

**Stock Repurchases in Canada:
Performance and Strategic Trading**

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ABSTRACT

During the 1980s, U.S. firms that announced stock repurchase programs earned favorable long-run returns. Recently, concerns have been raised regarding the robustness of these findings. This comes at a time of explosive worldwide growth in the adoption of repurchase programs. This study provides out-of-sample evidence for 1,060 Canadian repurchase programs announced between 1989 and 1997. As in the U.S., the Canadian stock market seems to discount the information contained in repurchase announcements. Value stocks announcing repurchase programs have particularly favorable returns. Canadian law requires companies to report how many shares they repurchase on a monthly basis. We find that managers are sensitive to mispricing as completion rates are higher in cases where undervaluation may be a more important factor. Moreover, trades are linked to price movements; managers buy more shares when prices fall and reduce their buying when prices rise.

1. Introduction

In recent years, corporations have dramatically increased the amount of capital devoted to repurchasing their own shares. In the mid-1980s, repurchase program announcements in the U.S. amounted to roughly \$25 billion per year. Between 1996 and 1998 however, more than 4,000 open market repurchase programs were announced which, if fully completed, amount to roughly \$550 billion.¹ During the first quarter of 1999 alone, Securities Data Company reports nearly 350 program announcements totalling \$40 billion. Interest in corporate repurchase programs is not limited to the U.S. as repurchase activity worldwide has grown in recent years. Countries such as Hong Kong and Japan recently implemented new regulations allowing companies for the first time to repurchase their shares. A recent Goldman Sachs study (March 1999) foresees stock repurchases becoming more common in Europe and discusses the potential impact on European equity values.

The literature is rich with motives as to why firms might repurchase their own stock. The list includes, for example, tax benefits, distributing excess cash and adjusting capital structure. Yet these reasons are not as popular with managers who often suggest when announcing buyback programs that current market prices are too low and hence their stock is an attractive investment (Dann (1983) and Wansley, Lane, and Sarkar (1989)). Several studies report evidence consistent with this managerial story of undervaluation. In a comprehensive examination of U.S. open market repurchase programs during the 1980s, Ikenberry, Lakonishok and Vermaelen (1995) find that the market's initial response to repurchase announcements is not complete. They report annualized abnormal performance of 2.9% over a four-year period following the announcement. For value stocks, where a stronger case can be made for undervaluation, the annual abnormal return was 6.4% over the same post-announcement period.²

¹ For comparison, the NYSE reports that aggregate cash dividends paid by member firms over this period was approximately \$490 billion.

² In an earlier paper on fixed-price tender offer repurchases, Lakonishok and Vermaelen (1990) also find evidence of positive abnormal returns lasting at least two years following the announcement.