Management vs. Product

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One of the fundamental teachings of investment education is to rely on *management* for success. Yet reliance on *product* instead of management is the path of least resistance for the novice or mediocre investor – and a common pitfall.

Clorox is "an example in reverse" that should get the point across. Since its stock was first offered publicly in May 1968, Biz and Axion with some half dozen other brands of enzyme washing products have been introduced with one of the most massive advertising expenditures in the history of grocery products.

The price of Clorox stock went down because many investors jumped to the conclusion that enzymes will replace bleaches. The product-oriented thinking has been exaggerated somewhat by weakness in the general stock market co-incidentally with the enzyme advertising blitz.

Nicholson

Is Clorox an investment opportunity?

Whether interested in making an investment in Clorox or not, a study of the company should brighten your investment skill, smarten you up, and help you deal more effectively in the future with questions of *management* and *product*.

A stock Selection Guide, a Standard & Poor's Listed Stock Report, President R. B. Shetterly's presentation of The Clorox Co. before the Security Analysts of San Francisco on Mar. 11, 1969 are the principal sources of material for this discussion.

The Stock Selection Guide appears on the opposite page, while the talk to the financial analysts may be obtained by writing the company. Every person who is interested in perfecting his investment skills should write for this speech as it is a vivid example of how management deals with problems. Women will find this discussion particularly informative and interesting.

"For investors who are product-oriented, it is important to realize that every product is subject to competition. Review Clorox's steps when enzymes blitzed the bleach market."

For a copy of the speech write:
The Clorox Co.
850 42nd Ave.
Oakland, Cal. 94601

Product

Clorox is the General Motors of the bleach business with about 46 per cent of the market.

"To do a good job of home laundering a housewife must have only two products – a good detergent and a good bleach. Other products play worthwhile supplementary or specialized roles – such as fabric softeners, starches, water conditioners and, now, enzyme products for pre-soaking clothes before washing," Shetterly told the analysts.

Clorox consumption, however, has slowed 5 per cent to 8 per cent since the enzyme blitz began, which compares with 6 per cent to 10 per cent for the industry.

Part of the slowup is because of the impression was planted that enzymes had replaced bleach and part resulted from other causes. According to Shetterly's talk, territories accounting for 90 per cent of Clorox's sales had four or more enzyme product introductions, including free samples to each home to get immediate trial, often one or two follow ups to get repeat trial, and a sustained barrage of "extremely heavy television and printed word advertising." This began around Oct. 1, 1968.

The part of the drop resulting from other causes includes the purchasing habits of the buyers of bleach. Consider the effect of free samples of enzymes against this background: while 40 per cent of American housewives use bleach every week, there are 70 per cent who use bleach in washing machines in the course of a month and nearly 100 per cent use bleach in the course of a year.

According to Shetterly, 50 per cent of all homes in the country have Clorox on hand at any given time, and over 80 per cent of housewives buy Clorox in the course of a year. Nearly every grocery in the country carries Clorox.

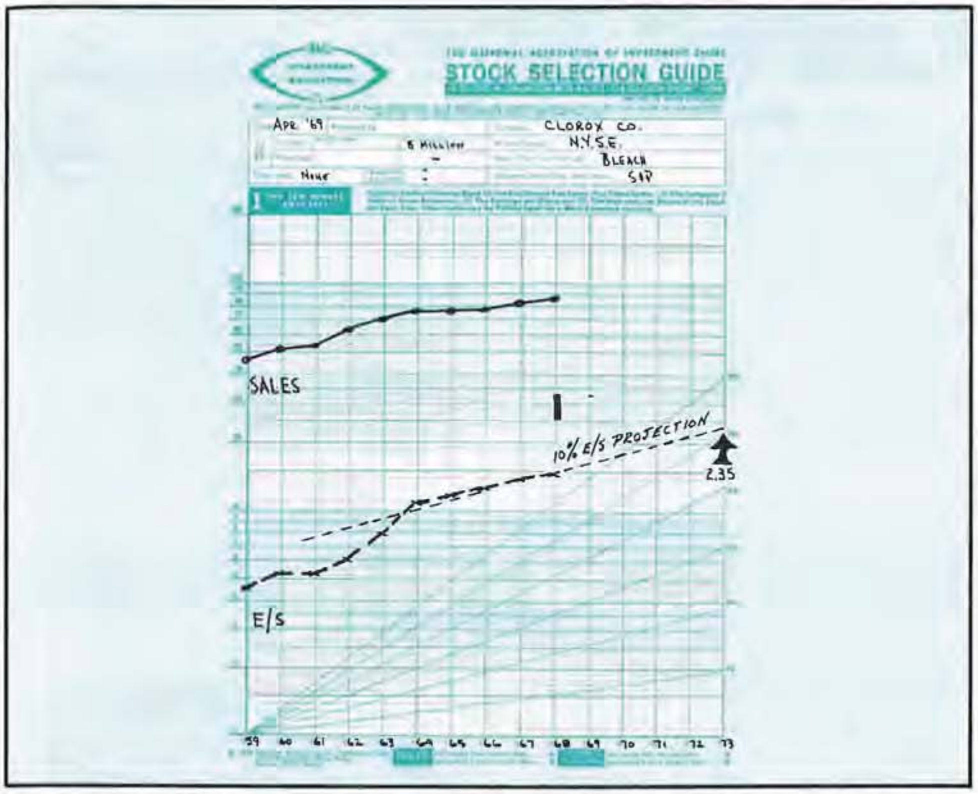
Furthermore he believes that housewives will realize the necessity of using bleach after one to five washings with enzymes. If you listen carefully to the Axion commercial's windup, you will know that good washing is a three-step process of an enzyme soak, a detergent, and a bleach.

