

# SISR Strategic International Securities Research Inc.

An Independent Research Firm



## Economics & Financial Markets

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United States Equity Markets

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### April Update: 2009 SISR Recommendation List

#### I. Introduction

Starting in September of 2008 we began our recommendation list. We are attempting to increase this list to 25 companies at which time we will more formally track these positions for returns.

Figure I: The SISR Recommendation List as of the Close of Trading April 3, 2009

Companies, Initiation Date and Price and Percentage Change					
#	Company	Initiation Date	Initiation Price	Current Price	Percent Change
1	The Mosaic Company (MOS)	Oct. 18, 2008	\$33.66	\$45.64	35.59%
2	Holly Corporation (HOC)	Oct. 23, 2008	\$16.75	\$22.23	32.72%
3	Abercrombie (ANF)	Nov. 3, 2008	\$28.96	\$26.94	-6.98%
4	Aeropostale (ARO)	Nov. 3, 2008	\$24.18	\$28.27	16.91%
5	Harris (HRS)	Jan. 25, 2009	\$42.80	\$30.49	-28.76%
6	Caterpillar (CAT)	Jan. 28, 2009	\$32.32	\$32.15	-0.53%
7	Accenture (ACN)	Feb. 4, 2009	\$33.11	\$28.04	-15.31%
8	Polo Ralph Lauren (RL)	Feb. 18, 2009	\$36.97	\$47.22	27.73%
9	Darden Restaurants (DRI)	Mar. 16, 2009	\$33.11	\$36.49	10.21%
10	Cheesecake Factory Inc. (CAKE)	Mar. 16, 2009	\$9.48	\$13.01	37.24%
11	Applied Materials (AMAT)	Mar. 16, 2009	\$10.43	\$11.81	13.23%
12	L-3 Communication Holdings (LLL)	Mar. 16, 2009	\$61.29	\$68.73	12.14%
13	Wells Fargo & Co. New (WFC)	Mar. 16, 2009	\$13.70	\$16.34	19.27%
14	Bank of America (BAC)	Mar. 16, 2009	\$6.18	\$7.60	22.98%
15	Lowes Companies Inc. (LOW)	Mar. 19, 2009	\$17.19	\$19.12	11.23%
16	J.B. Hunt Transport (JBHT)	Mar. 31, 2009	\$23.61	\$26.48	12.16%
Average					12.49%

Source: Reuters, SISR

## II. Current Opinion Updates

### 1. The Mosaic Company (MOS)

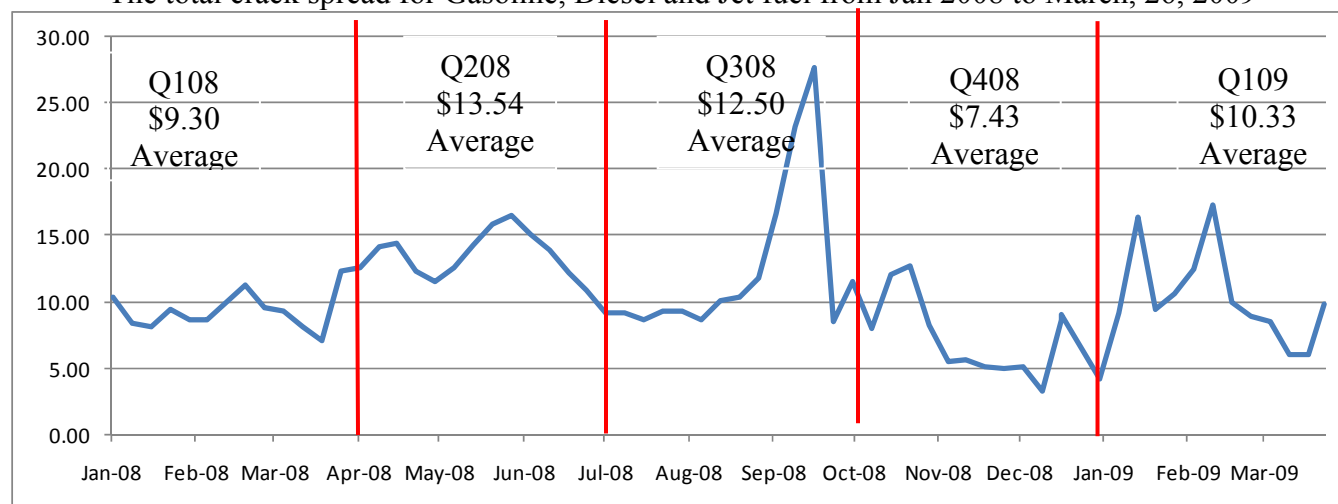
Since October we have reiterated our price target of \$60 while lowering our estimates. Since then we met with management during their analyst day in New York. We still feel comfortable with our price target. This is based on our belief that the company has tried to maintain the price of the fertilizer as we had projected and there was some price slippage as we had anticipated. The level of demand destruction was a bit under estimated, but well within our very conservative requirements for our price target to be met by year end 2009.

