

In Fertile Fields

It's getting to be springtime here in the Midwest, America's Breadbasket, not to be confused with the Garden State and the lovely toxic waste dumps located therein. Memo to Senator Jon Corzine: For another \$60 million in the next election, you can get the Joyce Kilmer rest stop on the New Jersey Turnpike renamed in your honor.

Of course, the whole notion of Nature's bounty is more of a quaint notion than most of us realize. In a nod to DuPont's old advertising slogan, we have better living through chemistry. Tired of hearing about greenhouse gases and global warming? Forget carbon, baby, and take a step up the periodic table to nitrogen, which shares No. 7 with Jack Daniel's whiskey and the late Mickey Mantle: No nitrogen, no protein; no protein, no you.

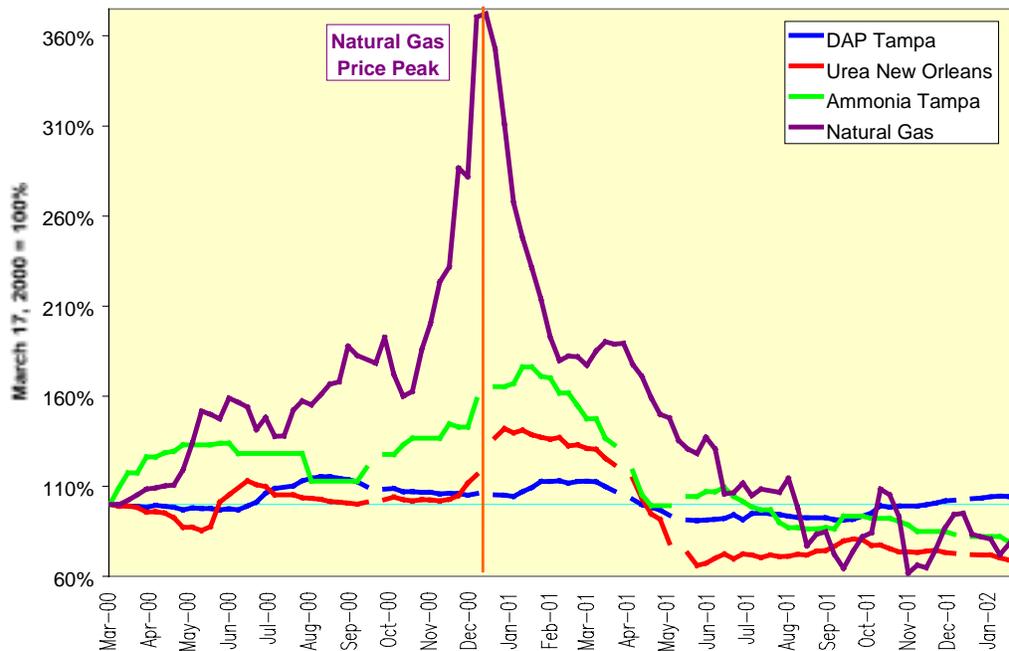
Since the development of the Haber process for synthesizing ammonia in 1909, the fertilizer and explosives industries have been free from the limited natural sources of nitrates, chiefly crystallized guano (seabird poop) deposits in Chile, South America's windshield. It's estimated that more than one-third of all of the nitrogen in living material is from these recent synthetic origins, and it's that stress on Mother Earth, not any carbon-based threat, that should put a fashionable worried look on your face at your next socially-aware cocktail party.

Spread It Around

For those of you whose chief interests in high school were biological and not chemical in nature, a quick refresher course may be in order. Ammonia, the feedstock for such fertilizer ingredients as ammonium nitrate, (think Timothy McVeigh's truck bomb) diammonium phosphate (DAP) and urea (New York subway) is NH_3 , and the cheapest place to get hydrogen (H) has been from methane, (CH_4) known better as natural gas. In fact, about 7% of natural gas consumption in the U.S. has been as an ammonia feedstock. We should note in passing that the Chicago Board of Trade tried futures on DAP and ammonium nitrate in the 1990s, and they now rest peacefully under the ground they were meant to nourish.

When natural gas prices quadrupled in 2000, this created problems for ammonia manufacturers such as Mississippi Chemical. This firm had hedged its natural gas costs by buying futures contracts thereon, and on December 11, 2000 they announced they were selling their natural gas back to the market. Natural gas prices peaked shortly thereafter. Now that the massive downturn in natural gas prices is behind us, let's take a look at the price of various fertilizer ingredients as best as we can: Fertilizer prices are reported at a lag by private entities such as Cargill or as part of an International Monetary Fund index. Fortunately, the share prices of such American fertilizer manufacturers as Scotts Company, IMC Global and Mississippi Chemical and of such Canadian producers as Potash Corporation and Agrium are available immediately.

