

Workshop for “Metrics” to Analyze Stock Buybacks

The report of Forum plans for a program to analyze a stock buyback case example¹ has stimulated discussions among experts about what should be measured. Since professional interest in the analytical issues that have been raised has justified unexpected levels of attention, we are establishing a special “workshop” project to present views of alternatives for your consideration.

The current plan is to offer presentations of workshop members during the next couple of weeks on the following two subjects, and to invite all Forum participants to comment on their views. (According to standard Forum policy, comments can of course be provided either anonymously or for attribution, and for reporting either privately to the workshop member or publicly to all Forum participants.)

1. ***Comparing returns from capital used to repurchase stock with returns from capital used to produce goods and services*** – Most analyses of buyback programs focus on overly simple calculations of only the immediate EPS result of an investment in reducing the number of shares outstanding, compared with an alternative rate of return from investment in the corporate enterprise (addressed in #2, below). These calculations typically do not account for the cumulative effects of capital that is invested in business operations to generate future profits, which create more capital for reinvestment.²
2. ***Basic measure of returns on corporate capital*** – There have always been healthy debates among corporate finance and investment professionals about the best way to measure returns on investments in a business enterprise, but recent discussions have revealed a surprising range of competing definitions.³ The Forum is of course committed to encouraging the consideration and testing of different investor views, including these views relating to returns, but we will necessarily have to settle upon a single definition of performance measurement as a foundation for our program’s consistent comparisons of buyback and corporate reinvestment alternatives.

It should be understood that the workshop’s objectives will be limited to developing definitions of these two basic measurements that all Forum participants can use in their analyses of alternatives for the use of corporate capital. To be reliable for our purposes, though, these measurements must be consistent with the measurements used by a company’s plant manager in a proposal for capital expenditures on new production equipment, as well as with the broad range of analyses that may be conducted to support the corporate board and investor decisions to

¹ See the [March 18, 2016 Forum Report: Inviting Proposals of Candidates for Analysis of Stock Buyback Policies](#) and [March 25, 2016 New York Times | Fair Game: "In Yahoo, Another Example of the Buyback Mirage."](#)

² An analytical framework for a “Net Profit Test” has been developed by Robert L. Colby, founder of the institutional research firm [Corequity Valuations](#), to show the rate of return from reinvestment in business operations that would be required to match the EPS results from the same amount of investment in stock repurchases. Mr. Colby has granted permission to present a draft of his report using this analysis for review by Forum participants: [“30 Stocks with significant buybacks between 2008 and 2015.”](#)

³ For a summary of basic differences, see [May 3, 2016 Wall Street Journal: "The Hottest Metric in Finance: ROIC."](#)

allocate that capital for the plant manager's use in producing goods. The scope of these more extensive applications has been summarized by Stephen O'Byrne of Shareholder Value Associates in a presentation for discussion of his professional views with other workshop members:⁴

Operating performance measurement has two key objectives:

- *Increasing shareholder value, which means that performance measures need to tie to discounted cash flow value.*
- *Isolating and rewarding management contribution to value, which means that performance measures need to be decomposed into the component due to management and the component due to industry factors.*

Please let me know if you want to participate in this workshop project, or if you have any suggestions of experts whose views should be invited. I will in any event continue to welcome your questions and comments on these or any other issues relating to the planned program, including suggestions of case candidates to be considered when we resolve the analytical issues.

GL – May 9, 2016

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⁴ See slide page 52 of [May 7, 2016, Stephen F. O'Byrne of Shareholder Value Advisors: "Improving Operating Performance Measurement: Linking to Discounted Cash Flow Value & Isolating Management's Contribution to Value."](#)