Finally, chlorine bleach has other uses such as cleaning, disinfecting, and deodorizing. Homemakers should resume normal purchases in due course.

For investors who are product-oriented, it is important to realize that every product is subject to direct and indirect competition and that for a period of time sales may slump, while the consumer is experimenting elsewhere.

Management

What about management? Is it better to place faith in the quarterback and the team that has to do battle with enzymes or rely entirely



on the product?

Shetterly is 54 years old and graduated from the University of Rochester in 1936. He was employed by Proctor and Gamble in the advertising department and specialized in brand management work, becoming advertising manager of P & G's food product division in 1956 and general manager in 1961.

He was assigned to Clorox in 1965. You can see from the Stock Selection Guide that sales increased regularly under his administration and you can also see the pre-tax profit margins increased to a record in 1968 fiscal year.

How did he respond to heading his own company? Did his imagination and experience speed growth?

As a guide, it is interesting to review Clorox's steps when the enzymes blitz hit the bleach market. First there was a study of the bleach market for the five months beginning Oct. 1, 1968. Total bleach volume consumption was off as previously noted, while Clorox was off less than the industry.

The study also revealed that inventories of bleach had built up and in recent months less bleach has been shipped than was consumed. These studies indicated that Clorox's per cent of industry had risen during that adverse period, showing that management was winning the battle against marginal companies.

Finally, the company's management is preparing the inevitable counter-attack. No doubt housewives will be fully informed on the uses of bleach and enzymes and having 46 per cent of the industry's sales, Clorox has a good chance of increasing its percentage of industry by leading the counter-attack.

The virtues of bleaches such as deodorizing and disinfecting can now be advertised more effectively because of the millions of advertising dollars spent on enzymes. It costs less to de-bunk excessive impressions than to promote a concept.

At this point, would you rather invest in enzymes or management?

Price

The Clorox divestiture by P & G under Federal Trade Commission order came in two steps. The first was an offering of 1,200,000 shares at $27.50 by Goldman Sachs in May 1968. The second was an exchange of 6,400,000 shares of Clorox for 1,721,518 P & G stock tendered by shareholders of that company on Jan. 2, 1969.

The first offering gave an indication of value before enzymes and this was 29 per cent above the current price of 21¼. The high to date was 32¼ in 1968 and the low has been 18 in 1969. The low (18) is significant because it came at the apex of the enzyme blitz and in a period when stocks were weak.

What price should a one-product moderate growth company command? How much higher a price should a one-product company command that intends to introduce a

READERS SAY

Sirs:

As assistant treasurer-agent, I would like to ask some advice regarding the liquidation of our club:

When we liquidate, is there any advantage or disadvantage taxwise to liquidate by distributing the stocks held in the portfolio to the members or should the portfolio be sold and cash distributed?

Also, about half of the present members would like to continue beyond the dissolution date and retain as a base as much of our present portfolio as possible. How could this be done and what is the best way to do it?

R.H.O.
Ravenia, O.

