

BEARISH ON THE MARKETS. BULLISH ON UNDERVALUED STOCKS.



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Company Watch: WD-40 Company

By Brady Willett & Hope Trites

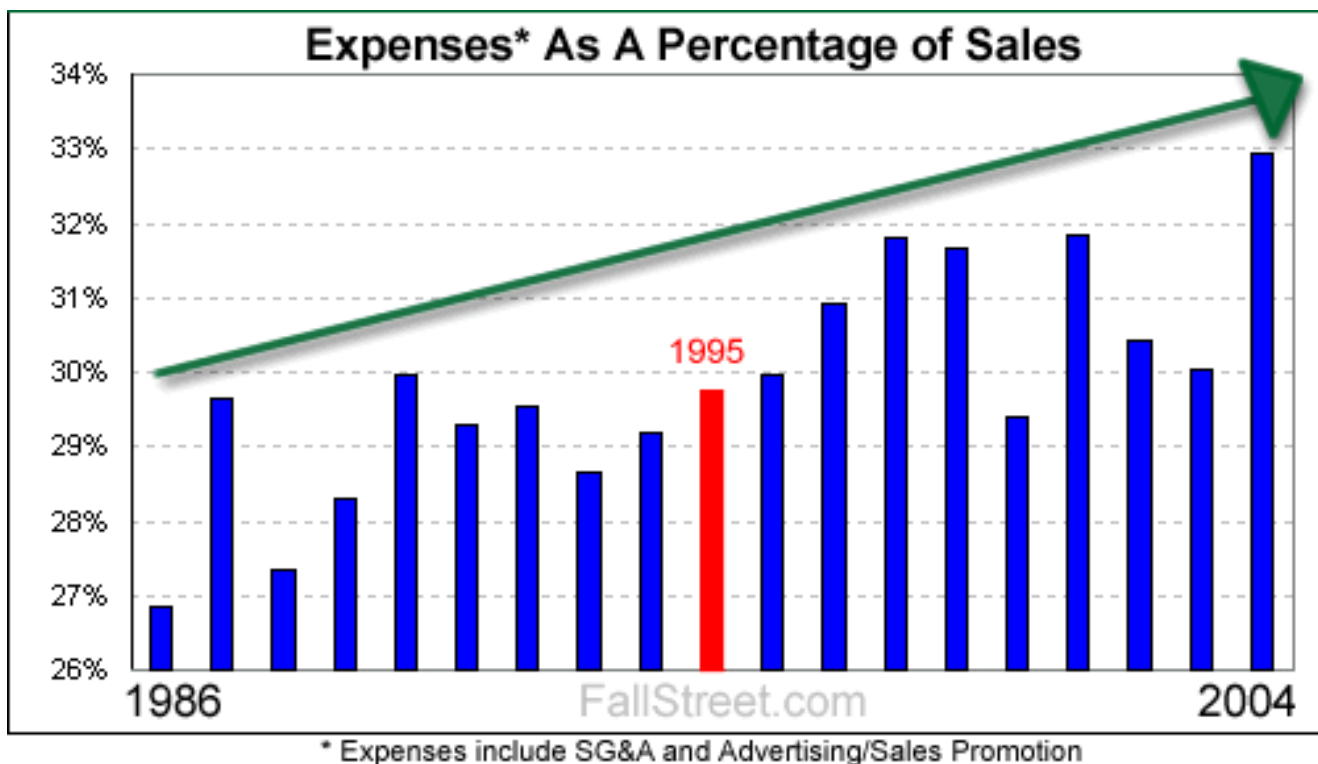
WD-40 – which is the abbreviation for ‘**W**ater **D**isplacement perfected on the **40**th try’ - was invented by three chemists in 1953. Following the commercial success of WD-40, the Rocket Chemical Company was renamed to ‘WD-40 Company’ in 1969, and went public in 1973. The rest as they say is history.

WD-40 Company is an attractive company because of the solid returns its best known product(s) generate. Contrarily, WD-40 is an unattractive company because its stock valuations are at historically high levels, and also because the company’s future is less predictable because of the adoption of many new brands. WDFC has been added to the ‘Watch List’ with an initial price target of \$25/share.

