*Ruminations of*
# The Contrary Investor
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## Hungry for Profits

The Contrary Investor is often asked where he gets the themes we study, and ultimately in which we invest. The simple answer is two areas we constantly and diligently try to understand: demographics and our environment. Under the broad heading of "demographics", readers know we have often weighed in on the impact of an aging population. But it is also most certainly a *growing* population, both domestically, and more dramatically, globally.

The world's population is expected to grow by about one-third to over 9 billion people by 2050. The lion's share of this growth will occur in developing countries, with rapidly expanding middle classes, and all of these people will need to be fed. Moreover, as the middle classes grow, the relative prosperity of the population grows with it. Growing prosperity has almost always been accompanied by a dramatic increase in the quantity of meat consumed, and more demand for meat means more demand for crops to feed the livestock that provide the meat.

Taking this train of thought to the next level leads to the inevitable conclusion that more demand for crops means greater demand for fertilizer. Fertilizer is considered a commodity, and some very smart people have identified a long-term secular trend toward higher commodity prices (notably, our friend David Fuller at www.fullermoney.com).

There was a huge run-up in the price of fertilizer, which reached a peak along with most agricultural commodities in 2008. Prices pulled back in 2009, and recent takeover/buyout activity in this space suggests that the bigger fertilizer companies see this as a buying opportunity before the next ascent within this long-term secular trend begins.

To back up one step, it is important to understand that fertilizer is broadly divided into nitrogen-based products and phosphate/potash-based products. The buyout activity is largely focused on the phosphate/potash side of the supply.

The biggest deal so far this year was unveiled on February 15th. Yara, a Norwegian fertilizer-maker, agreed to pay $4.1 billion for Terra, an American company. The deal will extend Yara's lead as the world's biggest maker of nitrogen-based fertilizer. Vale, a huge Brazilian mining company, has put up $4.8 billion for two recent purchases. These will boost its phosphate- and potash-based fertilizer businesses, which serve Brazil's vast and growing agricultural sector.

BHP Billiton, the world's biggest mining company, has also added considerable horsepower to its potash operations. In January it paid $320 million for Athabasca Potash, a Canadian business situated near a mine it owns in Saskatchewan. In a decade the combined sites could churn out 8 million metric tons of potash annually, twice the output of the world's largest mine and equivalent to a just under a sixth of global consumption. Such is the allure of potash that rumors last year suggested that Vale or BHP might bid for a big global fertilizer company such as America's Mosaic or PCS of Canada.

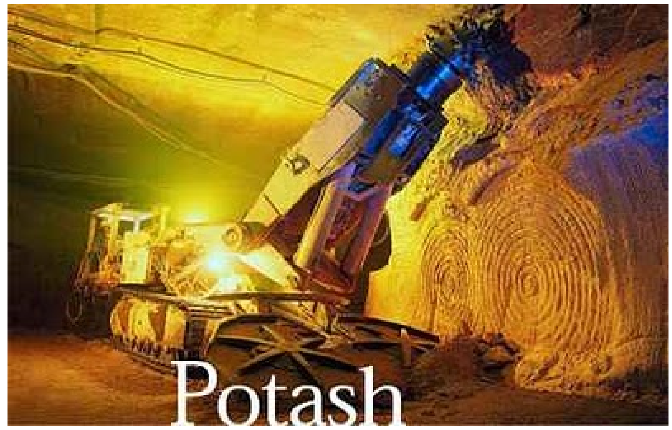
The Yara deal is partly a response to lower prices for natural gas in the U.S. Energy accounts for about three-quarters of the cost of producing nitrogen fertilizers, so cheaper gas and proximity to America's many farmers made Terra an attractive buy. China's demand for fertilizer is expected to be particularly buoyant as a result of its huge population and the poor quality of its arable land. China is largely self-sufficient in nitrogen fertilizers. But the country is already a big importer of phosphates and especially potash. It consumes around a quarter of the 50 million metric tons of potash produced in the world each year. By some estimates China alone might use 26 million metric tons a year within a decade and a half.

There are other factors at work besides the world's population pressures. The prices of fertilizers are recovering more slowly than those of other commodities, making fertilizer companies relatively cheap. That is especially true if the buyer is a mining firm, earning near-record prices once more for its ore. Big mining companies are also interested in phosphates and potash because they are generally extracted from the sort of huge mines that are their bread and butter.

The big players in the fertilizer industry include Agrium (AGU), CF Industries (CF), Mosaic (MOS), and Potash (POT). The International Fertilizer Industry Association estimates that demand for fertilizer fell by over 5 percent from 2008 to 2009, and is predicting a slow recovery this year — an increase of about 3.6 percent. But the largest potash fertilizer maker in the world, POT, sees demand rebounding sharply in the next few years. They forecast 50 percent more orders for potash this year, pushing prices from $400 in 2009 to $450 in 2010, and even $500 by 2011.

As credit eases and global economies begin to recover (if one believes that will happen), prices for fertilizer should catch up with other commodities. In addition, the buying frenzy of late does not hurt stock prices for these companies.

