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Corporate piggy banks are bursting

Share buybacks fuel debate over what to do with all that cash

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A rash of recently announced share buyback programs has heated up debate over what North American companies should do with the mountains of cash gathering dust in their bank accounts, dubbed "dead money" by Bank of Canada governor Mark Carney.

Due to economic uncertainty, Canadian companies have $526 billion in cash reserves, according to Statistics Canada. The amount held by United States companies varies from Federal Reserve reports of $1.7 trillion, to Internal Revenue Services estimates of $5.3 trillion, including all worldwide cash and cash equivalents. Apple alone has $74 billion sitting in its piggy bank.

In Canada, Suncor Energy said that it will buy back $1 billion of its own shares, in addition to the $1.5 billion it just repurchased and cancelled. PetroBakken Energy, plus Petrobank Energy and Resources, also announced buybacks. In the U.S., sportswear maker Nike approved an upcoming $8 billion share buyback over four years, after its current $5 billion buyback concludes.

Companies with extra cash can face three options. Governments usually prefer that firms spend the money on growth to boost the economy, investors often want dividend increases that put money in their jeans, and the corporations themselves frequently favour share buybacks that allow them flexibility.

"To me it's a companyspecific thing," said David Salloum, portfolio manager with RBC Dominion Securities in Edmonton. "If it's a stock that's more noted as a dividend payer than a grower, then you're probably going to up the dividend. But if it's a growth-oriented company, then I would rather they use the money to grow more."

Politicians usually want firms to spend available cash to expand their companies, either internally by starting new projects and hiring more employees, or externally by adding other companies through mergers and acquisitions.

"Looking forward to a multiyear decision, even political decisions in the U.S. will have implications here," Salloum said. "If I was a company, I would be reluctant to open a plant in the U.S. or Europe."

Microsoft is perhaps most notorious for plowing cash into growth. It was formed in 1975, taken public in 1986 and didn't start paying a dividend until 2004.

Investors generally prefer dividend increases or special dividends, but corporations often worry about sustaining dividends if business turns ugly. The closure of most income trusts, the volatility of equity markets and historically low bond yields have all combined to cause investors to jump into dividend-paying equities.

"Companies that are paying dividends are typically good at making investment decisions and good at allocating capital, aware that the market expects that dividend to continue," said Juliette John, portfolio manager with Bissett at Franklin Templeton Investments.

Based in Calgary, John is comanager of the Bissett Canadian Dividend Fund, whose top holdings are Bank of Nova Scotia, TransCanada Corp., Canadian Imperial Bank of

Commerce, Thomson Reuters and BCE Inc.

"Ultimately, the dividend needs to be secure, so we don't have the absolutely highestyielding dividend securities out there. But because usually they are also reinvesting back into the business, they're likely to get dividend growth.

"The Canadian banks have had good earnings and dividend growth, but it's going to be challenging for their valuations to expand given that their global peers are under pressure."

She has added to holdings in Crescent Point Energy and merchandiser North West Company, while reducing her weight in telecommunications after a good run-up. She's expecting opportunities with natural gas producers and is waiting to see if life insurers return to prosperity or if they continue to be weighed down by equity and bond market investments.

The third possible use of cash, share buybacks, is often used by companies because they can be curtailed if business drops off.

"In theory, there are fewer shares out there, so if they make as much or more money, either they should compensate you with a higher dividend or the share price should go up because there are less shares to spread the profit over," Salloum said. "But that doesn't always happen either, if the pipeline springs a leak or Nike runners cause people to slip and break their ankles."

How to deploy cash best could depend on timing. Suncor often spends cash to start new projects, but went with another share buyback due to stock market volatility and soaring labour costs.

A few years ago, famed investor Warren Buffett said he prefers that companies use cash to grow the business. But when his Berkshire Hathaway announced a share buyback this spring, he said he favours that route if a company has "ample funds to take care of operation and liquidity needs," and if its stock "is selling at a material discount to the intrinsic business value." He said you're better off if a stock price doesn't jump until after the buyback is completed at lower prices.

Buffett added that whether you spend cash on acquisitions or share repurchases, "what is smart at one price is dumb at another."

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