1 Canadian Growth Stock Uses Stock Buybacks to Help Drive High Returns

Description

Occasionally, **TSX** stocks perform normal course issuer bids (NCIB), a fancy term for stock buybacks. These stock buybacks must be approved in advance by the stock exchange, which allows for buybacks of up to 5-10% in a given period.

Share buyback programs are a double-edged sword. It makes perfect sense for a company to buy back its shares when the respective stock is undervalued. This would create value for long-term shareholders who would own a larger piece of the business if the shares were cancelled.

Repurchased shares are turned into treasury shares which can be cancelled or be reissued in the future. If cancelled, the shares are retired and the company's outstanding shares reduce, increasing the company pie for existing shareholders.

The company could also reissue the treasury shares through employee compensation or an equity offering. Ideally, in such an equity offering, the company would be selling the shares at a higher price than what it purchased them for. This is a good way for companies to raise capital to fund growth.

Assuming shares were bought back at good valuations for a growing business, it would be more tax efficient than receiving cash dividends for long-term shareholders. That's because cash dividends are taxed unless investors' shares are held in tax-advantaged accounts like TFSAs, RRSPs, RDSPs, or RESPs. The buyback would boost earnings and cash flow on a per-share basis, which drives price appreciation.

Unfortunately, many businesses find themselves to be cash rich in booming economic environments when their stocks could be trading at high valuations. So, many companies end up buying back shares at expensive prices, which destroys shareholder value. Similarly, they're often strapped for cash during poor economic environments. Consequently, they have no excess cash to make share buybacks when their stocks are cheap.

One Canadian growth stock doing stock buybacks correctly

Brookfield Asset Management (TSX:BAM.A)(NYSE:BAM) is a rare Canadian growth stock that has been buying back its shares (and those of its publicly traded subsidiaries) at attractive valuations.

For example, last year, during the pandemic market crash, it repurchased US$270 million worth of shares. Additionally, together with its subsidiary, **Brookfield Property Partners**, BAM bought back US$561 million worth of BPY shares from Q1 to Q3 2020 for an average price of US$11.67 per unit. Today, those shares trade more than 50% higher. Notably, they generate substantial cash distributions, as BPY maintained its dividend throughout. The price per share of US$11.67 implies a yield on cost of close to 11.4%!

BAM benefits from being a global asset manager that has a keen eye for value. Its management knows when its stocks are cheap and is very well capitalized to buy back shares where it makes the most sense across its subsidiaries.

Some investors prefer investing in Brookfield Asset Management's subsidiaries, for which most provide high yields. Investing across its subsidiaries gives rise to more opportunities for investors to buy on the cheap, as they tend to sell off independently at different time frames.

Alternatively, to keep it simple, other investors would consider solely investing in BAM stock whenever it's attractively valued and let the proven management do its mojo, creating long-term shareholder value.

In the past 10 years, BAM stock four times investors' money, delivering total returns of about 16% per year on the TSX. During the period, it also increased its dividend at 8% per year on average.

Currently, BAM yields 1.1% and analysts believe it's undervalued by approximately 17%, providing a decent buying opportunity.

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Date
2025/09/14
Date Created
2021/05/15
Author
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