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STOCKS
By Natalie Pace

Winners Among Companies That Buy Back Stock

David Fried profits on insider information without risking jail time. Rather than try to hit up the honchos for hot tips, he gets the skinny the legal way -- by investing in companies that are repurchasing their shares. "When a company buys back its stock," says Fried, "it's an enormous vote of confidence by those who know it best -- the company's senior executives."

Fried puts his views to the test in two online newsletters, *Buyback Letter Standard Edition* and *Buyback Letter Premium Portfolio.* Over the past five years, according to *Hulbert Financial Digest*, the portfolios in the older *Standard Edition* gained an annualized 14%, on average. That beat Standard & Poor's 500-stock index by 16 percentage points per year and makes the *Standard Edition* the fifth best-performing newsletter.

Dividends may get the headlines, but buying back stock is another way to reward shareholders. And corporate America has been handing out a lot of goodies. Last year, companies announced $233 billion in repurchase programs, according to Thomson Financial. That's up from $101 billion in 2003.

How It Works

Buybacks benefit investors by giving them a bigger piece of the company pie. Here's the math: Say Widget Industries has 100 million shares outstanding, earns $250 million per year (or $2.50 per share) and trades for $50. That gives the stock a price-earnings ratio of 20. Suppose Widget repurchases 5% of its shares, trimming the count to 95 million. Earnings per share are now $2.63, and the stock's P/E is now 19. Viewed from a different perspective, the stock would have to rise to $52.60 to attain a P/E of 20.

But a buyback strategy is more than just a numbers game. "Companies buy back stock when they are really undervalued or when there's something positive that's going to happen," says Fried. "Maybe things are turning around. Maybe the people who run the company see an efficiency-improvement story, or they see a chance to expand."

One problem with Fried's strategy is that some companies only talk the talk. To make sure that a company really is buying back stock, Fried generally waits for a firm to report quarterly earnings and looks for an actual reduction in the share count. Beyond that, Fried looks for high-quality companies with stocks that are cheap in relation to such basic measures as earnings or sales.

Among Fried's recent picks: **Home Depot**, the home-improvement giant. Home Depot (HD, recent price $42) bought back $6.1 billion of its shares over the past three years -- 6.6% of its market value of $92 billion -- with board approval to repurchase up to $7 billion. For a company so big to buy back so many shares "indicates euphoria for what the future holds," says Fried.

Sexy Stock

Fried, 48, also likes **Limited Brands** (LTD), owner of Victoria's Secret and other specialty retailers. Limited is a "serious buyback player," says Fried, having made four separate repurchase announcements last year. The stock, at $23, trades at a relatively inexpensive 14 times estimated earnings of $1.58 per share for the year ending next January.

Leave it to a former garment maker (Fried's business before he caught the investing bug) to tailor different portfolios to suit your needs. *Standard Edition* ($125 per year) contains six portfolios, including one that focuses on dividend-paying stocks, another that recommends technology stocks and a third that suggests health stocks. Active traders can select *Premium Portfolio* ($79 per month), which features Fried's top-five monthly picks. For more information, visit www.buybackletter.com or call 888-289-2225.)

--Natalie Wynne Pace