Behind the Illusion of Stock Buybacks

INVESTING
GRETCHEN MORGENSON

Stock investors have had one sweet summer. With the Standard & Poor's 500-stock index nearing 2,200, what's not to like?

Here's something. As shares climb, so do the prices companies are paying to repurchase their stock. And the companies doing so are legion. Through July, United States corporations authorized $391 billion in repurchases, according to Birinyi Associates. Although 29 percent below the dollar amount of such programs last year, that's still a big number.

The buyback beat goes on even as complaints intensify. Some critics say that top managers who preside over big stock repurchases are failing at their most basic task: allocating capital so their businesses grow. Even worse, buybacks can be a way for executives to make a company's earnings per share look better because the purchases reduce the amount of stock it has outstanding. And when per-share earnings are a sizable component of executive pay, the motivation to do buybacks only increases.

Of course, companies that conduct major buybacks often contend that the purchases are an optimal use of corporate cash. But William Lazonick, professor of economics at the University of Massachusetts Lowell and co-director of its Center for Industrial Competitiveness, disagrees.

"Executives who get into that mode of thinking no longer have the ability to even think about how to invest in their companies for the long term," he said. "Companies that grow to be big and productive can be more productive, but they have to be reinvesting."

One of the best arguments against stock repurchases is that they offer only a one-time gain while investing intelligently in a company's operations can generate years of returns. This is the view of Robert L. Colby, a retired investment professional and developer of Corequity, an equity valuation service.

"The simplest way to evaluate a company's asset allocation decisions over the years is to see whether its net profit growth is close to its earnings-per-share growth," Mr. Colby said. "Unlike an investment in the business, share buybacks have no effect on net profit and there is no compounding in future years."

A repurchasing binge may be a cause of low business investment.

Mr. Colby has developed an illuminating analysis that identifies a crucial difference between many truly successful companies and their underperforming counterparts. The exercise highlights the growth mirage buybacks have on earnings-per-share measures and shows that returns on investment need not be large to generate growth rates exceeding the evanescent earnings-per-share gains associated with buybacks.

In his test, Mr. Colby compared net profit growth and earnings-per-share gains at pairs of companies in the same industries from 2008 through 2015. In each case, he contrasted a company that bought back loads of shares during the period with another that did not. One case study examined Cracker Barrel Old Country Store and Jack in the Box, two restaurant chains. Cracker Barrel bought back $160 million worth of shares over the period while Jack in the Box repurchased $1.2 billion, reducing its share count by 37 percent.

Cracker Barrel passed the net profit test ably: Its growth in earnings per share was 13.6 percent a year while its net income grew at a virtually identical 14 percent.

Jack in the Box made quite a contrast. Its annual earnings per share rose by 6 percent, but its net profit declined by 0.5 percent a year. To bring its net profit to the level of growth it showed in per-share earnings, Mr. Colby said, Jack in the Box would have had to generate after-tax returns of only 4.8 percent on the $1.2 billion it spent buying back shares. That doesn't seem insurmountable.

Linda Wallace, a spokeswoman for Jack in the Box, said the company generated significant cash flow, "which our shareholders have told us they prefer to be returned to them." She added that the average price the company paid to buy back its stock was just under $37 a share, well below the Aug. 18 closing price of $98.78.

Investors may be dazzled by the earnings-per-share gains that buybacks can achieve, but who really wants to own a company in the process of liquidating itself?

KENDRICK BRINSON FOR THE NEW YORK TIMES

STUDENT AID SHIFT
Students seeking financial aid in college may now apply on Oct. 1. The University of California, Los Angeles.

Earlier Date for Filing College Aid Form

YOUR MONEY
ANN CARRNS

College-bound students should be aware of a new date that's important for future financial aid: Oct. 1.

That's the date after which students can file the Fafsa, or Free Application for Federal Student Aid. The form is used to calculate how much students and their families must contribute to the cost of college, and how much help they will get in the form of grants, scholarships and loans. Students seeking financial aid must file the form each year.

