Taking Stock: Sara Lee gets its just desserts

by Malcolm Berko

Dear Mr. Berko: My son recently joined Sara Lee Corp. in Downers Grove, Ill., and he is very excited about his new responsibilities. And to show his faith in his new employer he bought 150 shares of the stock. I bought 100 shares way back in 1999 at $24 and still have the stock. I'd consider buying another 100 shares but since it reduced its dividend I'm not sure if I should because I'm an income/growth investor. Please give me your opinion on this company and please advise me if it is a good issue to buy for a possible increase in its dividend and for growth. I know the company has many popular products but I can't afford to gamble and I need to be very careful with money.

H.T.

Aurora, Ill.

Dear HT: Yes, I'm familiar with Sara Lee. One must marvel how a corporation with 2004 revenues of $20 billion and earning of $1.59 could post expected 2007 revenues of $11.75 billion, earning of 60 cents then crash its dividend by 50 percent. One must wonder how a company with brands like Jimmy Dean, Hillshire Farms, Ball Park Hot Dogs, Earthgrains plus superb specialty meats, toothsome baked goods, numerous popular coffee brands, beverages and household/personal care products in every grocery and convenience store could perform so dastardly. And one must wonder how a company with many consecutive years of revenue, earnings and dividend growth could ignominiously crash from $32 a share eight years ago to an embarrassingly $17.05 today.

Sara Lee Corp. (SLE-$17.05) recognized that there were too many cooks in its kitchens and that that recipe was creating a disaster. So management decided to sell its non-core assets (eight businesses including Haines Brands and Playtex), which added about $3 billion in cash to its balance sheet. Meanwhile, SLE's net profit margins began falling like of bombs from World War II B-17s while return on capital and return on equity have been slowly collapsing into two huge bomb craters. And SLE's management recently but reluctantly reported a $62 million loss on higher revenues.

I think SLE will be a long time in getting back to the $24 price where you bought the stock in 2004. The company has superb products and excellent shelf space in supermarkets like Kroger, Safeway, Great Atlantic & Pacific, Albertsons, Publix and King Super. Its many brands rank among the top sellers in their categories. So what's the problem?

Well, in one simple word: management. Apparently this inutile rabble couldn't pour water from the toe of a boot if the instructions were printed on the heel. And SLE's board of directors must be spanked for allowing this feeble performance to continue. Certainly one must wonder about management's commitment as well as the board's commitment to the company. Together, doddering management and a feckless board of directors own less than one-half of 1 percent of the common stock. That's not a show of confidence in the future of Sara Lee, rather an indication that demonstrates their lack of confidence in the future.

The current price represents a good floor and the share probably won't fall below the $16 level but I don't see any compelling reason for the shares to move higher. If SLE can earn 60 cents this year (which is the Street's projection), that equates to a price-earnings ratio of 31 times earnings, which is well above its average P/E of 16 during the past nine years.

Meanwhile, I wish your son enormous success. If he's got lots of talent he may fail because management and the board seem to employ people in their own image.

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