

St. Valentine's Day (Commodity) Massacre

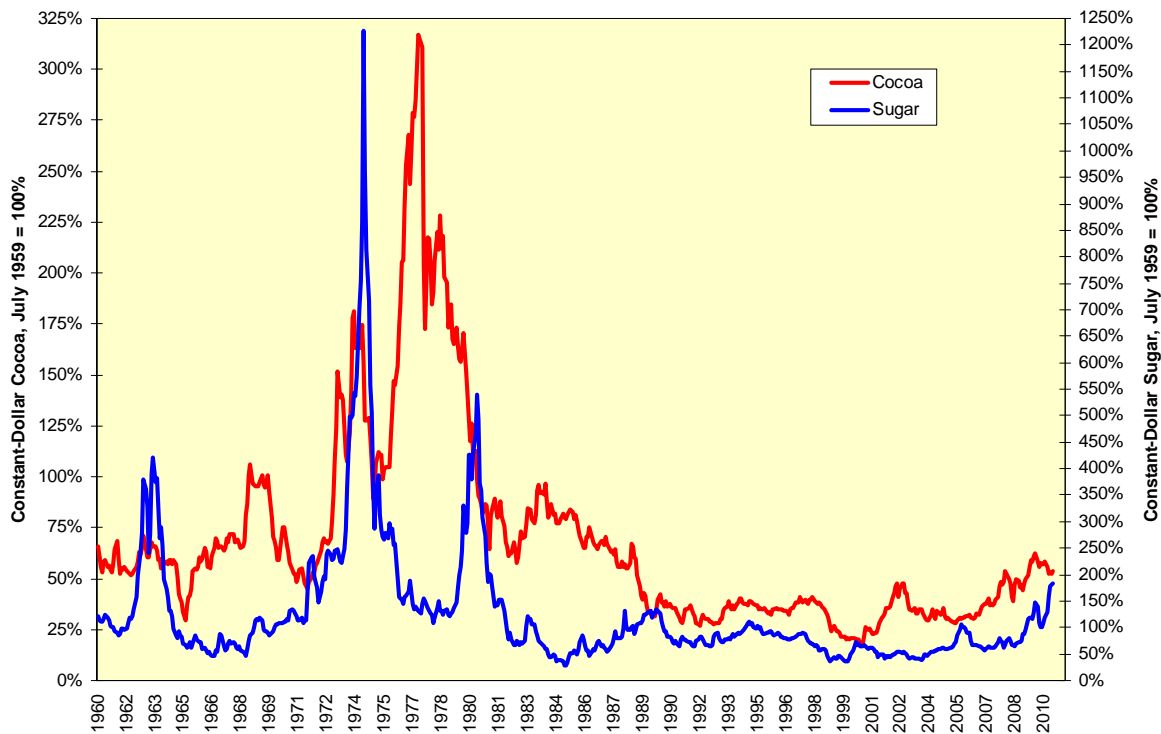
If Chicago was particularly famous for its Prohibition-related violence, it could have been equally famous for its confectioners as well. Years of sugar quotas forced domestic sugar prices up to levels regularly three times higher than prevailing world prices with the predictable result local businesses found candy was not dandy.

A second factor related to commodity-linked equities contributed to the consolidation of confectioners into larger food conglomerates: The volatility of commodities argues they be held in a horizontally integrated firm such as Kraft Foods, which recently acquired British confectioner Cadbury Schweppes. In addition, many commodity-related firms such as Cargill and Koch Industries are privately held so as to avoid dealing with shareholder freak-outs.

High, But Not Really High

The recent moves higher in the world price of sugar and in cocoa, two key ingredients for those Valentine's Day bon-bons, should be put into historic perspective. They are way below the levels seen in the 1970s in constant-dollar terms. Of course, I could and did say the same thing about gold ten years ago, and look what happened there.

