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Equity Investments

Not All Buybacks Are Created Equal: The Case of Accelerated Stock Repurchases

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Abstract

The authors documented the characteristics and market performance of ASR (accelerated share repurchase) stock. They found that post-announcement ASR stock performance is poor, unlike that documented in the literature for other repurchase methods, which implies that ASRs do not signal undervaluation, a frequently suggested motivation for repurchases.

A new and growing practice in which companies repurchase their own shares has been adopted by businesses as diverse as Home Depot, HP, and Dollar Tree Stores. Rather than use the traditional methods of open-market repurchase (OMR) or self-tender offer ("tender offer"), each of these companies used an approach known as an accelerated share repurchase (ASR). This repurchase strategy differs from a traditional share repurchase in that it enables the acquiring company to accumulate shares quickly.

In our study, we addressed three issues. First, we characterized ASRs and the companies that announced them. Then we assessed how ASRs differ from the prevalent alternative methods (OMRs and tender offers). Finally, we assessed the benefits and costs associated with the selection of ASRs over alternative methods. In this analysis, we evaluated the market performance of ASR-announcing companies and compared their performance with that of companies that selected other repurchase methods.

Our findings suggest that since their initial use in 2004, both the number and volume of ASRs have grown dramatically, reaching a total dollar value of \$42 billion in 2007. Investment banks commit to complete an ASR within a limited period of time that averages approximately six months. ASRs are generally very large repurchases and tend to be announced by relatively large companies. The average ASR size is about \$570 million, and the average market capitalization of an announcing company is \$12.5 billion. On average, ASRs involve 5.3 percent of the repurchasing company's outstanding shares, a percentage close to what is documented for OMR programs.

We reached several conclusions about how ASRs differ from OMRs and tender offers. We found that ASRs—like regular OMR programs (and unlike tender offer repurchases)—are preceded by a decline in the company's market-based rate of return. Yet, ASR announcements generate small (about 1.2 percent) but positive and statistically significant returns. These returns are smaller than the announcement returns documented in the literature for other repurchase methods. Several studies have documented significant positive long-run cumulative abnormal returns (CARs) after OMR and tender offer announcements. Surprisingly, we found that post-announcement performance of ASR stocks is poor (about -8.6 percent for the nine months following the announcement). When we repeated the analysis with a four-factor model, we found that the average CAR is less negative but is still significant at the 5 percent level. The poor post-announcement performance is robust. Naive returns and returns net of the market return are also negative. This result is very different from that documented in the finance literature for other forms of repurchase. Interestingly, we found that the majority of ASR announcements (85 percent) are accelerations of existing OMR programs. We also found some supporting evidence that companies engage in ASRs to avoid inflation in the number of shares originating from accelerated employee and management compensation in the form of stock and options.

Our interpretation of the relatively low announcement returns and the poor post-announcement performance is that unlike OMRs and tender offers, ASRs do not signal

undervaluation. Our findings suggest that the market recognizes that ASRs are different from other repurchase methods and greets them with a lower announcement return. But this explanation does not account for the full extent of the negative news. Over the long run, this information is revealed and the stock price declines.

Our findings also suggest that an ASR's main advantage is in allowing the company to obtain the shares much more quickly than in an OMR program, yet without paying the premium required in a tender offer. One possible motivation for obtaining the shares quickly is the desire to boost the company's EPS. Our analysis showed that a relatively large number of ASRs are announced in the second and third months of the fiscal quarter, consistent with a motivation to affect EPS. We also found that the quarterly growth rate for the number of shares outstanding doubles after ASRs, which suggests that companies might be using ASRs to offset accelerated inflation in the number of shares outstanding that results from management stock and option compensation plans.

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