
Good Stewards
Rob Scott

The following are the first few pages of “Good Stewards” by Rob Scott

Preface

Not all executives are sinful, evil parasites that plague our publicly traded companies, squandering precious resources upon consumption of millions of minuscule fractions of rewards called stock options and performance shares of stock. Most executives are bequeathed boundless rewards, spoils of gains in alignment with shareholders desires to be made money. Most shareholders do not discern the executive payments to be pillaged from them, those that truly own the resources of the company, from plans conceived by the executives to transfer as much wealth as possible from the shareholders to the executives by expensing cash upon share repurchases. The stock buybacks populate the treasury account, and are doled out to the executives in stock options and performance shares. This is embezzlement, but called legal stealing in jest because no one wants to believe in the nefarious nature of the executives to bleed the entity long enough to sustain its parasitic existence before it is detected, just to be replaced by another leech.

Just like the anesthetic saliva excreted onto the host to prevent pain during its process of feeding, so that the host does not detect them, so too does an executive provide a false sense of security that everything is the way that it is supposed to be. Executives consume seventy-five percent of compensation provided to employees, while the rest of us live off the scraps of what is left over from their debaucherous feast. In America there are 3,671 companies listed in the stock exchanges, called public companies, and 2,233 of them buy back shares of stock to do among other things to compensate their executives. It was not a lot at first, before 1999 it was very rare for a company to repurchase stock. But after 2010, it became an annual contest to see what company would announce the largest plans to spend the shareholders' cash on what was to become the largest compensation grab of all times, creating a despondent stock market during the time of the most unprecedented profit growth.

Not all executives commandeered all available cash to buy back stock. But many did. From 2011 to 2017 the executives of publicly traded companies spent a large portion of all available profits and cash upon repurchasing shares:

YEAR	COMPANIES	SPENT (Billions)
2011	394	$ 389.00
2012	489	$ 442.00
2013	606	$ 679.00
2014	696	$ 519.00
2015	731	$ 790.00
2016	564	$ 373.00
2017	534	$ 393.00

Over the course of seven years 2,233 companies spent $3.6 trillion of cash to repurchase shares of stock. It takes billions of dollars to buy back millions of shares. The same shares that the executives took as stock options and performance shares from the shareholders' treasury accounts. Well, if you ask the executives they were given to them, but they can't deny they didn't take them.

But what would have happened if they never did that? What if the cash was returned to the shareholders balance sheets now? What would the companies be worth today? Without saying all 2,233 cases were incorrect, what would a sampling of egregiously bad companies making repurchases have been valued if the cash was still in the balance sheets today?

Sample Size	: 136 companies
Market Cap at repurchase	: $3.8 trillion
Market Cap presently	: $4.8 trillion
Market Cap if shares never repurchased	: $25 trillion

What if these results were extrapolated out to 3,671 publicly traded companies?

YEAR	Stock Market Cap (Trillions)
2011	$15.64
2012	$18.67
2013	$24.08
2014	$26.33
2015	$25.07
2016	$27.35
2017	$32.12

The US Stock Market Capitalization would be $104 trillion.

The moral of the story is that over the past seven years, $3.6 trillion of cash from publicly traded companies was squandered upon stock repurchases to dole out stock options and performance shares to executives preventing $72 trillion in value from materializing.

Could have, would have - should have. It is all water under a bridge, right? But what can be done about it now?

Chapter 1: **Purpose**

"For to whom much is given, much more will be required"
-Luke 12:48

As the story goes, a master of servants is going away upon a long trip. To one servant he entrusted five bags of gold, to another he entrusted two bags and to the third he entrusted one bag of gold, each according to his own ability. The first servant put the money to work and gained five more bags of gold, the second servant did the same and garnered two more bags of gold. But the third servant buried his bag of gold. He did not attempt to use it make a profit for the master nor to risk any of it for fear he may lose some or all of it. Upon the master's return he thanked the servants for their profits accomplished but the third servant was scolded for not trying to do anything beneficial with the entrusted bag of gold.

In today's day and age, Hedge Funds are the servants entrusted with five bags of gold. They are the fewest controlling the most amount of money. Only they do not double profits each time they are entrusted with money or deposits, rather they tend to make slightly more than the stock market average returns. They are the preferred investment vehicle of the United States' truly rich. Those with millions and billions to invest entrust their wealth to the Hedge Fund managers to make them more.

Hedge Funds, for the most part, operate under the premise that executive management is correct in extracting 75% of compensation from a company while the 99% of employees live off the remaining 25% of compensation. But what would happen to their investments if they simply flipped the compensation arrangement?