Company Overview

Over the last decade WD-40 (the company) has spent \$16.89 million in total capital expenditures and paid out over \$195 million in dividends. Ordinarily these numbers would be switched (companies usually spend more on PP&E type investments rather than dividends). However, at WD-40 constant product reinvention/machinery retooling is not required: the manufacturing of WD-40’s products is outsourced to contract packagers, and - beyond changing the packaging - the WD-40 formula that was created 50+ years ago remains much the same today (less some VOCs).

Since WD-40 outsources its production needs the year-to-year cost configuration of the business is better tracked by following SG&A related expenses instead of capital expenditures. Over the long-term these expenses – which include everything from freight costs to currency gains/losses - are a good indicator of how efficiently WDFC is operating.

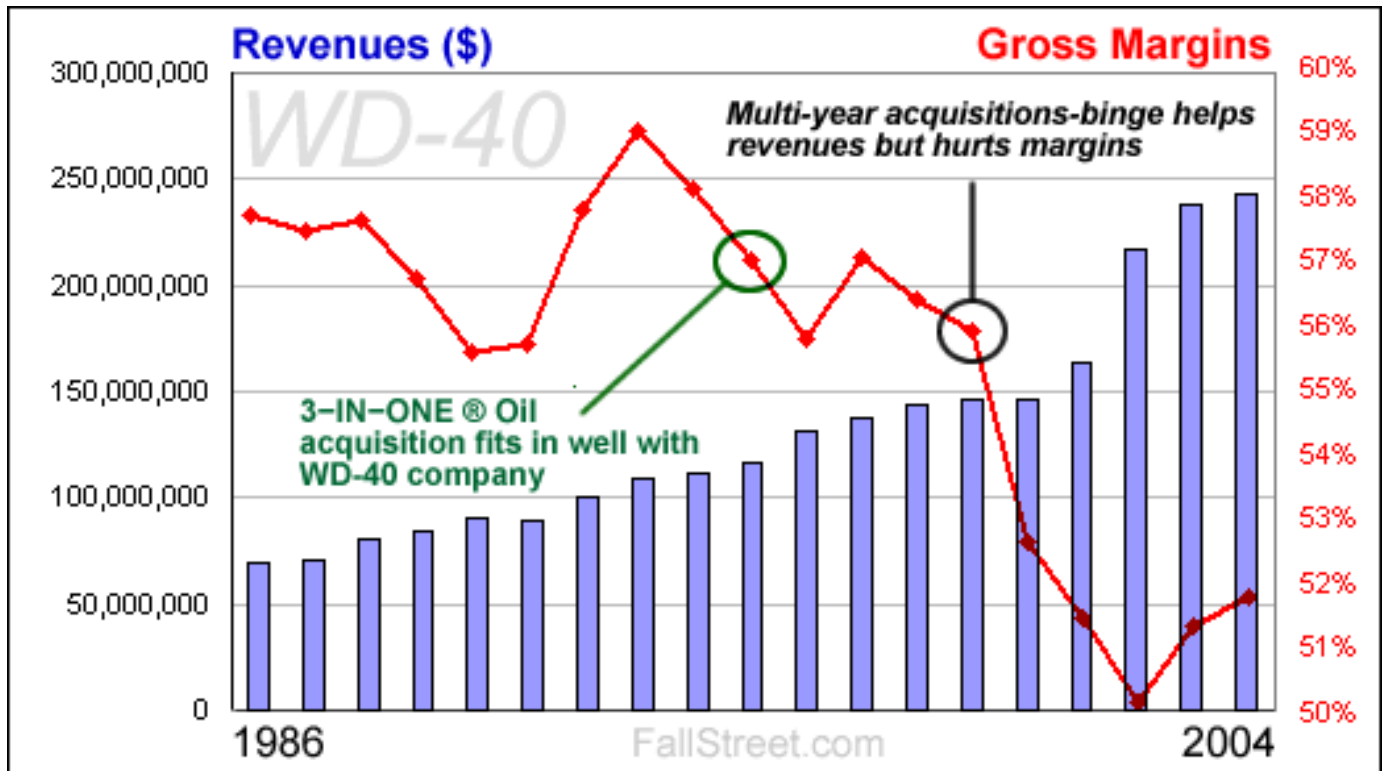


That expenses reached an all-time high (as a percentage of sales) in 2004 suggests - and the company confirms - that inflationary pressures are developing. To combat rising commodity prices WD-40 plans to raise prices in 2005.

