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# Utility Stock Offers an Attractive Dividend

By *David Peltier*

▲ **Duke Energy** (DUK) boosted its quarterly dividend June 24, to 23 cents a share. Shareholders at the close of trading Aug. 12 will qualify for the Sept. 16 payment. The energy utility is on track to cover the payout with 72% of expected 2008 earnings of \$1.28 a share.

While this is below my usual threshold for 50% earnings payout, regulated utilities like Duke can generally sustain a dividend that's up to 75% to 80% of earnings. While the company is on track to deliver just 2% year-over-year profit growth in 2008, it will mark the fourth year out of the past five where profits will have improved. I'm also encouraged by the fact that the company's bonds have A ratings from the major agencies.

In addition to about 4 million utility customers in the South and Midwest, the company has about 35,000 megawatts of electric-generating capacity in the Carolinas and Midwest. Duke also has more than 4,000 megawatts of electric generation in Latin America.

This is the type of defensive growth vehicle that I believe readers can use to ride out the current market volatility. With that in mind, Duke Energy looks attractive for its dividend at Thursday's closing price of \$17.45.

▼ **BB&T** (BBT) raised its quarterly dividend to 46 cents a share June 24, and investors at the close of trading July 8 qualified for the Aug. 1 payment. The North Carolina-based bank has increased its payout 37 consecutive years, and the new 8.3% yield can be covered 1.5 times with expected 2008 earnings of \$2.85 a share.

While BB&T has performed better than its peers during the credit crunch, the dividend coverage still falls below my usual threshold of two times earnings. The company's profit is expected to fall 10% this year, marking the second straight annual decline.

This momentum could likely carry into 2009, as even the strongest banks will continue to suffer from declining credit quality. With that in mind, I would not be surprised if BB&T gives a disappointing outlook when it posts second-quarter results July 17.

Even if the payout is safe for the time being, at Thursday's closing price of \$22.53, the stock is down 26.5% year to date -- eliminating the benefit of the dividend. With that in mind, I continue to believe that readers should largely avoid committing new capital to the financial sector.

*(Scorecard appears on the next page)*

## The Dividend Advisor Scorecard

Rating	Company	Yield	New Payment	Former Payment	Freq.	Must-Own Date
<b>Spotlight</b>						
↓	<b>BB&amp;T</b> (BBT:NYSE)	8.3%	\$0.47	\$0.46	Q	7/8
↑	<b>Duke Energy</b> (DUK:NYSE)	5.3%	\$0.23	\$0.22	Q	8/12
<b>Raised Dividends</b>						
↓	<b>Bank of the Ozarks</b> (OZRK:Nasdaq)	3.2%	\$0.13	\$0.12	Q	7/22
↓	<b>BB&amp;T</b> (BBT:NYSE)	8.3%	\$0.47	\$0.46	Q	7/8
↑	<b>Best Buy</b> (BBY:NYSE)	1.4%	\$0.14	\$0.13	Q	10/2
↓	<b>CVS Caremark</b> (CVS:NYSE)	0.7%	\$0.069	\$0.06	Q	7/16
↑	<b>CSX</b> (CSX:NYSE)	1.5%	\$0.22	\$0.18	Q	8/26
↓	<b>Cummins</b> (CMI:NYSE)	1.1%	\$0.175	\$0.125	Q	8/19
↑	<b>Darden Restaurants</b> (DRI:NYSE)	2.6%	\$0.20	\$0.18	Q	7/7
↑	<b>Duke Energy</b> (DUK:NYSE)	5.3%	\$0.23	\$0.22	Q	8/12
↓	<b>General Mills</b> (GIS:NYSE)	2.7%	\$0.43	\$0.40	Q	7/7
↓	<b>John Wiley</b> (JW.A:NYSE)	1.2%	\$0.13	\$0.11	Q	7/1
↑	<b>Medtronic</b> (MDT:NYSE)	1.4%	\$0.1875	\$0.125	Q	6/30
↑	<b>MSC Industrial</b> (MSM:NYSE)	1.8%	\$0.20	\$0.18	Q	7/7
↓	<b>Paychex</b> (PAYX:Nasdaq)	3.9%	\$0.31	\$0.30	Q	7/29
↑	<b>Spectra Energy</b> (SE:NYSE)	3.6%	\$0.25	\$0.23	Q	8/12
↓	<b>State Street</b> (STT:NYSE)	1.6%	\$0.24	\$0.23	Q	6/26
↑	<b>Walgreen</b> (WAG:NYSE)	1.4%	\$0.1125	\$0.095	Q	8/15
↑	<b>Washington Trust</b> (WASH:Nasdaq)	4.3%	\$0.21	\$0.20	Q	6/25

*(Scorecard continues on the next page)*

**Legend:** Stocks in the scorecard are rated ↑ -- **Attractive** or ↓ -- **Avoid**. These ratings are David Peltier's opinion of the stock, relative to its industry peers, and do not imply a buy or sell recommendation. Frequency: A: Annual; Q: Quarterly, M: Monthly, S: Semiannual, BM: Bimonthly, X: Special.s