We have been extremely encouraged over the past few weeks with some very good data coming in on fertilizers from: 1) exports, which had been declining for several months but last month m/m they increased indicating that the level of output declines had stabilized, 2) shipments as reported by the Department of commerce were up 7.2% in February and 2.2% in January. After falling for nearly a half year it appears that both the price and product have stabilized. This had led us to expect that on April 7, when MOS reports they will beat consensus estimates.

### 2. Holly Corporation (HOC)

HOC earned \$2.40 in 2008 and consensus is for them to earn \$2.85 for 2009. Consensus for Q109 is that they will earn only \$0.56, our estimate is they will exceed consensus when they report because the crack spread is \$3.85 higher in Q109 than it was in Q408 and they still earned \$1.01 per share and in Q108 they managed to earn \$0.90 when the crack spread was \$1.03 lower, all with comparable expected shipments.

The total crack spread for Gasoline, Diesel and Jet fuel from Jan 2008 to March, 26, 2009



Source: EIA, SISR

Additionally the crack spread on gasoline has reached parity with diesel/jet fuel for the first time in over a year and one half. The reason is that demand destruction that everyone was concerned about has not

been sustained with gasoline demand being equal to last year's demand. Demand for diesel has been weak but even here in the last few weeks demand has increased significantly.

### **3. Abercrombie & Fitch (ANF)**

We were hopeful that as gasoline became a less significant component of the household budget that households would spend more in the low cost item retail sector. All this was working until 3 months ago when individual began to panic as the economy turned significantly worse and began to use their additional disposable income on savings. The savings rate went from a rate of 0.45 in 2007 on average to 4.2% in February but down from 4.4% in January the first decline in saving.

In the past two month this thesis has been working. The data has been showing that small ticket nondurables are significantly outperforming durables. We have found this in the retail reports, the manufacturing report, and the wholesale reports, with apparel actually up m/m since January. Last Friday the nonfarm payroll report also showed that the only area with job growth were general merchandise stores and the motion picture industry. Also PPI and CPI showed pricing strength in this space.

### **4. Aeropostale Inc. (ARO)**

While ARO is a discounter they have been having extraordinary growth in this terrible economy of over 10% y/y. The entire sector as discussed for ANF has been showing up in the data as very strong.

### **5. Harris Corporation (HRS)**

The revenue growth for Harris has been solid, they took some good will charges in Q408 and lost \$0.29 but x good will they would have earned more than \$1.00 in Q408, and consensus for Q109 is for them to earn \$1.00 and \$4.00 for the full year.

The price of the stock is down because there is the expectation that they will be impacted by a smaller military. The reality, however is that there is a bifurcation between traditional defense and communication defense. Communication has been showing very strong new orders and shipments all year and there is no reason to believe that will slow down with greater emphasis on communication defense for Mexico, Afghanistan, and homeland security.

### **6. Caterpillar Inc. (CAT)**

Nonresidential construction has held up all year and is still up over 2% y/y is holding up, and was up again in February up 0.5% m/m. All year it has amazingly been holding up. Permits were up for residential construction for the first time in many months and there are signs that construction will be picking up on the residential side from extreme historic lows. Additionally as the stimulus program begins to kick in this should definitely help CAT.