Another reason for the increase in expenses is that the company has launched/maintained numerous new products since expanding beyond its founding product in 1995. These new products have been supported by increases in R&D, promotion, freight costs, etc.

Annual % Change In	2004	2003	2002	2001	2000	1999	1998	1997	1996	1995
Net Sales	1.8%	9.9%	32.4%	11.8%	0.1%	1.4%	4.7%	5.3%	12.1%	4.1%
SG&A	7.9%	6.6%	38.1%	7.8%	5.3%	4.1%	8.1%	6.4%	13.8%	7.1%
Advertising & promotion	23.4%	14.5%	-1.2%	71.8%	-36%	-5.7%	7.0%	13.3%	11.4%	3.8%
Since WD-40's first acquisition only twice has revenue growth outpaced SG&A growth.										
In both instances a strong increase in advertising expenses nullified any revenue gains.										FallStreet.com

The costs of maintaining brands and rising commodity prices are not the only things threatening WDFC's bottom line. Rather, new product lines not only required greater capital, but also generate smaller returns (compared to WD-40 line). For that matter, some new product initiatives (T.A.Z. in 1997 and the Lava U.K. launch in 2001) have failed to generate any positive returns. To better highlight the trend of diminishing returns one chart will suffice. To note: while commodity prices are currently a drag, they were not at all responsible for the plunge in net margins from 2000-2002.



Date	New Product Focus/Acquisition
1969-1995	WD-40
December 1995	3-IN-ONE® Oil brand acquired from affiliates of Reckitt & Colman, P.L.C.
April 1999	Lava® brand heavy-duty hand cleaner from Block Drug Company
October 2000	Solvol® brand heavy-duty hand cleaner from Unilever Australia, Ltd.
April 2001	2000 Flushes®, X-14® and Carpet Fresh®.
May 2002	Spot Shot® from Heartland Corporation.
April 2004	1001 line of carpet and household cleaners from PZ Cussons P.L.C.

