Taking Stock: Dow lacks wow

by Malcolm Berko

Dear Mr. Berko: In mid-2000 I bought 72 shares of Dow Chemical at about $40 a share for about $3,000 (was this company really started by a Mr. Dow?). And as you recommended, I reinvested all the dividends and now have 91.335 shares of Dow Chemical trading about $43. I am disappointed that the stock has not done better especially considering that the market has done so well in the past four or five years. The stock is now trading just about two points less than what I paid for my original 72 shares. Do you think I should sell my Dow Chemical and invest in another stock that has better potential? Or should I continue to hold Dow Chemical and be patient? And if you think I should buy more Dow Chemical I have about $2,500 that I could invest for my Individual Retirement Account this year.

E.R.

Joliet, Ill.

Dear E.R.: Yes, it was founded by Mr. Dow! In 1898 Herbert H. Dow built the commercial bleach manufacturing facility in the U.S.

Today Dow is nothing like the company Herbie built. Dow makes some of the most important stinky chemicals, plastic, surfactants, polycarbonates, films, solvents, latexes, monomers, natural gas liquids, sodas, resins and epoxies allowed to exist in the cosmos. And there are some of these stinky chemicals in everything we touch: from the bristles on your toothbrush, to the jumbo jets that land at Kennedy, to the bed in which you sleep, to your baby's play toys, to missiles shot from an F-14.

While Dow's earnings and revenues have doubled since 2000, the shares have yet to exceed their high price of $47.60 of seven years ago. In fact, share appreciation over the next few years looks about as exciting as watching a Japanese Kabuki dance. Earnings for this year are expected to come in at $4.15 versus $4.25 for 2006 while 2007 revenues will probably grow less than 2 percent to $49.8 billion. In fact, during the coming years Value Line, Morningstar, Merrill Lynch and Credit Suisse figure Dow's revenues will be flat as pizza crust and that net profit margins will decline from their recent 14.5 percent to 13 percent by 2010-2011. The $1.50 dividend (may be raised to $1.60 soon) provides an attractive 3.5 percent yield, which may be among the few positive comments I can make about your 91.335 shares of Dow.

Dow's blue-blood management at its Midland, Mich., home port are a few eggs short of a dozen. I'm disappointed that these highfalutin fellas who reside in richly furbished, imposing executive offices, can't generate enough enthusiasm to nudge Dow shares higher. I'm also disappointed that Dow's highly compensated and sweetly perked board of directors placidly condones this seedy stock performance. A board of directors is supposed to encourage shareholder's value not preserve executive suite sinecures. So "boo" on those bums, too.

Dow's 8.8 percent revenue growth is much lower than the industry average, gross margins are almost half the industry average of 26.1 percent and Dow is less profitable than its peers. So perhaps it's time for a collective emetic of the Dow leadership, the cost of which would gladly be borne by most shareholders. Competitors like Bayer, Total, BASF and DuPont have superior numbers a result of evidently better management.

But I recommend that you continue to hold your 91.335 shares of Dow even though share price, revenues and earnings are stuck in a rut and the muck. Because Dow is vulnerable, poorly managed and trades at lower multiples than its peers I'm hearing whispered gossip of a private equity buyout. No doubt management will be happy to glad-hand scores of millions of dollars to Wall Streets advisers, who like sharks, segue into a "greeding" frenzy when they smell blood. And the backroom wheeling and deal making between Dow management and private bankers is probably in process as you read this. So if Dow is bought by a consortium of filthy rich bankers, you have a potential gain of 16 to 18 points, making your initial purchase quite profitable.

The company has almost $10 billion in earnings and cash flow; attractive green to placate the covert rulers of the world - Blackstone Capital, Kohlberg, Kravis & Roberts and the Carlyle Group. The share price I'm hearing from an acquaintance, a regulator for the New York "Schlock" Exchange, is between $59 and $61 a share. And considering the source of this information I'd say that $60 is an accurate number.

I can't tell you this is a fait accompli. It could be a year before it happens but I feel strongly enough about my source to recommend that you purchase 59 more shares and increase your total to 150 shares. There's a 60 percent degree of probability that my source is accurate and an average 17-point gain in share price represents a 40 percent return on your investment. However if I'm wrong there's little downside peril from the current price so the low risk may be worth the potentially high reward.

Please address your financial questions to Malcolm Berko, P.O. Box 1416, Boca Raton, FL 33429 or e-mail him at malber@adelphia.net.