### **7. Accenture (ACN)**

Any company that has the political clout to have their company specifically written as a major expenditure bill as an exception must be doing something correct. They are positioned to receive a major part of the 19 billion in health technology from the stimulus bill and as the economy turns we expect them to fair quite well with significant growth from that stimulus line item, much of it will go to CAN.

### **8. Polo Ralph Lauren (RL)**

Ralph Lauren on February 4, 2008 announced their Q3 2009 earnings and despite troubled times their Q3 y/y net revenues were down only 1.4%, and net income down 6.6%, with EPS diluted down only 2.8% from a year ago. This compares to Abercrombie (ANF), for example whose sales plunged 19% and profits 68%. Their forward guidance was lowered slightly from \$4.00 - \$410 for the full year 2009 which ends on March 20, 2009 to 3.85 - \$4.00, with net revenues flat to down single digits.

Given this strong showing and following the same logic for ANF and ARO we are still very positive on this company.

### **9. Darden Restaurants (DRI)**

Darden Restaurants Inc. operates restaurants under six chain names: Red Lobster, Olive Garden, LongHorn Steakhouse, The Capital Grille, Bahana Breeze and Seasons 52. They currently operate approximately 1,700 restaurants primarily in the United States with some international under these names. Despite the recession their revenues increased from 1.522 B to 1.669 B for Q309 as compared to the same quarter for 2008, on net income of 59.7M for Q309 in comparison to 43.5M for Q308. They earned \$0.43 per share in Q309 in contrast to \$0.30 in the prior year for the same quarter. The appeal of Darden at this juncture is that as the economy recovers with disposable income increasing to the middle income families, from lower gasoline prices and slightly more income from the reduction in payroll taxes, these midlevel restaurants we project will to outperform the market in the intermediate term.

### **10. The Cheesecake Factory Inc. (CAKE)**

Cheesecake Factory Inc. operates 160 upscale full service casual restaurants mostly under the name Cheesecake Factory with 34 under the name Grand Lux Café. The company had revenues of 400.4M in Q408 as compared to 406.3M in Q407 on EPS of \$0.12 in contrast to \$0.19 in the same quarter last year. They had net income of 7.1M in contrast to 13.3M in Q407. The logic here is similar to that for DRI in that as disposable income increases, the current data has been indicating that individuals spending have increase on the lower ticket items in the retail space, like restaurants and clothing stores. Also traditionally restaurants and clothing are the one of the early movers in a post recession economy.

### **11. Applied Materials (AMAT)**

Applied Materials designs, manufactures, and sells semiconductor fabrication equipment, operating in 4 segments: Silicon, Applied Global Services, Display, and Energy and Environmental Solutions. The fastest growing segment is the energy and environmental solutions segment which increased revenues of over 100% y/y, becoming a 25% of revenue segment by the end of Q109. This segment however has been the only segment to lose money. The other segments were profitable but revenues in Q109 in comparison to Q108 were nearly cut in half. We are recommending AMAT for two very simple reasons: 1) we are expecting that technology will lead coming out of this recession and such a large component

of the technology space goes through AMAT, and 2) despite the losses in the energy segment with an emphasis on solar energy in the Stimulus bill it is likely that this segment emerge as a significant and profitable component to their business. This is a late 2009 to 2010 situation but we believe as the economy gets better that AMAT will at least market perform and begin to outperform by the end of the year.

## **12. L-3 Communication Holdings (LLL)**

L-3 communication provides command, control, communications, intelligence, surveillance and reconnaissance systems in four segments: 1) ISR (Intelligence Surveillance and Reconnaissance) including networked communication systems and secure communications products; 2) government services provide training and operational support services, information technology solutions, intelligence solutions and support, engineering solution services and other technical services. 3) AM&M (Aircraft Modernization and Maintenance) provides modernization, upgrades and sustainment, maintenance and logistics support services for military and various government aircraft and other platforms; 4) Specialized Products provides a broad range of products across several business areas that include power & control systems, microwave, avionics & displays, training & simulation, electro-optic/infrared (EO/IR), precision engagement, security and detection systems, propulsion systems, undersea warfare and telemetry and advanced technology.