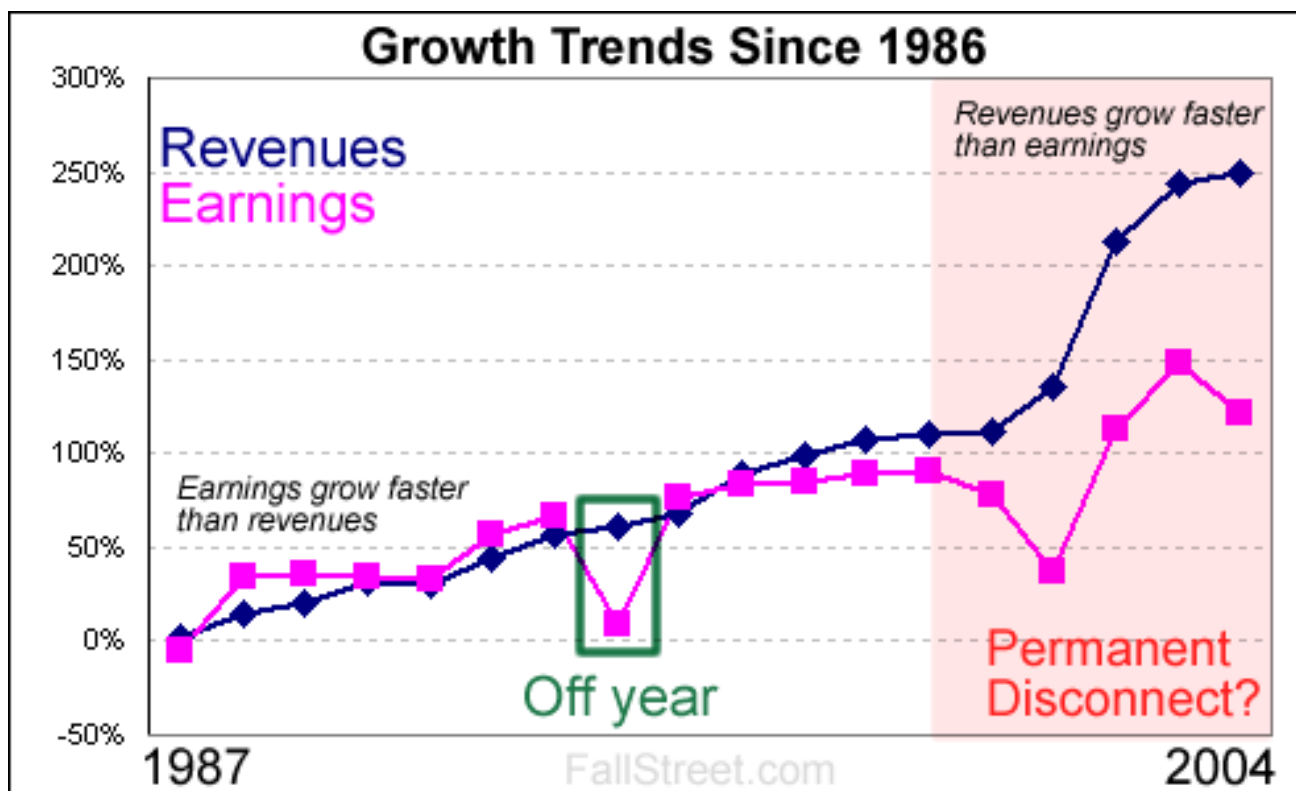
Whether intentional or not, the company's 'fortress of brands' strategy is all about sacrificing margins and dividends for top line growth.

The Lubricating King Has Quietly Been Taken Down a Notch

WDFC's stock price is near an all-time high. WD-40 Company recently released strong 1Q05 financial results and maintained its optimistic outlook for 2005 and beyond. With these things in mind why has the 'King' been taken down a notch? Because the takeovers have made WD-40 a significantly less potent enterprise.

WDFC - Highlights Only	2004	2003	2002	2001	2000	1999
Net sales	242,467	238,140	216,764	163,748	146,469	146,348
Gross profit	125,523	122,212	108,611	84,201	77,055	81,790
SG&A	58,311	54,061	50,718	36,733	34,067	32,362
Advertising/sales promotion	21,539	17,449	15,242	15,421	8,975	13,969
Net income	25,643	28,641	24,676	15,903	20,558	22,065
Common shares - not diluted	16,906	16,581	15,979	15,532	15,477	15,600
Inventories	6,322	6,322	6,143	10,535	7,000	6,104
Total current assets	84,229	95,261	67,663	55,867	46,362	52,147
PP&E, net	7,081	6,523	6,196	6,385	4,835	3,861
Goodwill	95,832	92,267	92,725	86,642	28,254	30,792
Other intangibles, net	43,428	35,700	36,650	0	0	0
Total Assets	236,775	236,658	215,045	166,712	84,950	91,957
Total current liabilities	42,535	44,673	35,262	34,838	21,247	20,362
Total shareholders equity	112,418	105,204	83,178	55,221	52,792	56,174
Total tangible equity	-26,842	-22,763	-46,197	-31,421	24,538	25,382
Cash From Operations	31,491	39,946	35,543	19,807	20,654	25,849
Capital expenditures	2,358	2,058	1,180	1,493	2,233	1,308
Dividends paid	13,559	13,272	16,094	18,293	19,797	19,963
In thous \$	1998	1997	1996	1995	1994	
Net sales	144,397	137,893	130,912	116,776	112,166	
Gross profit	81,413	78,607	72,987	66,547	65,138	
SG&A	31,098	28,770	27,027	23,759	22,185	
Advertising/sales promotion	14,811	13,846	12,219	10,973	10,570	
Net income	21,888	21,363	21,297	20,453	12,683	
Common shares - not diluted	15,604	15,512	15,424	15,400	15,372	
Inventories	1,697	3,341	3,341	3,867	2,470	
Total current assets	49,766	42,356	42,356	49,580	45,282	
PP&E, net	3,593	4,160	4,160	3,938	3,159	
Goodwill	12,468	13,435	13,435	14,392	0	
Other intangibles, net	0	0	0	0	0	
Total Assets	70,945	65,418	65,418	61,658	54,872	
Total current liabilities	13,910	11,368	11,106	11,080	8,187	
Total shareholders equity	54,998	51,340	47,171	44,505	42,095	
Total tangible equity	42,530	37,905	33,736	30,113	42,095	
Cash From Operations	23,676	23,309	18,192	21,434	10,333	
Capital expenditures	1,271	1,478	1,353	1,371	796	
Dividends paid	19,973	19,385	19,123	18,635	17,678	FallStreet

