**Stock Buyback Now May Spur a Big Bill Later**

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Buy back now. And maybe pay quite a bit more later.

Public companies are squeezing through another accounting loophole -- and again potentially misleading investors about the possible financial impact. This one involves a complex version of a stock buyback, those popular programs in which companies repurchase their shares and thus boost the important earnings-per-share measure for the stock still outstanding.

But in this variation, known as an "accelerated share repurchase," the company executes its entire buyback at one go, getting an immediate EPS boost -- even though the final cost of the buyback isn't known until later. In some cases, the cost of the buyback ends up being many millions of dollars more than the cost of the stock when the repurchase deal was struck.

ASRs have been around for years but have found new popularity since accounting rule makers in 2003 shut down similar loopholes. At least 30 companies announced buybacks via ASRs in the past year, including [DuPont](http://quotes.wsj.com/DD) Co. [dd -0.74%](http://quotes.wsj.com/DD) , [Northrop Grumman](http://quotes.wsj.com/NOC) Corp. [NOC +0.38%](http://quotes.wsj.com/NOC) , [Sara Lee](http://online.wsj.com/public/quotes/main.html?type=djn&symbol=SLE) Corp. and [Duke Energy](http://quotes.wsj.com/DUK) Corp. [DUK -1.15%](http://quotes.wsj.com/DUK)

Critics contend ASRs amount to a company betting on the future of its own stock. But companies and their bankers say ASRs get the buyback done faster, at a similar cost to a traditional repurchase plan.

Indeed, buyback plans are sometimes viewed cynically by investors who have seen companies announce share repurchases only to dilly-dally on executing them. "The biggest appeal of ASRs is in the signal it sends to the market about the company actually buying the shares and not simply authorizing a potential repurchase," says William Ortner, managing director of corporate equity derivatives at [Citigroup](http://quotes.wsj.com/C) Inc. [c -1.02%](http://quotes.wsj.com/C)

But accounting analysts from [Bear Stearns](http://online.wsj.com/public/quotes/main.html?type=djn&symbol=BSC) Cos. recently sent a report to clients criticizing the accounting rules that govern ASRs. Bear Stearns also warned that the initial per-share earnings gains from these transactions may be "transitory," and said companies using them may be at risk for per-share earnings shortfalls when the full costs of the deals are known.

The Financial Accounting Standards Board, which oversees U.S. accounting rules, "is aware of these issues and has two active projects on its agenda that improve the accounting for these financial instruments," Gerard Carney, a spokesman, said in a statement. Meanwhile, he added, companies are required to disclose details of ASR-type arrangements in footnotes to their financial filings.

As an example, Bear Stearns cited [TXU](http://online.wsj.com/public/quotes/main.html?type=djn&symbol=txu) Corp. , a big Dallas-based energy firm that used an ASR deal to buy back $3.4 billion of its stock in November 2004, giving a boost to its fourth-quarter results that year. But TXU's stock price rose afterward, requiring the company to pay an extra $523 million for the stock during the first half of 2005. The added costs caused TXU to post a per-share loss in 2005's first quarter, even though net income was $421 million.

The extra money TXU had to pay stems from the special deal that ASRs require companies to strike with their bankers. Tim Hogan, director of investor relations at TXU, said the ASR arrangement was "an appropriate thing for our shareholders from a long-term view," adding that the cost would have been the same if TXU gradually had repurchased the shares over that period.

In a traditional buyback program, a company announces a plan to repurchase shares worth a certain dollar value, then buys its stock in the market over time. If the stock gets too expensive or cash-flow circumstances change, the company can stop the buyback.

In an ASR, a company buys all the shares at once from an investment bank, which usually obtains the stock by borrowing it from institutional owners. Thus, the company shaves its shareholding base right then, so its earnings start to look better when divided by the fewer remaining shares.

But there is more to the arrangement. To cover its "short" positions, the investment bank buys back shares in the open market over time to replace those it has borrowed. If the stock price rises while the bank is buying the stock, the company has to compensate it for the difference. This settlement, which is part of a complex forward-sale contract, can be made in cash or shares, and is based on the stock's average price over the buyback period. If the share price falls during the buyback period, then the bank makes a payment to the company.

Critics term ASRs a type of derivative contract. Under accounting rules, many derivatives have to be "marked to market" each quarter, with any gains or losses recorded in the income statement.

This isn't the case with ASRs. Although some of the potential settlement amount is reflected in the earnings-per-share calculation while the ASR contract remains outstanding, accounting rules allow the sum to be excluded from the company's balance sheet and net-income calculation -- in effect creating off-balance-sheet liabilities or assets.

Even when the company makes its final settlement with the investment bank, the sum the company pays or receives doesn't count in figuring net income, but is included in per-share earnings calculations for that quarter.

Janet Pegg, a Bear Stearns accounting analyst, argues that gains and losses from ASR obligations ought to be recorded quarterly in net-income figures. Some companies, mindful of the risks of big share-price movements, have put floors and caps into their ASR agreements to limit the amounts the parties have to pay upon settlement.

Charles Mulford, an accounting professor at Georgia Institute of Technology in Atlanta, says it appears that ASRs are taking advantage of a "shortcoming in GAAP," or generally accepted accounting principles. "My biggest concern is that it creates these off-balance-sheet assets or liabilities that can be quite substantial," he says. "The cynical view is that the whole motive is to get this immediate reduction in shares outstanding to help the next quarter. The problem is, you have the outstanding derivative that doesn't show up anywhere and may come back to bite you."

Consider the example of [Intergraph](http://quotes.wsj.com/INGR) Corp. [INGR +0.09%](http://quotes.wsj.com/INGR) , a Nasdaq-listed software company based in Huntsville, Ala. In March 2005, it repurchased 5.4 million shares from Goldman Sachs Group Inc. in an ASR for a total of $150 million, or $27.74 a share. Because the buyback removed about 16% of the company's outstanding stock, it boosted earnings per share for the rest of 2005.

But since the deal was struck, Intergraph's shares have risen significantly, hitting more than $50 early this year before pulling back some. The stock's rise already caused Intergraph to assume an increase in its outstanding shares in calculating diluted earnings per share, diminishing the buyback's impact. With final settlement scheduled for late this quarter, Intergraph last week said it might have to pay up to $83 million to Goldman in cash or shares when the deal concludes. If the company pays cash, that won't affect net income, but almost certainly would more than wipe out its per-share earnings for the first quarter, and possibly for all of 2006.

Intergraph officials didn't return calls seeking comment. Richard Chu, an analyst at SG Cowen & Co., says some $80 million is "not a trivial sum" for Intergraph, but the substantial share-price rise following the ASR was likely "a favorable outcome for shareholders."

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