Permanent Share Buybacks: IBM's Path To Sustainable Wealth Creation

When Warren Buffett interviewed at CNBC last week, he mentioned that one of the reasons why he purchased such a large block of IBM shares— $10 billion dollars worth!—was because he was impressed by their relentless dividend growth and share buyback program. Because I hadn't been terribly familiar with IBM's history of share repurchases, I thought it was worth taking a look at how effective IBM has been at reducing its share count over the medium-to-long term.

In 1995, IBM had 2.1 billion shares outstanding. At the present time, IBM has slightly under 1.2 billion shares outstanding. In effect, IBM has been able to cut its share count in half over the past sixteen years, and this means that each share of IBM represents twice the earnings power per share than it would have otherwise since 1995.

I've included a chart that shows how IBM has steadily reduced its share count since 1995, and I have been impressed by the management team's tenacity in reducing the share count year in and year out. But unfortunately, the company hasn't been perfect in reducing its share count—for instance, IBM bought back 8.73% of its shares in 2007 when the Dow Jones Industrial Index was trading at its all-time high, but only purchased 3.43% of its shares in 2008 when the market hit its low. As a potential shareholder in IBM, you would like to see those numbers reversed—IBM buying more stock when the share prices are low and offer more value, and buying less when the prices are trading at artificial highs.

Year	IBM Shares Outstanding (	% Reduction
1995	2.188	n/a
1996	2.031	7.70%
1997	1.936	4.90%
1998	1.851	4.59%
1999	1.804	2.60%
2000	1.762	2.38%
2001	1.723	2.26%
2002	1.722	0.01%
2003	1.694	1.65%
2004	1.645	2.97%
2005	1.574	4.51%
2006	1.506	4.51%
2007	1.385	8.73%
2008	1.339	3.43%
2009	1.305	2.60%
2010	1.228	6.27%
2011	1.185	3.62%

But still, there is something impressive about a company that relentlessly reduces its share count every year (although 2002's share count reduction was less than a rounding error).

For investors wondering what to expect in the short-to-medium term with IBM's buyback, I think it's worthwhile to take a look at the Forbes press release from the company on October 25th:

"IBM this morning said its board has approved a $7 billion increase in its stock repurchase program, boosting the total available authorization to $12.2 billion. 'IBM's higher value, higher margin business strategy has enabled the return of over $109 billion since 2003 to our shareholders through share repurchases and dividends,’ CEO Sam Palmisano said in a statement. ‘Shareholders can expect that as IBM enters its second century we will continue to invest in new products and services, while expanding IBM’s business into new, emerging markets.’”

IBM is currently trading at $181 per share, and if the company used up its available authorization to purchase $12.2 billion worth of available shares, they would be able to retire 67 million shares from the market. Since there are just under 1.2 billion shares outstanding, IBM’s current repurchase plan would take 5.58% of the shares off the market.

It’s hard to tell just how good of a deal this is for investors—IBM has climbed 28% so far this year, making it the best achiever in the Dow Jones Industrial Average in 2011. Investors would be much, much better off if the repurchase took place before this spike in the per share price. However, IBM is still only trading at 14.5x earnings, which seems reasonable for a mega-cap tech company of its caliber, and if IBM can meet its stated goal of $25 per share in annual earnings within five years, then the current buyback program might contribute handsomely to the long-term growth that IBM shareholders have come to expect over the past century.