

## **Stock buybacks of publicly traded firms drop 13 percent in 2012 Dollar value of announced purchases declines by 11 percent**

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By Becky Yerak, Chicago Tribune reporter, January 27, 2013

Companies have been placing fewer bets on themselves. The number of stock buybacks announced last year by publicly traded businesses dropped 13 percent, to 1,008.

Fewer plans were made by companies to buy their own stock despite "a surge at the end of the year" that included Northbrook-based Allstate Corp., as well as Coca-Cola Co., Pfizer Inc. and General Electric Co., said Rob Leiphart, an analyst with Birinyi Associates Inc. Similarly, the dollar value of announced buybacks also fell last year, by 11 percent, the stock market research firm found.

Stock buybacks are generally cheered by investors because they're supposed to reduce the number of shares in the open market. So when the company makes money, profits per share are higher because those earnings are sliced into fewer pieces. That should make each share worth more because it's entitled to a bigger piece of the company's profits.

Take Minneapolis-based Whitebox Mutual Funds. In a recent fund letter to investors, it said it was "especially focused on companies that exhibited shareholder friendly behavior by returning capital to equity holders through buybacks and dividends."

Likewise for Delaware Investments, whose midcap value fund informed clients in its recent letter that it's sticking by Big Lots, an Ohio-based retailer whose stock has been beaten down after sales growth twice fell short of expectations.

"Still, we view the company's share buyback program as a positive, and we continued to hold the stock as of the end of the fund's fiscal year," the Philadelphia-based money management firm told its investors.

In what it said was a vote of confidence in its business prospects, Chicago-based Boeing last month said it was resuming a \$3.6 billion buyback authorized in 2007. It said it planned to repurchase more than \$1.5 billion in shares in 2013. That same day, Allstate approved a stock repurchase of as much as \$1 billion, with the home and auto insurer saying its financial strength gives it the wherewithal to make what's regarded as a shareholder-friendly move. It recently sold almost \$500 million in notes that it will use for general corporate purposes, including buying back stock.

Coca-Cola, Pfizer and General Electric in the fourth quarter all announced planned buybacks topping \$10 billion in value.

But such big companies generally have been more cautious. Through the first nine months of 2012, companies in the Standard & Poor's 500 spent 5 percent less to buy their own stock on the open market, according to data released in late December by S&P Dow Jones Indices.

During the same period, the S&P 500 rose 13 percent. That suggests that corporate America as a whole wasn't overpaying for buybacks.

As for the fourth quarter, talk about going off the "fiscal cliff" might have dampened the appetite for stock repurchases, said Howard Silverblatt, S&P senior index analyst.

"Companies may have taken a cautious approach to stock buybacks in the fourth quarter," he said. Through the first nine months of 2012, they spent \$299.8 billion.

Silverblatt distinguishes between companies that announce share repurchases and ones that pay up. He said he'll have a better idea of how many have carried through with their plans at the end of January, by which time many companies will have reported fourth-quarter financial results and submitted documents with year-end share counts.

For example, Chicago-based Northern Trust Corp. on Jan. 16 disclosed that in the fourth quarter it bought back \$62.9 million in stock for an average price of \$47.62 a share. Its share count has edged down from the same period a year ago. Northern Trust stock closed Friday at \$51.32. A company shouldn't overpay for its stock.

"The key to a successful buyback in the long run, like any investment, is the price paid when repurchasing the shares," said Steve Billimack, managing director for HighTower, a Chicago-based financial services firm serving wealthy families. "The more undervalued the stock, the more likely it will benefit shareholders."

For instance, Cintas Corp., the Cincinnati-based uniform provider, bought back stock recently for \$37 to \$39. It closed Friday at \$42.51. S&P's Silverblatt said that despite worries late last year about the fiscal cliff, there are indications that stock buybacks that have been authorized might have been carried out to some degree in the fourth quarter.

"Company buyback activity has been erratic over the past three months, but they continue to protect their earnings per share," Silverblatt said.

And S&P 500 companies have plenty of cash to buy back stock. Cash and cash equivalents at S&P 500 industrials set a record in the third quarter, at \$1.03 trillion, as earnings and cash flow outpace expenditures, he said. The S&P 500 industrials exclude financial, utility and transportation companies, which maintain high cash levels as part of normal operations.

Companies are expected to buy back stock to offset the dilutive effects of executive stock options that have been granted and exercised, Silverblatt said. Options give managers the right to buy a company's stock at a certain price during a certain time period.

When companies issue additional shares as managers exercise their options, the businesses, in turn, might also buy stock on the open market so those managers' additional new shares don't reduce, or dilute, earnings per share. "In the background is some talk of companies needing more shares to meet employee options, with more being exercised near year-end" due to the tax change that was anticipated, Silverblatt said. Those types of stock buybacks don't result in a decline in shares outstanding because the company is issuing more shares to managers while buying other shares on the open market.

Alan Loewy, portfolio manager for Chicago-based Avocet Capital Management, agrees with Silverblatt that the uncertainty of the personal and corporate tax landscape clouds the ability to interpret corporate stock buybacks.

"Corporate buyback decisions should be evaluated on an individual company basis, given the varying levels of corporate cash, exposure to cyclical trends in the economy and current share valuation," he said.

Chicago-based Kovitz Investment Group prefers buybacks to dividends. "Dividends are ephemeral, but buybacks are permanent," said Jonathan Shapiro, co-chief investment officer. "Once a dividend is paid, it is gone, out of the company coffers and into the hands of its shareholders to invest as they see fit."

Buybacks, on the other hand, result in a permanent change in the capital structure, he said. Also, dividends are taxed at a rate of 20 percent for

high-income earners, he said, so an investor only gets the use of the after-tax portion of the cash paid out as dividends.

"Buybacks, on the other hand, have no tax ramifications, so investors who don't sell their shares get the full impact," said Shapiro, who stresses that share repurchases make no sense if the stock is overvalued, which could be a "value-destroying endeavor."

#### How to find share counts

Your company has announced a stock buyback, which, ideally, will increase earnings per share because profits are divvied up over fewer securities. But are share counts really dropping? You can find trends in the company's share counts in its quarterly financial filings at sec.gov. On the income statement of Northern Trust Corp., for example, there's a line item listing "average number of common shares outstanding" for the latest quarter and the same period a year earlier. One set of figures refers to "diluted," which factors in options and other securities that may be converted into stock. In the fourth quarter, its share count from the same period a year ago declined to 239.9 million from 241.2 million.

#### **About Avocet Capital Management**

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