Candy Ingredients Still Lower Than Thirty Years Ago

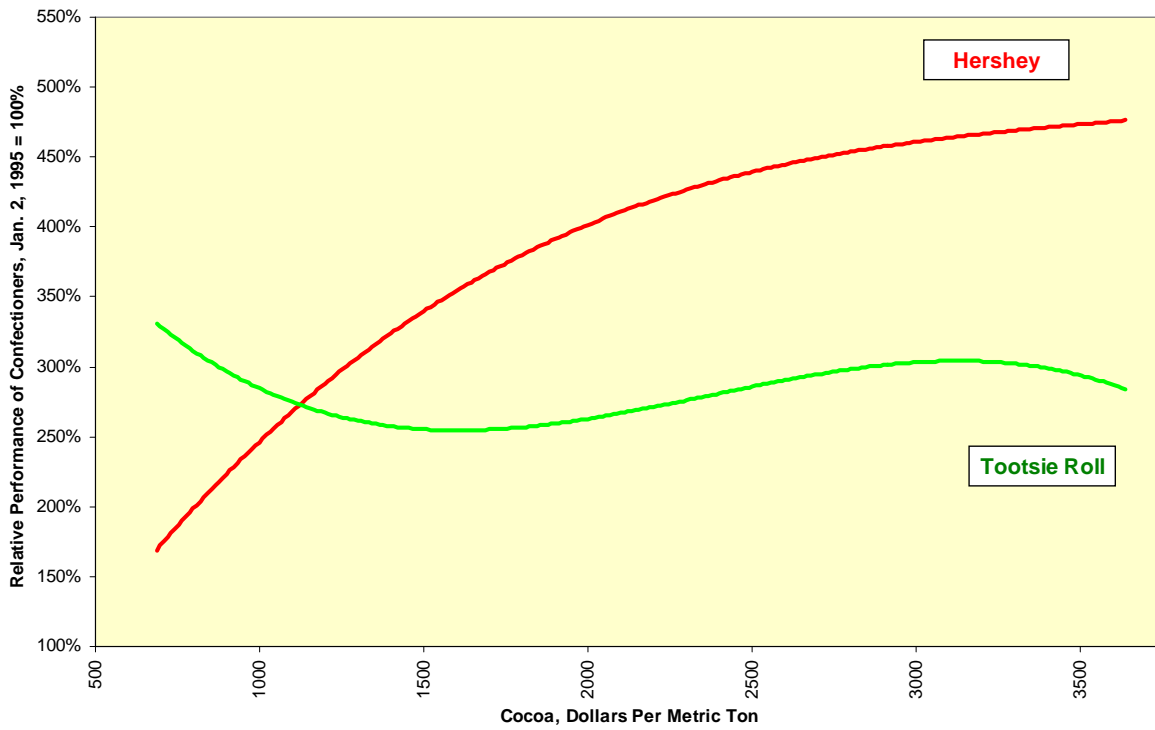


Mixed Effects For Mixed Chocolates

Let's map the relative performance of two remaining American confectioners, Hershey Foods and Tootsie Roll, as functions of cocoa and sugar prices, respectively. Neither firm is a pure play on chocolate candy, but dedicated chocolatiers such as Rocky Mountain Chocolate Factory tend to be small-capitalization issues. Only the trend-curves of the relationships will be displayed below to preserve visual clarity.

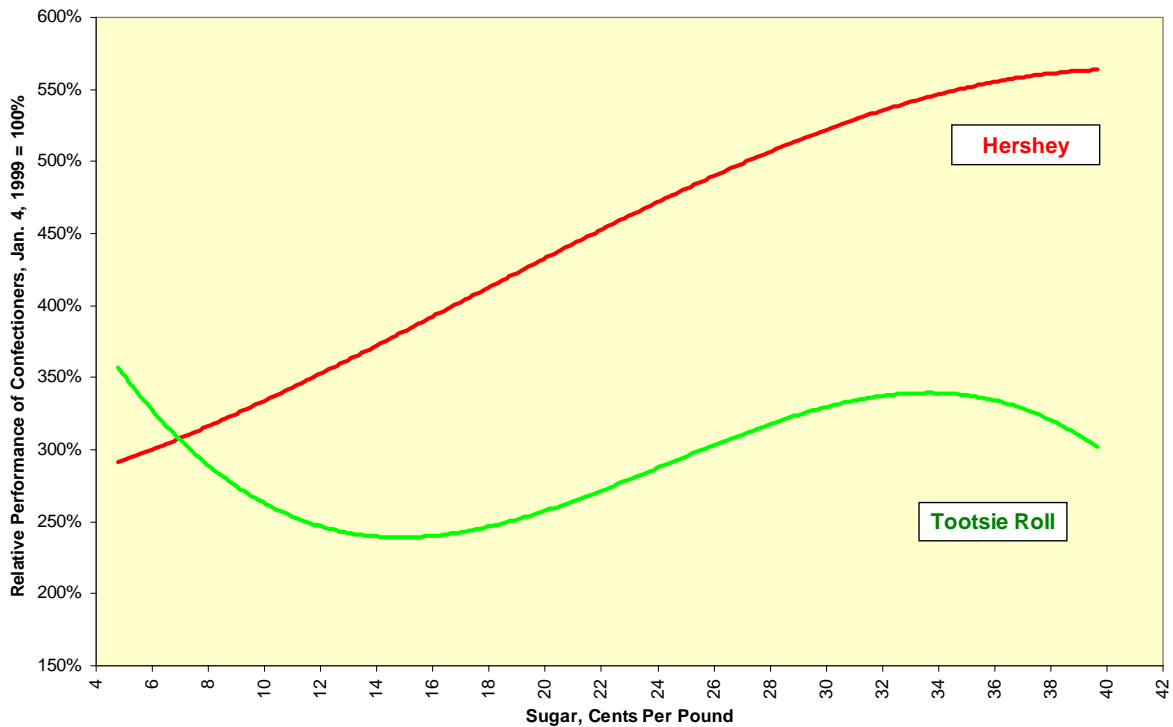
Hershey does a much better job of passing along higher cocoa costs to its customers than does Tootsie Roll. This is a rare case of a commodity buyer not only being able to absorb a higher feedstock cost but profiting from it as well.

Higher Cocoa Prices Affect Confectioners Weakly



If we draw the same map for sugar, we reach the same conclusion: Hershey shrugs off higher sugar prices while Tootsie Roll struggles. We can chew on that for a while.

Higher World Sugar Does Not Hurt Confectioners



If you have been a derelict sweetheart and forgot to acquire the appropriate gift for your one and only, forget the chocolates and buy a share of Hershey Foods in the scripophily market. And do not blame me for the outcome.