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Intel's Buyback Bonanza

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Intel’s announcement on Nov. 10 that it would buy back up to $25 billion in shares of its own stock caused a ripple of excitement among investors who favor the buyback strategy. This large vote of self-confidence by the board of directors at Intel, the world’s dominant chipmaker, would represent the repurchase of about 16% of the company’s shares outstanding (without accounting for dilution from options).

David Fried recommended Home Depot to *Forbes* readers last month at $38. It now trades above $42.50. Click here for other retailers to buy now from the Buyback Letter.

That’s a large chunk of the $150 billion market capitalization for one of the world’s biggest companies, and is therefore a momentous statement for Intel (nasdaq: INTC - news - people) to make. It is certainly among the biggest buybacks in recent memory. No doubt you remember the other super-size announcement in July 2004 when **Microsoft** (nasdaq: MSFT - news - people) said it planned to buy back $30 billion in stock during the next four years. At the time, that represented about 10% of Microsoft’s shares outstanding.

A buyback the size of Intel’s doesn’t come around very often, and when it does, it bears serious consideration.

As the editor and publisher of the Buyback Letter, the only investment newsletter devoted to finding investment opportunities among companies that repurchase their own stock, I salute Intel Chief Executive **Paul Otellini** for returning record amounts of cash to stockholders through one of the largest share buyback programs of any company. It’s music to my ears, plus there’s a lot to like about Intel:

***** It’s the market leader in chips, and it’s always good to buy the dominant player.

***** The concurrent announcement that the company will increase its quarterly dividend from 8 cents per share to 10 cents per share makes it even more attractive. A 25% dividend increase is a meaningful amount. Think about it: A 40-cent yearly dividend on a $25 stock gives you about a 1.6% yield. That, plus an additional 10%-12% share of earnings you will reap as the share count declines because of the buyback (taking into account dilution) makes this a noteworthy plan.

***** Earnings are strong. In the third quarter, Intel posted a $2 billion profit (32 cents per share), compared with $1.91 billion (30 cents per share) in the same time frame a year ago. Sales increased 18% to $9.96 billion, from $8.47 billion a year ago. CEO Otellini said investments in research and development have resulted in three years of double-digit revenue growth.

***** Even if it means nothing else, this colossal buyback and dividend windfall indicates the company is loaded with cash. In fact, at the end of the third quarter, Intel reported it had $11.95 billion in cash and short-term investments. That’s a good problem to have.

***** Intel has a robust buyback history. This plan continues a program started in 1990, and during those 15 years it has bought about 2.5 billion shares for nearly $50 billion. This year, Intel reported it purchased more than 300 million shares for about $7.5 billion in the first three quarters, compared with $7.5 billion in buybacks for all of 2004.

***** Sometimes a buyback announcement by a company is all smoke and mirrors, and the company either never follows through or has issued so many stock options that even though it is buying back, so many new shares are being created that the process is a wash. This is often the case with high-tech companies. Not so for Intel, whose shares have declined 4.6% in the last 12 months.

We don't own Intel--yet--in any of our six portfolios, but it will be eligible for inclusion in our five-stock Buyback Dogs portfolio as soon as one of the current position holders stops buying back. Our Buyback Dogs portfolio follows the "Dogs of the Dow" strategy, which, as you probably know, invests in the ten stocks with the highest dividend yields in the 30-stock Dow Jones Industrial Average. Investing in them is a contrarian strategy based on selecting the ten most out-of-favor Dow stocks. Why are they out of favor? Because dividend yield--the annual dividend divided by the stock price--is the measurement used to determine the ten most beaten-up stocks. Stocks that have a high dividend yield compared to other Dow stocks usually do so because the company is out of favor and the price is depressed. So you simply buy and hold those ten canines for a year and then select the ten new mutts when the new year rolls around.

Our five-stock Buyback Dogs portfolio adds another important factor into the metric. In addition to a high dividend yield and a low price relative to the market, we look for Dogs that are also buying back substantial amounts of their own stock. Our current Buyback Dogs include **Home Depot** (nyse: HD - news - people), **American Express** (nyse: AXP - news - people), **Wal-Mart** (nyse: WMT - news - people), **IBM** (nyse: IBM - news - people) and **Exxon Mobil** (nyse: XOM - news - people). When one of them veers away from the buyback strategy, we'll consider Intel as a replacement.

Intel's buyback announcement follows a course set by many other U.S. companies, which have been buying back stock at a torrid pace this year. Repurchases by companies in the Standard & Poor's 500 Index totaled some $197 billion in 2004 and are set to blast that record off the map this year since by the half-year point they had already bought back $163 million.

Anytime a company wants to increase shareholder value by using excess cash to reduce share count, we're in favor. Intel is part of a very big buyback club this year, and we're all in favor of the initiation rules.

David Fried is editor and publisher of the Buyback Letter and the Buyback Letter Premium Edition. Click here to learn more about Fried's premium portfolio.