

# **Do Firms Knowingly Repurchase Undervalued Shares?**

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Comments Welcome

## **Abstract**

One reason managers mention for repurchasing stock is a perception that their shares are “undervalued.” We reexamine the role of undervaluation in open market repurchase programs by incorporating concurrent insider trades. Using a comprehensive sample of repurchase programs, support for the undervaluation hypothesis is mixed. Prior to a program announcement, insiders increase their purchase activity. Moreover, repurchase firms where insiders are also buying shares show better long-run performance in comparison to cases where insiders are selling. However inconsistencies arise when attention is focused on “value” stocks. While the relative proportion of buying to selling activity is greater in value stocks, long-run performance does not materially differ between cases where managers are buying versus selling. To the extent that insiders reveal their optimism or pessimism through their personal trading behavior, this evidence questions the degree to which managers knowingly repurchase shares because of undervaluation. Interestingly, analogous evidence is reported using equity offerings where the results also are not entirely consistent with managers knowingly issuing overvalued equity.

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