

# Stock Buybacks Bite Back

## Jim Hurt

BETTERINVESTING NATIONAL CONVENTION

## Stock Buybacks Bite Back

James Hurt  
OKI Tri-State Chapter of BetterInvesting

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## Educational Segments

- A collection of the Power Point presentations used for the educational segments of CINMIC, the Cincinnati Model Investment Club, are under the "Education Files" folder at:  
<http://www.myiclub.com/club/folders/public.aspx?club=9159>
- Many of these same files are also at:  
<http://www.zacan.com/Jim/index.php?section=5>

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## Article in Barron's

- Title: "Stock Buybacks Bite Back"
- Barron's Magazine  
– Monday, Dec. 10, 2007
- Article available at:  
<http://online.barrons.com/article/SB119707820223717971.html>

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## Stock Buybacks

- A company buying back its own stock is a widely practiced strategy to boost company share prices.
- Theory is that reducing the number of shares outstanding will increase the earnings per share which in turn will increase the stock price.
- Does this strategy really work?

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## S&P Equity Research

- Titled: "How Rewarding Is Corporate Share Repurchase Activity?"
- Reported Nov. 6, 2007.
- From Jan. 1, 2006 through June 30, 2007, S&P 500 companies spent \$700 Billion buying back 20 Billion shares.
- How did the stock prices for those companies fare?

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## Conventional Wisdom

- Stock prices go up as a result of buybacks.
- More buybacks are better than fewer buybacks.
- Announced buybacks actually reduce the number of outstanding shares.

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## First Conclusion

- 423 of the 500 companies on the S&P index engaged in buybacks.
- Stock price for 103 (24%) of them did better than the index. Most of these gains were from a boom in energy and commodities prices.
- Stock price for the other 320 (76%) did worse than the index.

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## Conventional Wisdom

- Stock prices go up as a result of buybacks. **False!**
- More buybacks are better than fewer buybacks.
- Announced buybacks actually reduce the number of outstanding shares.

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## A Quote

- “It is especially noteworthy that the median performance of companies that didn't buyback any stock was better than the S&P 500 overall.”

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## Second Conclusion

- The companies who were most aggressive in buybacks, buying back the largest fraction of their outstanding shares, had the weakest performance.
- These included the companies who borrowed money in order to buyback stocks.

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## Conventional Wisdom

- Stock prices go up as a result of buybacks. **False!**
- More buybacks are better than fewer buybacks. **False!**
- Announced buybacks actually reduce the number of outstanding shares.

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## Third Conclusion

- While 20 billion shares were involved in these buybacks, the total number of shares outstanding decreased by only 4.4 billion (only 22%)!
- My opinion: 78% (almost 4 out of 5) shares bought back were used to fill stock options.

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## Conventional Wisdom

- Stock prices go up as a result of buybacks. False!
- More buybacks are better than fewer buybacks. False!
- Announced buybacks actually reduce the number of outstanding shares. False!

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## Fourth Conclusion

- “Oftentimes, shareholders would be better served if, instead of buying back shares, the company would put that money into Treasury bonds.”

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## New York Times 4/7/2008

- “One reason for buybacks is to avoid dilution of earnings from the exercising of stock options.”
- <http://norris.blogs.nytimes.com/2008/04/07/profits-plunge-buybacks-dont/>
- Translation: Stock buybacks are a way of enhancing pay for executives and employees.

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## New York Times 4/7/2008

- “Shareholders — the ones that don’t cash out, that is — benefit if the stock price the company pays turns out to be cheap. But all too often the opposite is true. Companies spend freely on shares when the price is high, then cannot afford to buy any more — or even have to issue new shares if buyers can be found — when times are bad and the share price is much lower.”

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## Conclusions

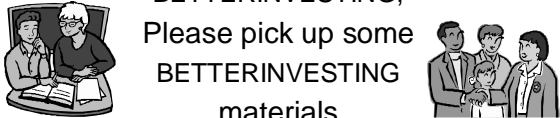
- Stock buybacks are good for management, but not for shareholders.
- The announcement that a company is going to buyback stock is bad news for investors, not good news.

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Someone's Life

If you have benefited from  
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Please pick up some  
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materials  
and introduce others to this opportunity.

The image contains two line drawings. The first, on the left, shows two people sitting at a desk with a computer monitor. The second, on the right, shows three people standing and talking to each other.