Since the takeover of 3-IN-ONE in 1995 goodwill/intangible assets have arrived on the balance sheet and have continued to increase with each new acquisition. Moreover, the returns since 1995 have not evenly spread out. For example, revenues have more than doubled since 1995 (above chart in red), while earnings have only increased by 25%.



With the exception of 3-IN-ONE - which broadened WD-40's distribution channels and made the company even more competitive in lubricants - other acquisitions have been an expensive grab for revenues. Obviously Garry Ridge (CEO) and others would disagree: management is quick to tout the growth benefits of 1001 (the latest acquisition), and that products like SpotShot are expected to grow in 2005. However, what management fails to mention is that growth has not come easy. To be sure, interest expense has gone from nil in 1999 to more than \$6 million in 2004, Return on Equity is in freefall, dividends have been cut, and working capital has been drawn down. Suffice to say, the company likes to point out that it is growing, yet the long-term stockholder cannot help but wonder at what cost.

Is WD-40 management is proud of this?

	2004	2003	2002	2001	2000	1999	1998	1997
ROE %	22.81%	27.22%	29.67%	28.80%	38.94%	39.28%	39.80%	41.61%

Valuations Rich

The valuations story on WD-40 follows the pre and post 2000 stock market mania to perfection.

Pre-Crash: 'Old economy' stock WD-40 is ignored by investors. Company has attractive dividend yield and stable growth prospects.

Post-Crash: After 2000 WD-40's dividend yield starts to decline as 1) U.S. interest rates decline, 2) Investors become more attracted to dividend paying companies, and 3) WD-40 begins to focus on long-term growth instead of increasing shareholder wealth (via dividends). As for WDFC's stock price: from its lows in 2001 to its highs in 2003 WDFC stock more than doubles.

Selected Statistics	1997	1998	1999	2000	2001	2002	2003	2004
Price to Earnings	16.74	17.93	17.44	15.32	20.10	16.51	15.60	20.69
Price to Sales	2.59	2.72	2.63	2.15	1.95	1.88	1.88	2.19
Price to Book	6.97	7.14	6.85	5.97	5.79	4.90	4.25	4.72
Price to Tangible Book	9.44	9.23	15.16	12.84	-10.17	-8.82	-19.62	-19.76
Dividend Yield	5.42%	5.09%	5.19%	6.29%	5.72%	3.95%	2.97%	2.56%
Dividend Payout (%)	90.7%	91.3%	90.5%	96.3%	115.0%	65.2%	46.3%	52.9%
Debt/Assets	21.5%	22.5%	38.9%	37.9%	66.9%	61.3%	55.5%	52.5%
Quick Ratio	3.73	3.58	2.56	2.18	1.60	1.92	2.13	1.98
Acquisitions slowly stress WD-40's balance sheet.								
Dividend yield declines below 3%, and payouts decline (as a % of earnings)							FallStreet.com	

Currently the company has a dividend yield of 2.39% (versus a 4% 10-year Treasury yield). At the height of the stock market mania the company traded at a P/E ratio of 15 and had a dividend yield of 6.29%. The average 10-year Treasury yield for the year 2000 was 6.01%.

