3 Stocks About to Aggressively Buy Back Shares

Description

When an excellent business announces a share buyback program, investors should pay attention. In an old letter to shareholders, Warren Buffet said that companies in comfortable financial positions, and with shares trading at reasonable valuations, could find no action more beneficial to shareholders than buying back shares.

The reasoning is simple—rather than spending money on an acquisition that often involves paying a premium, buying back shares at a discount allows a company to reduce its share count, increasing the earnings per share for an often lower cost than acquisitions or even re-investing in the business.

Buybacks can also indicate a very strong underlying business. A company won't buy back shares unless it has plenty of excess cash flow and a strong balance sheet.

This is why investors should consider **Magna International Inc.** (TSX:MG)(NYSE:MGA), **Potash Corporation of Saskatchewan Inc.** (TSX:POT)(NYSE:POT) and **Canadian National Railway Company** (TSX:CNR)(NYSE:CNI). All three businesses are in a position to buy back large amounts of shares at reasonable values.

Magna management has committed to restarting share buybacks

In 2014, auto-parts supplier Magna spent a huge $1.7 billion buying back shares, but so far in 2015 it has been fairly inactive. This is because the company has been busy with several transactions, including the $2 billion acquisition of transmission manufacturer Getrag.

The company is expected to now move aggressively on buybacks, however, and the reasoning is simple. In 2016, Magna is expected to have about $1.1 billion in free cash flow, and about $1.5 billion this year. The company only pays out about a quarter of its free cash flow in dividends, leaving it with plenty of spare cash.

Although Magna has yet to pay for its $2 billion Getrag purchase, the company is sitting on $1.1 billion in cash, and is expecting another $675 million or so from the sale of various businesses during the year. Since the company plans to use debt and cash to pay for Getrag, Magna will have leftover cash on its balance sheet on top of the great amount of cash it plans to generate in 2016.

In a recent conference call, Magna management stated that they want to increase their net debt from 1.2 times earnings before income, taxes, depreciation, and amortization (EBITDA), to 1.5 times EBITDA. Magna stated they will do this by repurchasing shares, which means spending the excess cash on their balance sheet and a larger portion of free cash flow going forward.

Just how much will Magna spend on buybacks? Analysts at RBC are forecasting a 28 million share buyback in 2016 alone, about $1.5 billion, with potential to do more.

Potash Corp. has plenty of free cash flow to start buybacks

Potash Corp. is in a similar position to Magna. The company embarked on a massive capital expansion program back in 2003 that will see about $8.4 billion spent in total by the time the projects are complete in 2016. This means Potash Corp.'s capital expenses will drop and its cash flow will rise. This means plenty of free cash flow.

In 2016, the company is expected to produce about $1.6 billion in free cash flow. The company currently spends about $1.2 billion on the dividend, leaving $400 million annually remaining. The company is currently sitting on $500 million of cash, and is also considering divesting its equity stakes in SQM and Israel Chemicals, which could yield cash proceeds of $3 billion.

Potash Corp. has a history of repurchasing shares, and now that they have withdrawn their bid for K+S, and the share price is at a multi-year low, analysts think buybacks are likely.

CN Rail will likely renew their current buyback program

CN currently has an annual share repurchase program running until the end of October 2015, and the company had spent $833 million on it at the end of Q2 2015. CN has been completing regular buybacks since 2000, and there is no reason for this to stop.

The company has been generating around $2 billion of annual free cash flow, with a similar number expected in 2015 and 2016. Even factoring in the expected increases to the dividend payout ratio, CN will have between $600-800 million to spend annually on buybacks. The company's diversified business model, growth outlook, and industry-leading low-operating costs will generate growing free cash flow to support ongoing buybacks.

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1. NYSE:CNI (Canadian National Railway Company)
2. NYSE:MGA (Magna International Inc.)
3. TSX:CNR (Canadian National Railway Company)

4. TSX:MG (Magna International Inc.)

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amancini