Hedge Funds have latent power, a lot of it, mostly untapped and the Hedge Fund managers are largely ignorant of it. A few hundred Hedge Funds control a few trillion dollars in market wealth. Most of the managers of these funds choose to do nothing with that power. They do not make changes to executive structures nor change nor influence the way compensation is distributed among companies they hold in trust within their Hedge Funds.

Everybody answers to someone, always. Shareholders elect a board of directors who in turn hire executives to manage the corporation. If a Hedge Fund owns a large percentage of the corporation, then the board of directors and the executives therein are subject to the wishes of the Hedge Fund. Most of the time, a few Hedge Funds will collectively own upwards of 50% of the outstanding shares of a major corporation. But many times the Hedge Fund owns entire corporations within their portfolio of holdings. In these cases everything the Hedge Fund wants, it gets.

For the most part, cash and debt are the two primary measurables that determine the value of a company. Cash in the absence of debt allows for maximum valuation based on multiples of earnings. For a typical manufacturer twenty times earnings with a substantial amount of debt is an acceptable valuation. Pay off debt and multiples of forty or fifty times earnings are feasible. Cash is so important to valuation that it should be conserved as much as possible. However, it is not generally conserved. Rather it is expensed by the billions to buy back shares annually. If debt is paid off and cash is maximized, then the valuation of the company is generally at its peak.

Why do most publicly traded companies expense cash so irresponsibly to buy back shares, pay outrageous bonus and executive salaries? Because those with the power and authority to address these problems choose not to do anything about it.

Chapter 2: Cash Is King

What a company has left over after all the bills are paid, after the employees are paid, and after the debt is serviced is profit, measured in cash. If there is a little bit of it, the stock is worth a few dollars a share. If there is a lot of it, the shares are worth hundreds of dollars more. Executives commandeer as much cash as possible to the benefit of themselves. They award themselves the largest amounts of stock options ever heard of, millions of shares, which cost the company billions of dollars to repurchase into the treasury account. This is done year after year, billions of dollars of cash expensed in this manner over and over again. The outstanding shares are not reduced permanently, just recycled by the executives over and over. Stock buybacks are a temporary solution that ultimately enriches the executives and has no effect for the shareholder than just embezzled cash from the company.

Stock buybacks were designed to compensate the executives by aligning their goals with the shareholder goals. If the stock appreciates in value beyond the strike price of the stock option, the executive is entitled to sell the share and collect the difference. The problem is that the cash used to buy that share came from the shareholders. So that earnings per share are not changed, the shareholder has to buy another share to remain even. Every time an executive exercises a stock option, two shares have to exist, one pre-exchange and one post-exchange.

"It's legal stealing" states a prominent Hedge Fund manager which asked to remain anonymous, "If it is legal then it is not embezzlement".

The shareholders should beg to differ. An example of this chronic problem is seen within share repurchases by IBM. Over the last seven years (2011-2017) an average of $9 billion of cash was expensed every year, a total of $64 billion or $70.00 per share of cash. Meanwhile the price of a share of IBM fell from

2011 ($160.00) to $138.00. Had the executives not spent the cash, and simply held it in the balance sheet, a share of IBM today would be worth $739.00 per share.

In total, over seven years, 40% of profits were expensed as cash upon share repurchases, $3.6 trillion dollars squandered upon stock options for a net loss of $41 billion dollars in stock market value but a true loss to shareholders of $72 trillion in profits foregone upon wasted cash.

Chapter 3: Debt is Slavery

Debt is a necessary evil of corporate expansion and progress to build larger production, distribution, supply chains and to finance inventory. However corporate executives view debt much differently. They view it as leverage, the ability to borrow at less than cost to maximize a gain and increase a profit by borrowed multiples. If an executive had his complete way, he would borrow debt to buy back stock and reap the difference between the share price and the strike price. In this manner, the executive would largely enslave the shareholders. Not to say it is not already being done. Many large corporations sell bonds and improve their cash position just to buy back more stock with the cash. In this manner the debt is buying back shares of stock enslaving the shareholders to the practice of issuing billions of dollars of debt to repurchase stock. Had the company not sold the debt, the cash would not have materialized and the billions of dollars of shares would not have been purchased, propping up the price of the stock with artificial demand. It is when demand slows or stops for a stock that prices decline to entice more buyers to come in and prop up a stock price. The system the executives have created keeps enough artificial demand upon the stock markets to keep prices stabilized. But it could be so much better.

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