**Special Dividend**

Rating	Company	Yield	New Payment	Former Payment	Freq.	Must-Own Date
↓	<b>Centurytel</b> (CTL:NYSE)	8%	\$0.6325	N/A	X	7/1

**Lowered Dividends**

↓	<b>Circuit City</b> (CC:NYSE)	0%	\$0	\$0.04	Q	N/A
↓	<b>Frontier Financial</b> (FTBK:Nasdaq)	2.5%	\$0.06	\$0.18	Q	7/2
↓	<b>Hanmi Financial</b> (HAFC:Nasdaq)	2.4%	\$0.03	\$0.06	Q	7/1
↓	<b>Spartech</b> (SEH:NYSE)	2.3%	\$0.05	\$0.135	Q	7/21

**Legend:** Stocks in the scorecard are rated ↑ -- *Attractive* or ↓ -- *Avoid*. These ratings are David Peltier's opinion of the stock, relative to its industry peers, and do not imply a buy or sell recommendation. Frequency: A: Annual; Q: Quarterly, M: Monthly, S: Semiannual, BM: Bimonthly, X: Special.

## The Model Portfolio

### Closing Out

**Cato** (CTR) gained 17% Thursday, closing at \$17.19. The company posted June same-store sales growth of 4%, compared with the 2.3% estimate.

Management also boosted its second-quarter (ending July) profit guidance to 42 cents to 44 cents from 28 cents to 33 cents. While Cato said that the retail environment remains difficult, CEO John Cato cited tight inventory controls and lower markdowns as reasons for the higher earnings guidance.

That said, with the stock now trading at its highest level since February, I will sell Cato from the model portfolio at Friday's opening price. Following Thursday's gains, the dividend yield has been bid down to 3.7%, and given management's mixed track record of delivering on expectations in recent quarters, I'm not confident the retailer can build upon this recent operating momentum in the second half of the year in such a difficult consumer environment.

### Mega Merger

On Thursday, **Dow Chemical** (DOW) offered to buy **Rohm & Haas** (ROH) for \$15.3 billion, or \$78 a share of cash. The price tag represented a hefty 74% premium to Rohm & Haas' closing price Wednesday, leading Dow followers to believe the company may have overpaid for the deal. For one thing, Dow believes the deal was in line with the prices paid in recent similar deals by BASF, Akzo Nobel and **PPG** (PPG:NYSE) -- especially when you factor in the expected cost savings.

Dow CEO Andrew Liveris is confident that the deal can generate \$800 million of annual pre-tax synergies, phased in over two years. The largest factor in this deal is expected to be realized by increased purchasing power for raw materials, as well as combining overlapping operations.

The purchase materially changes Dow's business model, as Rohm & Haas is more focused on specialty chemicals, rather than basic commodity chemicals. And the basic commodity chemicals sector is where Dow's margins have been at the mercy of soaring input costs.

According to Dow, specialty chemicals will contribute 70% of revenue and earnings after the deal is consummated, compared with the current approximate 50%/50% split with basic chemicals.

As a result, the deal is expected to be accretive in 2009. Dow, which had previously targeted earnings of at least \$3.50 a share in the next cycling business trough (expected around 2010 or 2011), believes that the earnings floor will now be closer to \$4 a share following the acquisition.

In relation, Dow is expected to earn about \$3.30 a share in 2008, which would mark the company's third straight annual decline from a peak of \$4.37 a share in 2005. Under its former commodity-centric business model, the company's trough earnings in 2002 were 34 cents a share.

While I believe the deal makes strategic sense for Dow, it still doesn't answer why it paid such a hefty premium for Rohm & Haas. Throughout 2007, speculation talks circled around Dow, with foreign buyers reportedly interested in buying some parts or all of the company.

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In December, the company also raised some \$9.5 billion by selling half of its commodity plastics unit to a Kuwaiti company, and also created a joint venture to create access to low-priced energy commodities. At that point, Liveris said that Dow would look to either re-invest those funds into a sizable acquisition of a specialty chemicals firm or use the cash to execute an accelerated share-buyback program.

Given the reaction of Dow shares to Thursday's news, perhaps the buyback -- which most likely would have been more accretive to earnings -- would have been more helpful for near-term shareholder value.

That's because Rohm & Haas' business has been struggling of late. The company is a leader in coatings and electronic materials businesses, where demand has slowed in recent quarters. Margins in the specialty materials division have also been hurt by slower automotive and housing end markets.

In the meantime, Dow shares closed Thursday at \$32.52, sending the dividend yield up to 5.2% -- some 300 basis points higher than the current payout of the average **S&P 500** company. While the purchase will boost the company's debt load, management believes that its debt-to-total-capital ratio will remain within target levels.

Given the fact that Liveris remains confident regarding higher trough earnings going forward, the 42-cents-per-share quarterly dividend appears secure. The trouble is, however, that it will take at least a year to see if this deal pays off.

In the meantime, Dow remains at the mercy of higher energy and feedstock costs. So while I would not commit new capital to the stock at current levels, the hefty dividend yield makes me stop short of advising readers to abandon Dow.

