

LETTER TO THE EDITOR:

## In Defense of Stock Dividends

Walter Schloss, security analyst, commenting on recent communication from Dr. Neil Carothers, cites alleged advantages to stockholders of stock dividends over alternatives. Maintains stock dividend is instrument of expansion by progressive companies. States main purpose is to benefit shareholders while conserving cash, and build up future profits.

Editor, Commercial and Financial Chronicle:

It seems to me that Dr. Neil Carothers in his letter to the editor, published in the "Chronicle" of Dec. 10, regarding the evils of stock dividends over-simplifies a complicated situation. No one, I believe, has said that paying cash dividends is worse than paying stock dividends, although sometimes payment of large cash dividends may jeopardize a corporation's expansion program.

The payment of stock dividends is used when a corporation decides that earnings have to be retained for expansion purposes, but that the stockholder should get some tangible evidence that the directors are cognizant of his needs.

The articles, I believe, that Dr. Carothers is so incensed about appeared in the Aug. 3 and 10 issues of "Barron's" by Benjamin Graham. These articles pointed out the advantages of paying stock dividends rather than having the company pay large cash dividends which are taxable to the stockholder and then have the corporation turn around and issue rights to buy additional shares to these same stockholders (i. e. American Tel. and Tel.). A stock dividend program will also help those investors in companies which have been paying small cash dividends and re-investing the balance of the earnings without giving the stockholder a fair return on his investment (capital and surplus).

There is no question, in my opinion, that the company that pays a small stock dividend annually in addition to a cash dividend will sell at a higher price than the same company that just pays the cash dividend. In fact, it seems to me, the more wide-awake firms with a view to expand have paid stock dividends while the more old-fashioned firms have tended to ignore the advantages of paying them.

Where a company pays a cash dividend and a stock dividend as well, which total is more than the earnings of the company, there is no question that this could lead to an inflated market price for the shares. This explains the recent action by the New York Stock Exchange in regard to International Business Machines.

### Preferable to Unincreased Cash Dividends

In Dr. Carothers letter he says "the misconceptions I have in mind boil down to three propositions." I will quote each alleged misconception and then try to answer them.

"(A) Stock Dividends are a desirable substitute for cash dividends."

Stock dividends are not a desirable substitute for cash dividends, but they are better than no increase in dividends. When a corporation needs to expand and therefore feels that it is better to reduce its cash payout by reducing its dividend from say \$3.00 to \$2.00 a share (i.e. Caterpillar Tractor), it is better for the stockholders to get a stock dividend as well rather than a reduction of a cash dividend from \$3.00 to \$2.00 with no stock dividend. Market-wise the stockholder is better off than if the dividend was abruptly reduced with no stock dividend forthcoming.

"(B) Stock Dividends reduce income taxes for the stockholders."

Stock dividends tend to reduce income taxes by translating regular income to capital gains. Taxes are paid on dividends received. If the corporation is profitable and plans to build new plants on which additional earnings are created, the stockholder is better off to take stock rather than getting nothing while he waits. If a corporation is already paying something a stock dividend modestly increases the former dividend.

"(C) Stock Dividends are a desirable instrument for converting earnings into permanent capital."

By converting earnings into permanent capital you are making the management earn money on this reconverted capital. Obviously the larger the invested capital is the more money the corporation should earn, and the more the stockholders should receive when the expansion program is completed. Note the recent Preferred Stock Dividend declared by Consolidated Cigar.

### Misconception of Intent

Dr. Carothers implies in his article that those in favor of stock dividends claim that they are better than cash dividends. For example, Carothers states, "There is an attempt in the articles in question to present a stock dividend as a profitable exchange for a cut in dividends provided the stockholder sells his stock dividend."

This is not the intent of stock dividends. I believe that when a company needs its money for proper business purposes, it is better for the company to pay and for the stockholders to receive some stock dividends.

Corporations have many problems to meet. A large cash dividend does not necessarily solve these problems despite the fact that some stockholders need the immediate cash return.

The purpose it seems to me of a stock dividend policy is to help stockholders immediately when cash is not available for a larger distribution and at the same time give them and the corporation a more profitable business in the future.

WALTER J. SCHLOSS,  
Security Analyst, Graham-  
Newman Corporation

441 East 20th St.,  
New York 10, N. Y.  
Dec. 28, 1953