one of these guaranteed products how and who is managing this conflict of interest? In these final days the company is buying back less shares per unit of value spent at these higher share prices while the out-performance (fee bucket that it would appear the broker is paid a fraction of) increases by 50% in this same period. It appears that the broker is trying to maximise the out-performance of the program. This out-performance increases at the same time as the weighted average purchase price of the shares (red line) is also increasing. This means that the company and therefore shareholders are simultaneously buying less shares per unit value spent whilst the overall out-performance (fees) is also increasing, neither of which are in the interest of shareholders. Is this a conflict of interests? If it is how and who is managing it?

Other Potential Governance Issues

This BNP share buy-back is particularly interesting when you think about conflict management and the related governance issues.

Firstly BNP is a financial institution, whose broker Exane appears to sell these products to other corporates – this [“ESG Buy-back”](#) for BIC looks like such an example.

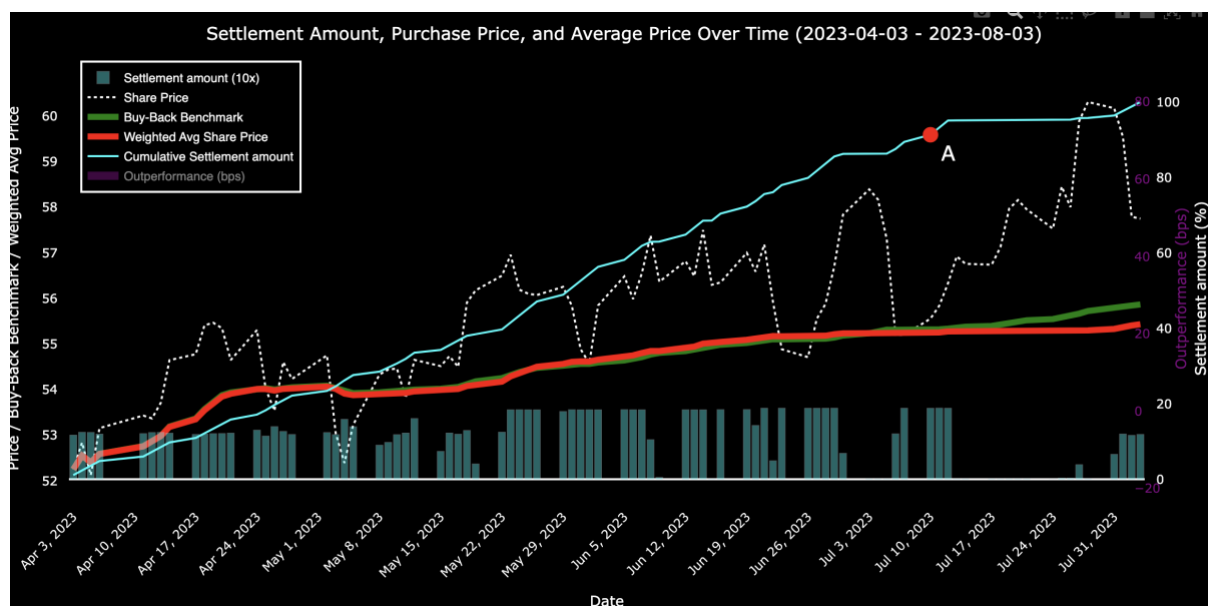
Secondly, if what the BNP IR told us is accurate and Exane is indeed the broker. They what questions does this pose? How does a subsidiary guarantee a parent (the issuer) any “out-come” when buying their own stock? If the “guarantee” resulted in a financial loss for the broker wouldn’t the brokers capital be at risk? Wouldn’t any resulting economics just be a PnL transfer within the overall entity from parent to subsidiary rather than an actual guarantee? If there was a loss due to the guarantee whose capital is lost? If a performance

fee was actually paid, should we think of this as a value transfer from BNP's shareholders to BNP's own broker? Is this now broker revenue? We don't hold ourselves up as understanding the accounting processes and other important aspects of this, we just question it as it appears to be very circular to us.

Going back to BIC's ESG buy-back mentioned above. We do not want to get side tracked on this now, but when the press release says "... BNP Paribas' willingness to help its clients innovate and develop in a sustainable manner..." might this also be considered as helping to transfer funds that BIC publicly disclosed would be used to buy-back shares, and yet a portion of these funds appear to have been re-directed to some other projects? It could also be argued that the sorts of projects that were funded maybe had some "marketing value"? As we say we do not want to be side tracked on this topic, we want to highlight that we are trying to point to issues we see with some of these buy-back "products" and not with the issuers themselves.

Dividend Adjusted Version

Fig 2.



This is a crude attempt to redraw the chart after adjusting the share price for the dividend. All we have done is subtracted €3.9 from the share prices they went ex-dividend on May 22nd. We leave the share price after the ex-date the same. The turquoise bars could do with being rescaled, but I think for the purpose of illustration hopefully you can draw your own conclusions.

Some of the questions we think shareholders will be thinking about are things like how many shares could have been bought if the execution strategy was designed in their best interest? Nobody has a crystal ball, so the initial few weeks are hard to critic. But when the share price falls sharply in early May why did the broker not increase their rate of spending up to whatever they felt was the max value they could spend (seem like €46m a day). Why in late Jun and early Jul, when the share price dropped were they not trying to complete the program?

How would the brokers own institutional execution business have managed this program if it was their own risk? How would an independent transaction cost analyst evaluate the overall performance of this share back if they were given all the relevant details. Indeed, how would Exane's own TCA team evaluate it? Would they would raise similar questions to the ones we are asking?

Did BNP really spend €2.5bn if the shares that were bought cum divs on phase 1? When the company announced that it would pay a €3.9 per share dividend, how many shares did they assume would be outstanding (i.e. not cancelled or held in treasury due to tranche 1 of the buy-back)? We are not accountants or competent at understanding annual reports, so this might be obvious to some, but we wonder what happened to the differential €67.5m? (17.3 mil shares purchased in phase 1 x €3.9 per share dividend = €67.5) Will this value also get returned to shareholders later?

We are sure that there are many more questions, however we ask shareholders and analysts if you think that any of these or other questions warrants further investigation? The company does not seem to want to respond with Candor Partners as we have offered help and shared concerns however we have received no response to date.

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