

# SISR Strategic International Securities Research

An Independent Research Firm

## Economics and Stocks – April 2007 PPI

April 24, 2007

Philip L. Miller - 212-551-7998

[pmiller@sisresearch.com](mailto:pmiller@sisresearch.com)

### Stocks Mentioned:

Tyson Foods Inc. (TSN)  
Pilgrim's Pride Corp. (PPC)  
Sanderson Farms Inc. (SAFM)  
Smithfield Foods Inc. (SFD)  
Mosaic Co. (MOS)  
Agrium Inc. (AGU)  
Terra Industries Inc. (TRA)  
CF Industries Holdings Inc. (CF)  
Monsanto Co. (MON)  
Johnson Controls Inc. (JCI)  
Cummings Inc. (CMI)  
Biggs & Stranton Corp. (BGG)  
Woodward Governor Co. (WGOV)  
Precision Castparts Corp. (PCP)  
United States Steel Corp. (X)  
Reliance Steel & Aluminum Co.(RS)  
Nucor Corp (NUE)  
Ipsco Inc. (IPS)  
AMR Corp. (AMR)  
UAL Corp. (UAUA)  
U.S. Airways Group Inc. (LCC)  
Continental Airlines Inc. (CAL)  
Air France KLM (AKH)  
British Airways plc (BAB)  
Southwest Airlines Co. (LUV)  
China Southern Airlines Co. Ltd. (ZNH)  
Jet Blue Airways Corp.(JBLU)  
Alaska Air Group Inc. (ALK)  
Dell Inc. (Dell)  
Hewlett-Packard Co. (HPQ)  
Microsoft Corp. (MSFT)  
Gateway Inc. (GTW)  
Best Buy Co. Inc. (BBY)  
Circuit City Stores Inc. (CC)  
RadioShack Corp. (RSH)  
Weyerhaeuser Co. (WY)  
Masco Corp. (MAS)  
Louisiana-Pacific Cp. (LPX)  
Universal Forest Products Inc. (UFPI)  
Deltic Timber Corp. (DEL)

### Report Summary: Producer Price Index Report: April 2007

#### Positive Pricing

- **Processed Young Chickens:** Up 27.5% y/y, 1.1% m/m.
- **Beef and Veal:** Up 5.3 y/y, 4.1 m/m
- **Phosphates:** Up 33.6 y/y, 15.8 m/m
- **Transformers and Power Regulators:** Up 20.4% y/y 2.4 m/m
- **Steel Mill Products:** Up 13.1 % y/y, 2.3% m/m
- **Iron and Steel Scrap:** Up 40.3% y/y, 18.8 % m/m

#### Negative Pricing:

- **Jet Fuels:** Up 6.7% y/y, Up 12.4% m/m (negative for airlines, positive for oil companies).
- **Electronic Computers:** Down - 23.2% y/y, - 2.5% m/m
- **Electronic and Appliance Stores:** Down -18.1% y/y, Up .2 m/m
- **Softwood Lumber:** Down 15.4% y/y, Up 0.1% m/m

