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# SUNDAY MONEY: INVESTING; Sending Out a Message By Buying Back Shares

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BUYBACKS are back, and portfolio managers are taking notice.

Companies have been repurchasing their own shares at record levels, and the trend shows no sign of letting up. In the first half of this year, share buybacks reached $163 billion, according to Standard & Poor's, up 91 percent from the first six months of 2004. Howard Silverblatt, an equity market analyst at S.&P., estimates that they will surpass $300 billion for the year. That would be well above the $197 billion for all of 2004.

Companies are splurging on their own shares for a simple reason: they have a lot of cash and need to do something with it. Companies in the S.&P. 500-stock index have cash equal to 7.3 percent of their market value -- slightly off the 7.7 percent peak reached earlier this year, which was the highest level since 1988.

That pile of cash accounts for not only the increase in stock buybacks, but also for rising dividend payouts and a higher level of activity in mergers and acquisitions.

"Companies have more cash than they know what to do with," Mr. Silverblatt said. "The number is just huge, especially in an environment where it is cheap to get money. So companies have plenty of money to do buybacks."

In general, buybacks are good for investors. After all, they represent a vote of confidence by management in the company's stock. And all things being equal, buybacks increase the earnings for each share by decreasing the number of shares held by investors.

David L. Ikenberry, a finance professor at the University of Illinois at Urbana-Champaign who studies corporate buybacks, found that the stock price of companies that announced buybacks tended to outperform those that did not.

In an unpublished study of 7,725 announced corporate buybacks from 1980 to 2000, Mr. Ikenberry and three other researchers found that investors who held those stocks for four years earned a return that was 15.6 percentage points higher than that of a similar basket of stocks from companies that might or might not have announced repurchases. The results were consistent with a similar study published in the Journal of Financial Economics in October 1995 by Mr. Ikenberry and two other academics that focused on stock buybacks from 1980 to 1990. The study is at http://papers.ssrn.com/sol3/papers.cfm?abstract--id=686567.

"It is a phenomenon that is fairly robust," Mr. Ikenberry said. "Companies buy back stock for all kinds of reasons. The biggest one is a perception of mispricing. So these stock buybacks are considered signals that management is confident of where the stock prices should be headed."

Until legislation in 2003 cut the tax rate on qualified dividends to a maximum of 15 percent, there were tax advantages to share buybacks over dividend payouts. With the tax changes, however, dividend payouts -- which have also been rising -- and share buybacks have become more equal.

"A few years ago, we preferred stock buybacks over dividends because there used to be a tax rate difference," said Ronald H. Muhlenkamp, manager of the Muhlenkamp Fund, which was up 28 percent a year, on average, in the three years through Thursday. "Today our preference is simply a matter of how high the stock is priced. If the stock is cheaply priced, we would prefer a buyback."

Mr. Muhlenkamp said the question to ask when looking at buybacks was whether the company could get a better return by buying back shares, paying a dividend or expanding its business. "If they don't have projects that can maintain their return on equity," Mr. Muhlenkamp said, then the money should be paid to shareholders in a dividend or by repurchasing shares.

But not every buyback announcement is significant. Not all companies that say they will buy back shares actually do. And many buybacks -- particularly among technology companies -- are simply a way of offsetting the dilution that would otherwise accompany the exercise of stock options. "So many companies are doing buybacks, but they may not all be doing meaningful buybacks in the sense that they are big enough to give the company a reduced share count," said David R. Fried, president of Fried Asset Management in Pacific Palisades, Calif., and editor of the online newsletter buybackletter.com.

That said, more companies are doing meaningful buybacks these days and some in huge quantity. Consider Exxon Mobil, the world's largest energy company. As oil prices have soared, it has accumulated cash, and it has been sharply increasing its share repurchases, up to $5 billion in the third quarter from $3.7 billion in the second quarter.

S.&P. data shows that the number of companies that have reduced their outstanding shares by at least 0.5 percent has risen -- to 81 companies in the second quarter from 62 in the first quarter, and the moves have started to affect corporate earnings.

AND the buyback announcements keep coming, sometimes from companies that have gone through tough times -- like Time Warner and Motorola. "They've had some problems recently, and they're trying to do some signaling to the market," says Timothy Loughran, a finance professor at the University of Notre Dame. He compared current buybacks to the stock repurchases made after the stock market plunge in October 1987. "It's been a pretty good signal," he said. "And I think it is generally a positive signal for the market as a whole."

If you're interested in investing in companies that have had buybacks, Mr. Fried recommends looking at valuations as well as the size of the buyback programs. Among the stocks he likes are AutoZone, the auto parts retailer, trading at 12 times earnings; Intuit, the maker of Quicken software, trading at a multiple of 22; and Cigna, the insurer, at a multiple of 8. "We look for situations where you've got the buybacks and the valuations," he said.

Photos: The Manhattan headquarters of Time Warner, which said it would buy back shares. Companies that make such announcements tend to outperform their peers. (Photo by Andrew Harrer/Bloomberg News)

Chart: "Reclaiming Ownership"
With substantial cash on hand, companies are spending heavily to buy back their own stock.

Graph tracks the aforementioned trend since 2001.

(Source by Standard & Poor's)