Conclusions and Investment Opinion

WD-40 is one of the most remarkable product stories of all time. There are cheaper, equally effective products on the market, but none of them have the brand power of WD-40. When purchasing WD-40 you not only get a lubricant that can be used for more than 2000 different jobs, but you also get a conversation piece. By way of contrast, Lava soap cleans your hands.

Since 1995 the WD-40 Company has purchased and developed brands that have a strong market presence, but none of these new products have the long-term appeal of WD-40. In fact, some products – Carpet Fresh and X-14 to name two – will probably need to be constantly updated and promoted to simply remain viable products in the competitive household products category. Suffice to say, acquisitions have not only transformed the company into a less potent enterprise, but have also diluted the exposure the investor gets from the WD-40 product alone.

There are items of interest - including broker concerns/old lawsuits, product counterfeiting in China, unexpensed stock options, and potential class action suits (toilet cleaner issues) - that the investor should be aware of when analyzing WD-40. Moreover, the investor needs to be aware that WD-40 management has been infected with acquisitions-bug; that future financial success/failure will be tied more to how acquisitions pan out and not to how well the world's most popular lubricant performs (the WD-40 pen looks like it will be a great success in 2005!). That being said, before attempting to draw any final conclusions it is worth remembering that WD-40 trades at 27 times free cash flow, more than 20 times earnings, and yields only 2.39%. These rich valuations mean that WDFC and its brands are only worth serious consideration should its financial performance and/or stock price hit a road block. At \$25 WDFC would be trading at 20-times free cash flow (diluted) and its dividend yield would be 3.3%. At \$25 a share WD-40 Company warrants, at minimum, another test drive.

WDFC - Highlights Only	30-Nov-04	31-Aug-04	31-May-04	29-Feb-04	30-Nov-03	31-Aug-03
Net sales	60,688,000	71,704,000	59,742,000	58,481,000	52,540,000	73,378,000
Cost of product sold	30,119,000	35,308,000	28,878,000	28,152,000	24,606,000	35,303,000
Gross profit	30,569,000	36,396,000	30,864,000	30,329,000	27,934,000	38,075,000
SG&A	15,371,000	15,797,000	14,338,000	14,042,000	14,134,000	15,453,000
Advertising/sales promotion	5,261,000	5,167,000	5,839,000	5,092,000	5,441,000	4,908,000
Net income	5,635,000	8,938,000	6,072,000	6,243,000	4,390,000	10,275,000
Common Shares - Diluted	16,725,632	17,118,829	17,244,931	17,254,329	17,073,910	16,758,775
Inventories	6,191,000	6,322,000	6,464,000	5,916,000	5,140,000	6,322,000
Total current assets	85,392,000	84,229,000	80,651,000	106,408,000	96,597,000	95,261,000
PP&E, net	7,365,000	7,081,000	7,245,000	7,007,000	7,043,000	6,523,000
Goodwill	96,125,000	95,832,000	95,893,000	92,423,000	92,350,000	92,267,000
Other intangibles, net	43,733,000	43,428,000	43,693,000	35,700,000	35,700,000	35,700,000
Other assets	6,141,000	6,205,000	6,236,000	6,323,000	6,266,000	6,265,000
Total Assets	238,756,000	236,775,000	233,718,000	247,861,000	237,956,000	236,658,000
Total current liabilities	49,602,000	42,535,000	37,127,000	41,025,000	37,565,000	44,673,000
Total shareholders equity	116,299,000	112,418,000	116,606,000	117,851,000	112,647,000	105,204,000
Total tangible equity	(23,559,000)	(26,842,000)	(22,980,000)	(10,272,000)	(15,403,000)	(22,763,000)
Working Capital	35,790,000	41,694,000	43,524,000	65,383,000	59,032,000	50,588,000
Cash from operations	12,653,000	8,034,000	6,217,000	9,678,000	7,562,000	10,325,000
Capital expenditures	727,000	341,000	692,000	467,000	858,000	650,000
Dividends paid	3,315,000	3,376,000	3,416,000	3,403,000	3,364,000	3,336,000
BASIC FREE CASH FLOW	20,845,000	15,574,000	17,596,000	23,885,000	18,556,000	24,616,000
(Trailing 4Qs)						FallStreet.com