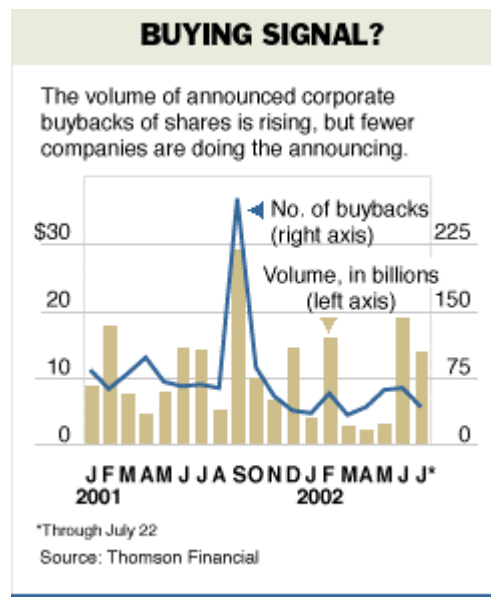


Increase in Share Buybacks Sends Investors Mixed Signs

By Ken Brown
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As the stock market has tumbled these past two weeks, dozens of companies have shouted to the world that they believe their stocks are cheap by announcing share buybacks. But investors desperate for signs that the market has hit bottom should view these announcements with caution.

Until recently, stock-buyback announcements have lagged far behind last year's pace as companies hoarded their cash and polished their balance sheets. But after easing to its slowest rate in seven years, announcements of share repurchases so far this year have reached \$60.8 billion, just 12% lower than last year's total repurchases of \$69 billion.

The pace of announcements has accelerated in recent weeks as companies have announced second-quarter earnings. Since July 1, companies have said they would buy back \$14 billion of their own shares, compared with \$8.4 billion in the year-earlier period. It isn't unusual for companies to announce buybacks when they post their earnings, because buybacks reduce shares outstanding and boost earnings per share, which is good news for investors. Yet even though the buyback pace has picked up, investors can't relax. Fewer companies have announced the actions -- only 332, compared with 491 this time last year -- says Thomson Financial.

That means the announcements are bigger, so they are likely to be coming from larger, healthier companies. Indeed, many of the biggest buyback announcements have been made by companies that are producing reasonable, if not great, earnings numbers, including Citigroup Inc., Home Depot Inc. and PepsiCo Inc.

"It's certainly encouraging that companies are doing it, but as an analyst or investor it's important to look at it on a case-by-case basis," said Richard Bernstein, Merrill Lynch's bearish market strategist.

The good news, however, is that this means many of these big companies, which have been reluctant to spend for the last year or so, are beginning to feel confident again. "This sort of activity is a gauge of the level of internal comfort that corporations have," said Lou Crandall, chief economist at Wrightson Associates, a bond-market research firm that tracks buybacks. That confidence could extend to more spending on things such as computers or new buildings, and it could be a precursor to a rebound in earnings, which would put the market on more solid ground.

So say the optimists.

Others caution that investors can't draw conclusions from the buyback announcements, in part because companies don't always follow through by actually buying the shares. There was a flurry of buyback announcements right after the 1987 market crash, but most of those never happened, said Rick Escherisch, who tracks buybacks at J.P. Morgan Securities.

"What will be interesting to see is whether these announcements are similar to those in the 1987 crash, which were to reassure the market, but the companies really didn't follow through on them," Mr. Escherisch said. Dozens of companies announced buybacks in the days after the crash, but fewer than half followed through on their promises, in part because the market bounced back relatively quickly.

Despite the lack of follow-through after the 1987 crash, Mr. Escherisch's research shows that between 80% and 95% of companies eventually fulfill their promises. But few companies ever announce they have completed a buyback, and most launch a new one before the last one is done, so it's nearly impossible to keep score, he said.

Buyback skeptics warn that just because a company is buying its own shares doesn't mean it is making a sound investment decision. After all, the reason investors buy a stock is because they think the company's management can provide a better return on their dollar than they can get elsewhere. So by buying back its stock, the company is saying that it has looked at all of its operations and come to the conclusion that buying back its stock is the single best use of its cash. The company is also making a bet on the market, which isn't generally the expertise of corporate executives.

It's unclear how good those bets have been. According to research by Morgan Stanley, many big companies cost their shareholders hundreds of millions by buying back stock at high prices during the stock-market bubble. Shares of [Intel Corp.](#), [Bristol-Myers Squibb Co.](#) and [Sun Microsystems Inc.](#) are well below the prices at which they bought significant amounts of stock back in 2000. Sun, the maker of computer servers whose share price has sunk 94% since its peak in 2000 and 47% in the last quarter alone, bought \$226 million of its own stock this past quarter, although it had slowed its purchases significantly in the preceding two quarters as its stock was slumping.

"We're looking at this as an investment, and [as] the best way to use our cash," said Steve McGowan, the company's chief financial officer.

Other companies have better track records. For example [Philip Morris Cos.](#), [Washington Mutual Inc.](#) and [PepsiCo](#) have made investors billions by buying their shares when the price was down.

"Are companies good at signaling whether their shares are over- or undervalued? It's pretty mixed," said John Leonard, head of U.S. equities at UBS Global Asset Management.

Many technology companies such as [Microsoft Corp.](#) are frequently in the market buying shares to offset dilution caused by options. Microsoft said last week that it has bought nearly

\$4.8 billion of its own stock in the second quarter, one of the largest buybacks in recent quarters. The company has about 802 million employee stock options outstanding, out of about 5.36 billion total shares.

"We felt it was a good opportunity to take a big step in our antidilution activity," Microsoft Chief Financial Officer John Connors said last week.

The problem with such buying at many companies, the Morgan Stanley study says, is companies in general are selling low and buying high. In 2001, the average company bought back shares that cost almost three times the price of the options they had doled out.

"We do pay attention to buybacks though it's really hard to draw black-and-white conclusions about them," said Mr. Leonard of UBS.

-- Lisa Bransten and Rebecca Buckman contributed to this article.