## Earnings Previews

- **Kimberly Clark** (KMB) is expected to announce second-quarter results July 24. The consensus analyst estimate is for the company to earn \$1.09 per share, up from \$1.04 per share a year ago, on \$4.89 billion of revenue. Management has exceeded the consensus analyst estimate three of the past four quarters, but that feat will be much more difficult this time around.

Kimberly continues to suffer from rising energy costs, and the latest round of announced product price increases will not take effect until the third quarter. Volumes will likely be flat during the quarter, but higher prices should drive low- to midsingle-digit organic sales growth. For the time being, the company also continues to benefit from a weak U.S. dollar.

Kimberly will host a conference call at 10 a.m. EDT, though no further details have been provided by the company. With slow consumer spending spreading from the U.S. to western Europe, I'm reluctant to aggressively buy Kimberly shares at Thursday's closing price of \$60.00 (3.9% yield), ahead of the quarterly results.

- **U.S. Bancorp** (USB) is scheduled to post second-quarter results the morning of July 15. The company is expected to earn 60 cents a share, down from 65 cents a year ago, on \$3.78 billion of revenue. The bank has exceeded the consensus bottom-line estimate two of the past three quarters, but few market watchers are expecting any impressive results in the sector this time around.

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Although U.S. Bancorp is better positioned than most banks, the company is not immune to the current credit deterioration. That said, net interest margin likely remained stable, and the company should post positive loan and fee income growth during the quarter.

U.S. Bancorp will also host a conference call at 2 p.m. EDT that readers can access at 866-316-1409, using the passcode 52522493. A replay will also be made available for one week at 800-642-1687, using the same passcode. Both the live call and a replay can be accessed at the company's Web site: [www.usbank.com](http://www.usbank.com).

The stock has lost 12% in recent weeks, closing Thursday at \$26.22. The financial sector remains under heavy selling pressure, with solvency rumors circulating regarding **Lehman Brothers** (LEH) and shares of **Fannie Mae** (FNM) and **Freddie Mac** (FRE) trading down into the single digits on dilution fears. Even so, U.S. Bancorp's 6.25% dividend yield remains one of the few secure payouts in the industry.

### Company Update

- **Newell Rubbermaid** (NWL) lost about 13% over the past few weeks, closing Thursday at \$15.84. The company continues to suffer from rising plastic resin and steel prices, which will hurt margins in the coming quarters. Even so, the 21-cent quarterly dividend (5.3% yield) remains secure, based on Newell's expected full-year earnings of \$1.76 a share.

### Dividend Advisor Model Portfolio

Company & Ticker	Open Date	Cost Basis per Share	Annual Yield	Ex-Dividend Date	Current Price	% Gain/Loss (excl. dividends)	Total Return
Cato CTR	6/22/07	\$21.22	4.40%	6/5/08	\$17.19	-18.99%	-15.88 %
California Water CWT	5/13/05	\$34.95	3.60%	5/2/08	\$32.76	-6.27%	3.65 %
Dow Chemical DOW	6/23/04	\$40.75	4.80%	6/26/08	\$32.52	-20.20%	-5.72 %
Consolidated Edison ED	1/24/03	\$40.44	6.00%	5/12/08	\$39.17	-3.14%	27.94 %
Kraft Foods KFT	8/31/07	\$31.92	3.70%	6/25/08	\$28.95	-9.30%	-6.77 %
Kimberly-Clark KMB	11/11/05	\$58.78	3.80%	6/4/08	\$60.00	2.08%	11.76 %
Mercury General MCY	2/4/04	\$46.44	4.90%	6/11/08	\$46.50	0.13%	18.13 %
Newell Rubbermaid NWL	3/3/06	\$24.97	5.00%	5/28/08	\$15.84	-36.56%	-28.99 %
T. Rowe Price TF PRTAX	3/21/03	\$9.90	4.44%	12/31/07	\$9.73	-1.72%	21.79 %
Reynolds American RAI	8/31/07	\$66.21	6.80%	6/6/08	\$50.54	-23.67%	-18.53 %
U.S. Bancorp USB	3/30/07	\$35.09	6.10%	6/26/08	\$26.22	-25.28%	-20.58 %
World Wrestling Ent. WWE	12/8/06	\$16.57	9.20%	6/11/08	\$15.41	-7.00%	4.59 %

### TheStreet.com Dividend Advisor - Performance

Total Average Return	12.91%	Performance results listed here reflect values of stocks as of the close of the most recently completed trading day, including dividends paid, but do NOT take into account interest earned or commissions. Results are updated overnight and posted prior to the market open the following business day. The Total Average Return figures reflect changes since inception on 1/24/2003. *The DVY is the iShares Dow Jones Select Dividend (DVY:NYSE) exchange-traded fund.
2008 YTD Return	-9.45 %	
2008 YTD Return on DVY*	-23.77%	

(If you have any questions or comments for David, please [send an email](#) directly to him. He welcomes your feedback.)

## Contact Info

### Reader Feedback and Questions

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