The questions you ask in your letter are asked of us quite frequently. When you liquidate the interest of a member at any time you can, by transferring to the withdrawing member securities in which you have a large profit, eliminate the immediate payment of taxes by the remaining members of the club and you can do this without affecting the tax situation of the member who withdraws. By transferring a stock in which you have a substantial profit to a member who has withdrawn at its current value and at the current value of his acount you are able to settle his account without the sale of a stock and the consequent creation of an immediate tax liability for the remaining members. The member who receives the stock receives the stock not at the club's cost, but at the proportionate cost of his investment in the club. The withdrawing member, if he wishes cash, may immediately sell the stock. If he does not wish cash immediately he may continue to hold the stock without any immediate tax consequence.

Since a substantial number of your members wish to continue in the club, rather than liquidating the whole club your best procedure is to pay off each member who wishes to drop out and continue the club with the remaining members. This will keep the commissions you have to pay on the sale and transfer of securities at a minimum and also will keep your realization of taxable gains to a minimum for the remaining members.

Kresge a Success Story

The *S. S. Kresge* turnaround is already one of the success stories of American business. K-Mart outlets are now the most important part of their operation and new units are opening at a rapid pace. Management plans to continue expansion of the K-Marts which should aid sales.

Litton has been discussed in the Repair Shop in recent months. The club bought the stock while quarterly earnings were decreasing. In my opinion, it is more prudent to wait until earnings return to an upward trend before buying.

I look for additional growth from *Magnavox* although possibly not as rapid as in the past because of a potential slowdown in consumer spending.

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TWENTY-FIVE INVESTMENT CLUB REPORT CARD SUBJECTS	GRADES			
	A	B	C	D
Major Considerations				
Price Paid			X	
Management	X			
Up Side Potential			X	
Secondary Considerations				
Diversification	X			
Defensive Strength				X
Big-Small Company Concept		X		

The lowest mark is in defensive strength and this is primarily because of the high price-earnings ratio stocks in the porfolio. In a declining market, they would be more subject to a correction of price than stocks with lower multiples or dividend protection on the down-side.

HAZARD (From page 10)

Sixty-two per cent *opposed* common stocks as being unsafe and a gamble and another 58 per cent opposed real estate on the grounds that prices were too high.

And that was when banks were paying 2½ per cent and the Dow-Jones Average was selling for about nine times earnings.

Thus I expect that between now and 1980, we are going to get some surprises. I wish I knew what they were.

Is it conceivable that a craze could develop for art, culture and beautifying our cities in the manner of the gold age of Greece? Or a revolt against credit cards and instalment purchases and a wild desire to pay cash? Or could peace break out all over?

Well, what about stocks right now?

A great many stocks are being bought these days, not for their value as investments, but to sell to someone else at a higher price.

Boom Due But Be Careful

All this churning around makes stocks go up and down and gives good opportunities to the nonprofessional who is looking for ultimate value.

One way to operate is the investment club principle to buy regularly every month or at some other interval thus averaging out the cost. Another involves the principle of buying at the low end of the annual price-to-earnings range.

But you have to watch out for a psychological problem here. It's easy enough to avoid buying when the price-to-earnings ratio is at its historic high. But when it is close to its historic low you find yourself saying, "Something must be wrong. Why aren't the big boys buying it?" Actually, the big boys are so busy trying to outguess each other you should disregard them and stick to your program.

We see, then, for the long term, a bigger boom than ever, but watch for unexpected shifts within the economy. For the rest of this year, a collision between fast rising prices and fast contracting credit, outcome in doubt. A good time to shop for bargains in the market but I would say slowly and with caution.

NICHOLSON *on Clorox*

series of new products a year or two hence and is already embarked upon an acquisition program? There is no obvious answer now, but the market should soon spell it out.

A return to the former high would be a gain of 52 per cent. A 100 per cent advance would require 42½. The most impressive factor to me besides management competence is the fact that the management has the opportunity to share in the rewards of creating a quality grocery products company.

Charting

Although sales will be slow in 1969, the growth thereafter should run somewhat ahead of recent years because of new products and acquisitions. The company has just announced plans to merge with Jiffee Chemicals. It is likely that profit margins will tend to narrow and sales gain as the product mix changes.

A growth of 10 per cent compounded, if realized, would be "2.35 in 5 years." The P/E ratio might well continue at about the average for 1968 or 20 times earnings. A price of 47 would result.

The object of the charting at this stage should be to see if the company can improve substantially on the record of the past five years.