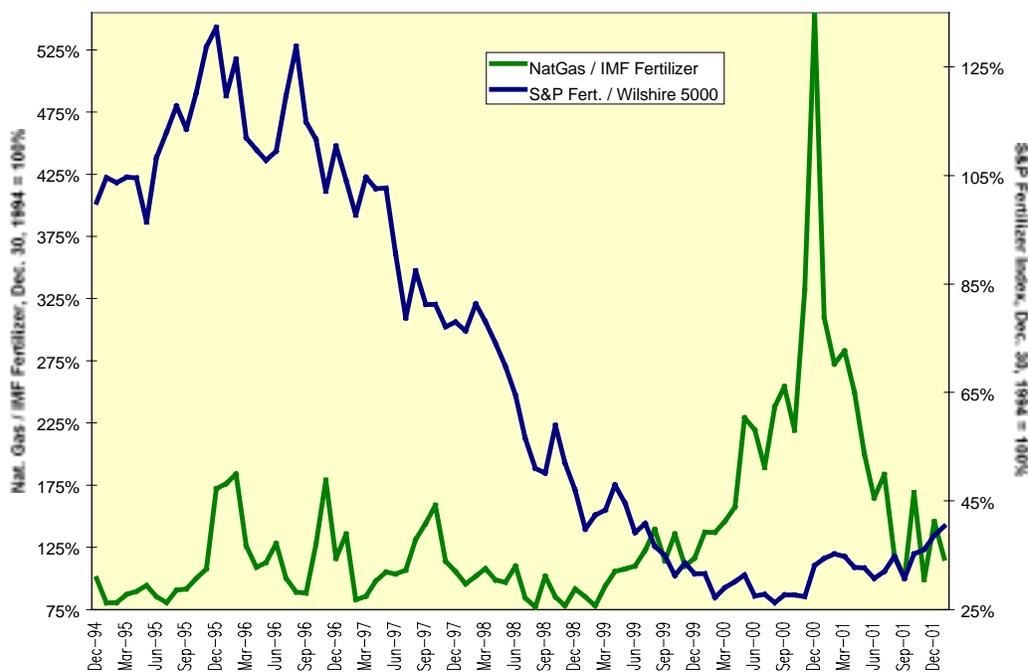
Key Fertilizer Prices



The jump in natural gas prices in 2000 pushed ammonia prices higher, but as economic theory would predict, the margins for ammonia production got compressed. And, the higher ammonia cost could not be passed on to farmers in the form of higher DAP and urea prices. As natural gas prices tumbled in 2001, the margins for ammonia production and subsequently for DAP and urea production expanded apace.

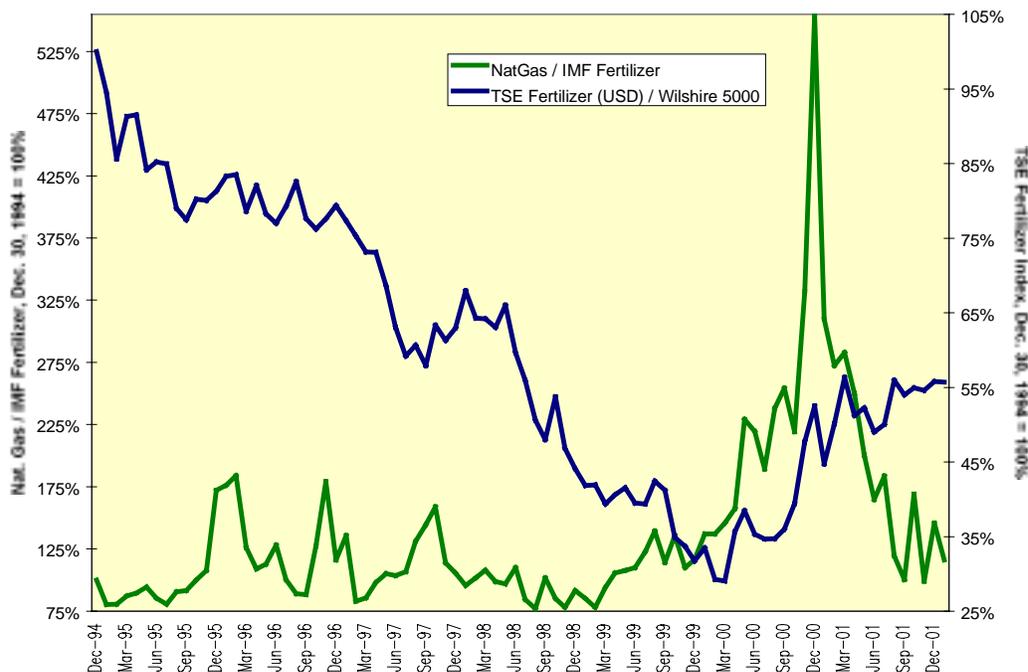
Not surprisingly, the economics of these margins affect the relative performance of fertilizer producers. If we take the relative prices of U.S. natural gas to the IMF's world fertilizer index and chart the relative performance of the S&P fertilizer index – IMC Global, Scotts, and Mississippi Chemical – we see how the rising natural gas prices turn these stocks into underperformers. This group enjoyed a modest rebound starting last fall, but it's still hard to get enthusiastic about a sector so dependent on 1) natural gas prices remaining low, and 2) farm incomes remaining high. That's a coming-and-going squeeze that's tough to beat.

Fertilizer Stocks Get Squeezed By Gas



Since we mentioned the Canadian producers earlier, we can extend the same comparison to the Toronto Stock Exchange's chemical and fertilizer index:

No Better Up North



Don't Get Back To The Basics

The lackluster performance and uninspiring prospects for fertilizer manufacturers should serve as a reminder to those of you ready to swear off technology: A basic industry with a real business, real sales, real earnings, long

product cycles and low research expenses can have dull and underperforming stocks. You can sell a dream on the latest high-tech bauble, but how can you do it for a basic commodity mix whose most inelegant and unspeakable ancestor is still sold in 50-pound bags in garden stores everywhere?

Salesmen of the world, a challenge awaits you.