In the past, students had to wait until Jan. 1 to file. But in an effort to align the financial aid process with the typical college admissions cycle, the federal Education Department moved the initial filing date three months earlier. The department also changed the rules to allow students to complete the form using older financial information. (Students filing for the 2017-18 academic year will use 2015 tax data.) Previously, the form that was available on Jan. 1 used income from the tax year that had just ended. Students filing the form early this year, for instance, had to use 2015 income tax data.

That presented a problem, however, because most people do not have the necessary information, like wage statements, to file their tax returns in early January. Instead, they had to file Fafsa forms using estimated income data and remember to revise the form after they filed their tax return. That often meant the form was selected for "verification," which requires submitting extra documents, said Mark Kantrowitz, a financial-aid expert. The alternative was simply to file later and risk missing out on aid.

The main benefit of that change is that many more students can use the Internal Revenue Service's Data Retrieval Tool, which automatically fills in the online Fafsa form with the necessary tax information, said Lauren Asher, president of the Institute for College Access and Success. "This really does simplify the aid process."

Colleges are notifying students of the new date.

One question is whether colleges will change their own financial aid application deadlines. Some are reportedly moving up their "priority" financial aid application deadlines to November or December. That could put students in a time crunch in the fall, said Carrie Warick, director of partnerships and policy at the National College Access Network, which promotes college education for low-income students.

"At some institutions, if you miss a the priority deadline, there may be little to no aid after," Ms. Warick said.

The network, she said, is urging colleges to set their aid application deadlines no earlier than Feb. 1.

Q & A

¶ Does the change mean I must file the form by Oct. 1?
No. The Fafsa form becomes available on Oct. 1, and you can file when you're ready — although it's still wise to file as soon as you can, Mr. Kantrowitz said.

¶ I filed a Fafsa form this spring. Should I file it again?
Yes, if you're seeking aid for the 2017-18 academic year. Because of the filing date change, students may actually file two separate Fafsa forms this calendar year, one that they already completed, for 2016-17 and a second one, which can be filed starting in October, for the following academic year.

¶ How do I use the I.R.S. Data Retrieval Tool?
The online Fafsa form has a link that will allow you to use the tool.

Jackpots, and Losses, Rise

STRATEGIES
JEFF SOMMER

If you've noticed that colossal lottery winnings are becoming almost common, it's no accident. Four of the 10 biggest jackpots in United States history have occurred in 2016. That's thrilling if you are the rare winner.

But whether it's a good thing for millions of other people who play lottery games is questionable.

What is immediately evident, though, is that the high frequency of enormous jackpots results from skillful planning, says Salil Mehta, an independent statistician. "This was deliberate," Mr. Mehta says. "The jackpots are growing very rapidly, and at a certain point when the jackpot rises into the hundreds of millions of dollars, there is a buzz, and people start betting much more."

Consider that on July 30, an unidentified person in New Hampshire won a $487 million Powerball jackpot. We've also seen jackpots of $429 million, $536 million and $1.586 billion. That's according to a tally kept by Mr. Mehta.

