

Numbers Game

When companies make stock buybacks, they call them investments. When the investments bomb, they call in accountants.

Losses? What losses?

By Penelope Wang

LAST SEPTEMBER, Hospital Corp. of America, fresh with cash from the sale of 103 acute-care facilities, decided to invest a portion of the proceeds in some of its own stock. Its board authorized a buyback of 12 million shares at \$47 a share. HCA has spent \$564 million to repurchase about 12 million shares, but after Black Monday the stock plunged. By year's end the shares stood at only 31½. So is HCA now out \$190.5 million on its investment?

Common sense would answer with a resounding yes. But beyond common sense lurks the logic of accounting, and according to current accounting principles HCA didn't lose a penny on the buyback. Moreover, that's exactly what the company's annual report will reflect.

Call it the no-risk investment, a key reason buybacks have become the with-it new way to deploy shareholder money. In this era of stock market volatility, no other use of money of-

fers firms the same opportunity to tell shareholders that they have made a terrific investment—without ever having to own up to the bad news if it turns sour. Says John Tighe, partner at the accounting firm of Deloitte Haskins & Sells, "You'd have to be a pretty sophisticated investor to figure out that a company lost money on its own stock."

Many of the 1,500 corporations that authorized buybacks in 1987 have since seen their stock prices drop below the purchase price. But investors won't see those losses in the financial statements. Why not? Because a 1938 securities rule, which effectively prevents firms from speculating in their own corporate stock, requires repurchased shares to be held as treasury stock or retired.

To account for a buyback, either the company's assets get reduced or its debt load gets raised by an amount equivalent to the cash used (or borrowed) to pay for the deal. Doing so reduces corporate equity. But the shares that are acquired in the process

also disappear. "You're simply closing out a transaction that began when you issued the securities," says Peter Knutson, associate professor of accounting at the Wharton School. "There are no further losses to write down."

It's a different story when a company buys stock in another firm. Then, the corporation usually counts its equity holdings as long-term assets. If the stock goes down, those assets must be marked to market at the end of each reporting period. Moreover, if there are significant losses in that item, the firm must disclose the loss, often in a footnote. In 1986 the Williams Cos. lost \$239.7 million, mainly because of a writedown of its long-term investments.

As a practical matter, the only real advantage arising from a buyback is to reduce the number of shares outstanding in the market. One reason for wanting to do so might be to help guard against a hostile takeover. That's what GenCorp., an aerospace concern, had in mind last spring when it paid \$1.6 billion to acquire 12.5 million shares from the public at \$130 a share, only to see the stock price eventually decline to 22½ by year's end anyway.

Alternatively, the purpose of a buyback might be simply to ginger up the stock. This could occur if a company's business generates more net income than the yield available on T bills, for example, or perhaps short-term certificates of deposit. In that case, earnings per share would go up and (presumably) the stock's price would subsequently rise.

Though buybacks, practically speaking, amount to little more than zero-sum games, such companies as ITT, Kraft and IBM now routinely refer to them instead as "investment opportunities" and "good buys." Says a spokesman for Burlington Industries, "We feel that our stock repurchases are an attractive investment and an excellent opportunity to build shareholder value." Burlington authorized the buyback of up to 5 million shares after the market crash.

And small wonder it did so, since current accounting rules offer so few useful clues that buybacks can just as easily be a waste of money as a clever use of it. Says Jerry Castellini, vice president at Kemper Financial Services: "Anytime you make an investment with corporate assets and lose money, it's a loss to shareholders and poor use of corporate capital." Shouldn't accounting rules reveal this important truth, rather than help obscure it? ■

Seven buyback losers

Company	Date buyback anncd	Price on day before anncd	Shares bought back (millions)	Dec. 31 price	"Losses" (millions)
Allied-Signal	9/25†	44½	27.4	28½	\$289.3
ITT	4/7	63	8.0	45	40.0
Hospital Corp of Amer	9/17	47††	12.0	31½	190.5
Kraft	10/1	57½	2.8	48	26.0‡
IBM	2/24†	144½	19.0**	116½	288.9**
GenCorp	4/6	130††	12.5	22½	1,118.8
Merck	7/28	184½	5.7	158½	94.4

*Based on latest reported purchase price. †Several buyback plans in effect. ††Self-tender. ‡Estimate.
**Includes 1986 repurchases.