These 2 TSX Stocks Handle Buybacks the Right Way

Description

First Asset Canadian Buyback Index ETF's (TSX:FBE) research has found that stock buybacks rather than dividends are the more tax-efficient way for companies to return cash to shareholders who are holding those shares in taxable investment accounts.

That seems plausible enough.

Unfortunately, many companies do a poor job with stock buybacks, choosing to buy when share prices are nearing their highs rather than their lows. So, while they might be a more tax-efficient method of rewarding shareholders (non-registered accounts only), they're often one of the worst capital-allocation levers a CEO can pull.

Alimentation Couche-Tard (TSX:ATD.B) could buy back $1 billion of its stock at all-time highs, or it could pay down $1 billion in long-term debt. If I asked you which option you would prefer, I would hope that your answer, 10 times out of 10, would be the latter.

Remember Warren Buffett's credo: buy great companies at fair prices. All-time highs aren't necessarily what I would call fair.

There are, however, companies that do a better-than-mediocre job of buying back stock, and those companies are to be commended by shareholders.

First Asset has 40 holdings. I believe two of them handle buybacks the right way.

What's the right way?

It's simply a company's ability to buy back its stock in any given year at less than the midpoint between the high for a 12-month period and the low. For example, if a company's stock traded in 2015 at a high of $100 on October 31 and a low of $50 on July 2, and the average price it paid during 2015 was less than $75, it did it the right way. If it paid an average of $80, it did it the wrong way.

Canadian Pacific Railway Limited (TSX:CP)(NYSE:CP) is the First Asset ETF's ninth-biggest holding at a 2.62% weighting. In 2015 it repurchased 13.5 million of its shares at an average price of $202.79. Its stock traded at a high for the year of $245.05; its low was $168.12; and its midpoint was $206.59.

By my standard, Canadian Pacific Railway did it the right way in 2015. The really good ones do it right every year, but those are few and far between.

Onex Corporation (TSX:OCX) is FBE's 12th-biggest holding with a 2.39% weighting. It's not entirely unexpected that a private equity firm of Onex's stature would be better than average at share buybacks.

In 2015, Onex repurchased 3.1 million of its shares at an average price of $70.32. Its stock traded at a high of $87.86 in 2015 and a low of $64.30 for a midpoint of $76.08. Onex management was able to pick up its stock for 7.6% less than the midpoint, 580 basis points better than Canadian Pacific's efforts.

Bottom line

It was hard to find any companies, let alone two, that are handling buybacks the right way.

Most of the large caps held by FBE are simply doing enough share repurchases to maintain their share count. Very few, in my opinion, appear to be doing it to actually reduce the share count, as is the ETF's mandate.

Canadian Pacific and Onex stand out among the crowd.

CATEGORY

1. Investing

TICKERS GLOBAL

1. NYSE:CP (Canadian Pacific Railway)
2. TSX:CP (Canadian Pacific Railway)
3. TSX:ONEX (Onex Corporation)

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