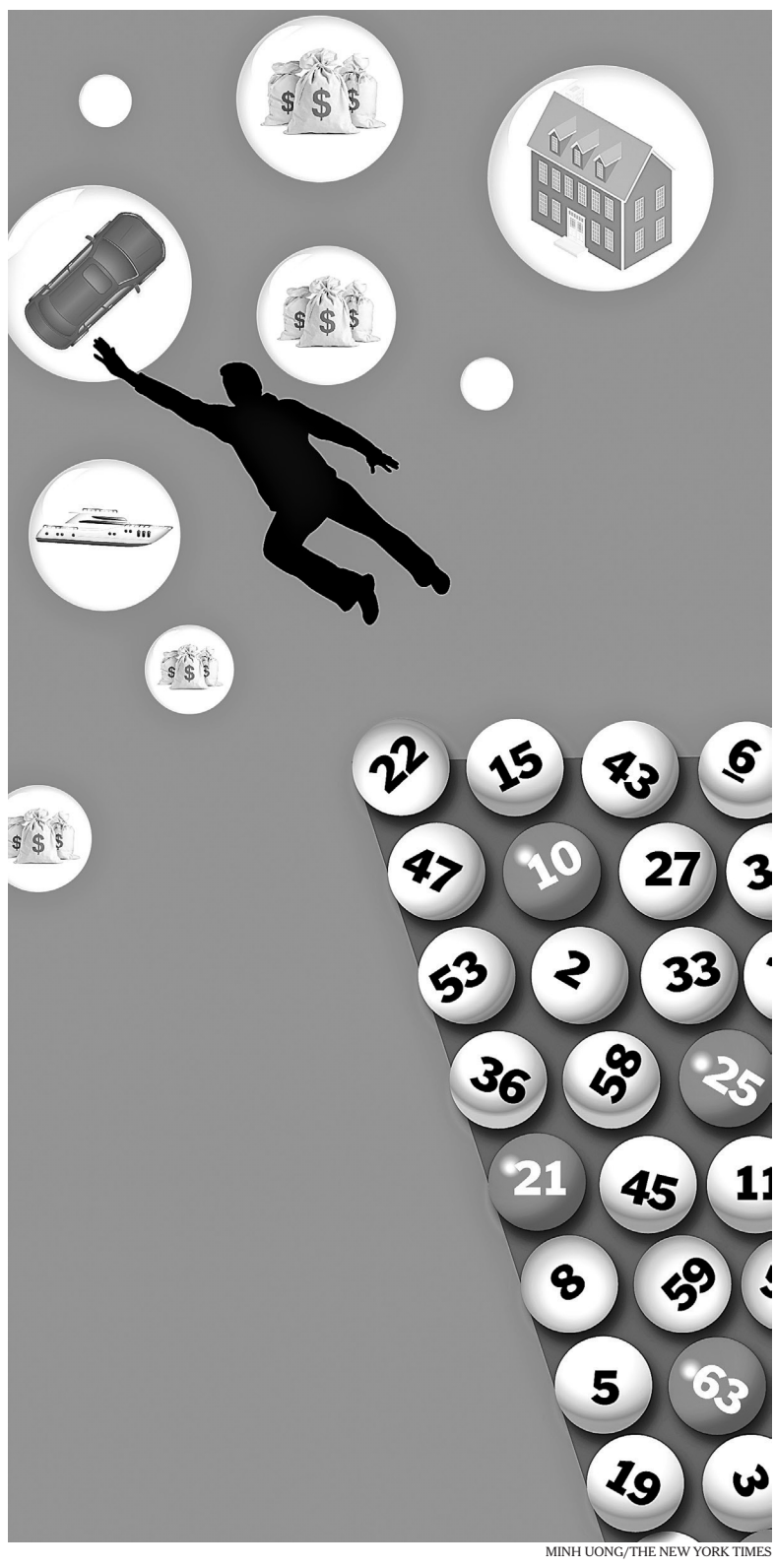
He says that the rapid buildup of enormous prizes resulted from redesigns of the two big multistate government-sponsored lotteries: Mega Millions in 2013 and Powerball in 2015. The idea was to stimulate gambling and increase revenue for state governments after the financial crisis. It worked. Overall sales of state-run lottery games increased to $73.9 billion last year, according to the North American Association of State and Provincial Lotteries, from $70.1 billion the previous year.

Those gigantic jackpots set people dreaming. But Mr. Mehta persuaded me to crunch the numbers to see what effects they are having on people who buy tickets regularly. The results are troubling.

Consider that for state-run lotteries as a whole, only about 60 cents of every dollar goes back to ticket buyers in the form of winnings, an analysis of Census Bureau data shows. The flip side is that in the long run, players as a group lose about 40 percent of the money they put into the lottery.