# Trading Ideas

## I. Ideas for Long Positions:

- 1. Process Young Chickens:** The ethanol phenomenon goes way beyond corn and gasoline. With corn prices increasing by 90.5% y/y and feed prices rising 20.2 y/y this has lead to the increase in the price of processed young chickens. Since feed costs are only a subcomponent of the entire cost structure chicken distributors like Tyson (TSN), Pilgrim's Pride CP, (PPC), and Sanderson Farms (SAFM) continue to be on our outperform accumulate list. We are adding Smithfield (SFD) to our accumulate list because of the recent increase in beef and veal prices and the 7% increase in pork prices over the past three months.
- 2. Phosphates:** Phosphate fertilizer is one of the three major fertilizers products. With an increase in the price of Phosphate fertilizers driven in part by the boom in the farm economy and ethanol production we continue to recommend holding Mosaic (MOS), Potash (POT), and Agrium (AGU), Terra Industries (TRA) and CF Industries (CF). All these stocks are very expensive currently, and suggest purchasing on dips, but we believe that these stocks will continue to outperform the market. A related company is Monsanto (MON) which is a beneficiary of the increase in corn acreage via the sale of seeds.
- 3. Transformers and Power Regulators:** The dichotomy between residential construction and non residential construction is still an interesting anomaly. With non residential construction still relatively positive companies in this space like Johnson Controls (JCI), Cummings (CMI), Biggs & Stratton (BGG), and Woodward Governor Co (WGOV) have continued to perform well and remain on our outperform list.
- 4. Steel Mill Products & Iron and Steel Scrap:** The price of steel continues to be the primary driving factor in the earning of steel companies. With the complications of the international steel market, pricing is often the first place to look for steel company, with currency being a second central component performance. The obvious names to look at here are: Precision Castparts Corp. (PCP), United States Steel (X), Reliance Steel & Aluminum Co (RS), Nucor Corp. (NUE), and Ipsco Inc. (IPS), staying with U.S. companies.

## II. Ideas of Short Positions:

- 1. Jet Fuels:** Jet fuel was up a significant 12. 4% m/m indicating a significant move up in this commodityt. Most of the major airline have been able to hedge their fuel costs so this one time move should not be significant, however, we need to watch this measure for future major increases that would push the average hedged cost of fuel up, over an extended period of time. Some of the international airlines may be of particular interest here since currency valuations are a critical component for this segment both for fuel costs and currency translations, particularly if the companies operate primarily in non U.S. regions but are

ADR's or some other form of similar listing on the U.S. exchanges. (A complete review of these factors will be forthcoming). The dominant airlines that we maintain interest in are: American Airlines (AMR), UAL Corp. (UAUA), U.S. Airways Group (LCC), Continental Airlines (CAL), Air France (AKH), British Airways (BAB), southwest Airlines (LUV), China southern Airline (ZNH), Jet Blue (JBLU), and Alaska Airlines (ALK).

- 2. Electronic Computers:** The one month downturn of 2.5% m/m appears significant and in line with the trend of the past year. Any expectation that the new operating system from Microsoft (MSFT) have not really impacted this space in any significant manner, certainly with respect to stabilizing pricing. The obvious names affected by the continued decline in computer prices are Dell Inc. (Dell), Hewlett-Packard Co. (HPQ), Gateway Inc. (GTW). We will continue to watch this sector very closely, expecting that once Vista and Office 2007 begin to catch on there will be a stabilization of pricing in this sector. Once that occurs we will likely reverse our underperform recommendation on this sector.
- 3. Electronic and Appliance Stores:** With prices having declined by over 18% y/y this sector has suffered a significant decline. We are watching this category closely because as soon as we see some price stabilization we will reverse our underperform recommendation for this sector. The principle stocks in this sector are: Best Buy Inc. (BBY), Circuit City Stores Inc.(CC), and Radio Shack Corp(RSH).
- 4. Softwood Lumber:** With the housing slump continuing we would expect that pricing of lumber to continue to decline. However, there are several factors at work here that one needs to be careful to follow: a) the housing slump has not been followed up by a slump in non residential housing as seen above with respect to transformers and power regulators, and b) if housing stabilizes with increases in non residential construction we need would begin to see some expansion of lumber needs. As always ppi for lumber is one of the best single indicators to look for as a leading indicator of stock price. The dominate companies in this sector are: Weyerhaeuser Co (WY), Masco (MAS), Louisiana-Pacific (LPX), Universal Forest (UFPI), and Deltic Timber Corp (DEL).

**Precautionary Notes:** This research report is based on a review of the April 13, 2007 release by the Department of Labor of the Producer Price Indexes. We used a single variable to elaborate trends in particular sectors. As a single variable analysis, of course there are limitations; however we believe that a review of PPI by sub sector is an invaluable leading indicator of both stock price and future earnings. We expect to report all anomalies in this monthly report on a continuing basis and hope to fill in the limitations of the single variable approach with expanded analysis of the companies mentioned, as well as the review of complementary data by subsector as it is released.

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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.

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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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