In Q408 L-3 earned 4.01B in revenues in contrast to 3.81B in Q407 with net income of 247M and 207.4 million in the respective quarters with EPS of 2.04 vs. 1.64 in Q407. There are various facts that we at SISR believe are a near certainty: 1) the defense budget will be brought in somewhat, but the communication defense budget will continue to expand 2) the level of surveillance that was developed under the Bush administration will continue at the same pace if not faster as technology improves (the groups that are targeted may change, but the level of surveillance will only increase; 3) the war in Afghanistan will not be over for at least two years (Russia could not solve Afghanistan, Pakistan is not willing to currently have American troops fighting on their land, and the population in Pakistan is currently putting pressure on their not to allow the Allied forces from entering their country). 4) President Obama opposed the war in Iraq because that was not where the war on terror emanated from, but he is not a Bertrand Russell pacifist either, and if anything good diplomacy is always associated with good information. LLL is the premier communication company and communication will be the strongest component of the military budget going forward. There is an expectation that the military budget will be reduced but the communication component is likely to be the growth area. Please see our work on the military bifurcation on this point.

## **13. Wells Fargo & Co. New (WFC) &**

## **14. Bank of America (BAC)**

We have been arguing for the past few weeks that the major U.S. banks are currently bullet proof in terms of their likelihood of survival given the existing programs in place between the TARP, TALF, and additional funding for the FDIC. The remaining question is how much more capital if any will it take to keep these banks supported further diluting their stocks, and how likely is profitability going forward in Q109.

Whenever the FFBond (10 year note less FF rate) spread approaches current levels of 2.5% or greater these are very supportive level for banks to attain profitability. With the likelihood of Wells Fargo and B of A being profitable in Q109 and going forward, barring another catastrophe, it is likely that they will significantly outperform the markets. Historically, the financials have significantly outperformed the markets from the market lows coming out of a recession.

### **15. Lowes Companies Inc. (LOW)**

We added Lowe's Companies Inc. (LOW) to our recommended list in large part because of the actions that the FOMC had taken to: (1) enter the market to purchase \$300M in longer term Treasury Securities. This will have the net effect of reducing interest rates on the long bond and (2) their decision to purchase an additional 750B in agency mortgage backed securities, which will further put pressure on lowering mortgage interest rates.

### **16. J.B. Hunt Transport (JBHT)**

There are three reasons why we added JB Hunt to our recommended list:

1. Diesel prices are 52.6% lower than they were one year ago and they are currently 30.4% lower than they were last quarter.
2. After nearly falling off a cliff demand for diesel has been unexpectedly increasing as shipments of manufactured goods have been improving slightly.
3. We are looking for the economy to recover significantly by the middle to the end of the summer, given that all the necessary and sufficient conditions for a recovery are currently in place.

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### **Stock Rating:**

- 1 – Recommended List – The stock has our highest recommendation and is expected to outperform the average equal weighted expected total return of the overall Market irrespective of sector. Our investment horizon is 12 – 18 months except as specified by the reporting analyst.
- 2 – Overweight – The stock is expected to outperform the equal weighted expected total return of the sector coverage. Our investment horizon is 12 – 18 months except as specified by the reporting analyst.
- 3 – Neutral – The stock is expected to perform in line with the equal weighted expected total return of the sector coverage. Our investment horizon is 12 -18 months except as specified by the reporting analyst.
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- 5 – Rating Suspended – The rating and target price have been suspended temporarily to comply with applicable regulations and/or firm policies in certain circumstances including when SISR Inc. is acting in an advisory capacity in a merger or strategic transaction involving the company.

### **Sector Ratings:**

- 1 - Recommended Sector – The sector has the highest recommendation with continued improving valuations and rapid growth.
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## **Price Chart:**

A price chart, with changes of ratings and price targets in prior periods, is included above, for all securities covered in this report.

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