For the July 30 Powerball drawing, for example, the lottery sold roughly 74 million tickets. In addition to the $487 million jackpot winner, lottery statistics show that one ticket won $2 million. Other people won money too, but they didn't win much: Just under 4 percent of tickets — fewer than one in 25 — produced any winnings. And for 78 percent of those winning tickets, the prize was $4. For more than 96 percent of tickets, though, you kissed your money goodbye.

How much are people losing at state-run lottery games? For some, it's $10 or $20 a year. But for the millions of regular lottery players, it's a different story. I estimate, very roughly, that as many as 50 million are swallowing net losses that average $1,000 a year.



MINH UONG/THE NEW YORK TIMES

That's a lot of money for a lot of people, and over a lifetime it could make the difference between a comfortable retirement and utter penury. In fact, if you were to invest that money in a diversified mutual fund every year from the age of 20 until 65, and it returned 5 percent annually, you would have a nest egg of about $150,000. These numbers don't take into account the impact on poorer people, who truly cannot afford to forgo such sums of money.

I'm not a puritan. I have no problem with gambling as a form of entertainment. But the government ought to be doing no harm to its citizens, yet it appears to be promoting and benefiting from activities that are surely harming the life prospects of many people.

It's true, lottery revenue may help the government finance education and other programs. Yet policy levers could be used in other ways. Local and state governments could instead engage in aggressive and creative marketing schemes that would actually improve our odds of attaining a decent financial future.

You Have Permission To Make a Big Change

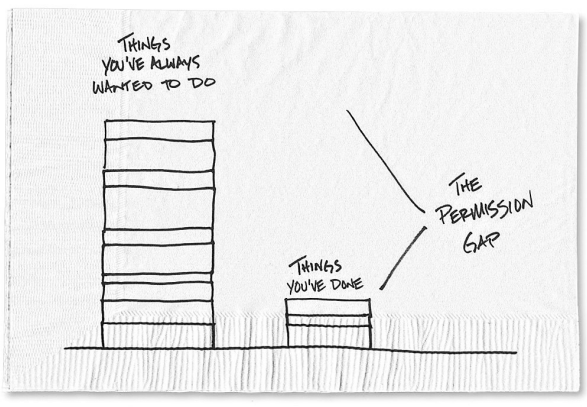
SKETCH GUY
CARL RICHARDS

Next month, my family and I will board a plane for New Zealand. Not for a vacation — but to live and work for the next 12 months or so. It's something I've always wanted to do.

Big changes are terrifying. But that doesn't mean you shouldn't make them.

My family's choice aligns with a simple theory of the economist and co-author of "Freakonomics," Steven D. Levitt: People who aren't sure about uprooting their lives probably should. "As a basic rule of thumb, people are too cautious when it comes to making a change," he told a reporter for The Atlantic.

To test his theory, Mr. Levitt asked participants who were undecided about a major decision to flip a virtual coin. Heads, they go ahead with the change. Tails, things stay the same. Based on the results of tossing over 20,000 virtual coins, the study found that people were happier after making a major change, whether they did it because the coin forced their hand or because they decided on their own.



CARL RICHARDS

Knowing this, you would think that my own life-changing move would become much easier. But it hasn't. And the reason is the voice inside my head that keeps screaming at me. "People just don't do this sort of thing," it yells. "Name one person you know that's done this," it demands.

What the little voice is doing is something that I bet many people can relate to. He's looking for permission. My biggest fears right now are not dealing with the bureaucratic nightmares of moving to a new country.

My big concern has to do with my right to do this. When it comes to making a big life change, approval can be hard to find. People expect you to stay the course. And if you get bogged down looking for that affirmation to make a change, you may never make it.

To me, the most interesting part of Mr. Levitt's experiment was that a simple coin toss was permission enough. Perhaps it doesn't matter where the permission comes from.

Well, you know what? I hereby proclaim myself the president of permission granting. And by all of the power vested in me, I grant everyone who reads this column the permission to do that thing. Whatever it is, you now have permission to do it.