For the more adventuresome, there are much smaller companies producing/mining potash. Potash One trades on the Toronto Stock Exchange under the ticker KCL at around $3 per share, and has a market capitalization of a couple of hundred million dollars. — far below the radar of many analysts and investors, and way below POTs market cap of about $36 billion. KCL is involved in the so-called "Legacy Project" in Canada that owns permits on 515,000 acres, and is potentially the first new potash mine there since 1987. The bulk of the world's potash is extracted from less than two dozen deposits, and Saskatchewan is home to the largest of those. And unlike a number of countries that are the source of a variety of minerals, Canada is politically stable and strategically located for transport to agricultural centers.




A couple of caveat emptor's to consider. First, China has historically exerted downward pressure on potash prices, which is to be expected as a result of their disproportionate share of the market (and it will in likelihood only grow). For example in late 2009, expectations were that large potash contracts would be in the $350 per metric ton range, and China negotiated a price closer to $300. Second, share prices for POT, AGU, et al are very near 52-week highs, so the entry point right now might not be so attractive for value-oriented investors.

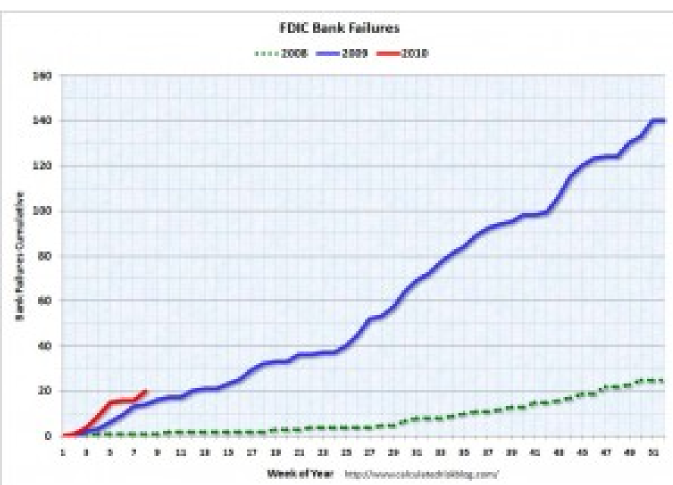
But the Contrary Investor believes that demographics is destiny (although some would disagree and label the phrase overused!). If one believes that the secular commodities boom will continue, and that a growing global population with a growing appetite for protein in their diet — in particular meat — is the future, then fertilizer companies might be worth digging into. An old adage says that "if it can't be grown, it must be mined." Last time we checked, profits in the stock market had to be mined!

- Alex Seagle

## What We Have Here is a Failure to Communicate

Many financial industry pundits are agreeing that 2010 is on track to see as many bank failures as there were in 2009 — around 150, or an average of about 3 each week. With real estate values continuing to fall, it is likely we will see the Federal Deposit Insurance Corporation setting up more shotgun bank marriages a la WaMU/Chase and Wachovia/Wells Fargo in 2009.

The number of distressed banks in the U.S. rose to 702 in the fourth quarter of 2009, the highest level in sixteen years, according to a report released by the FDIC. That number is up from 552 at the end of September and 416 at the end of June. This is the largest number of banks on its "problem list" since June 1993. Banks insured by the FDIC dropped to a total quarterly profit of $914 million in the fourth quarter, compared with $2.8 billion in the third quarter. However, the result was significantly better than the $37.8 billion loss for insured institutions during the fourth quarter of 2008. Insured deposits reported full-year net income of $12.5 billion. The FDIC reported that its Deposit Insurance Fund dropped further into negative territory, reporting a $20.9 billion loss in the fourth quarter, worse than its $8.2 billion loss in the third quarter. The agency hopes to make up that loss through advance payments by banks of $45 billion in fees.




The graph above shows bank failures for 2008 (the dotted line), 2009 (the long solid line), and 2010 to date (at the lower left).

A look at the historical relation between the Savings and Loan crisis of 1982 to 1989 and the unemployment rate reveals that bank failures take years to peak after the unemployment rate has peaked. Unemployment peaked in 1981 and steadily fell after that. At the same time, bank failures mounted with nearly 2000 banks brought to their knees in about 6 years, with 1989 accounting for some 534 of them. In the 1980s, bank failures did not spike in one year and then come back down, but rather remained elevated for an extended period from 1988 through 1993.

When a bank fails, it seems the other remaining financial institutions in the community are reluctant to aggressively market themselves to the failed bank's customers. They don't want to seem insensitive to the hardship placed on the community, nor come across as if they were dancing on the grave of their fallen peer. The psychology is understandable, but the strategy is a huge mistake and a massive missed opportunity — a mistake which the Contrary Investor does not see continuing.

All of this goes to a theme we have focused on and believed in for some time: increasing consolidation within the financial services sector. This trend is global, and extends beyond banks to include investment management firms, investment banking names, and even insurance companies.

2009 experienced a pause in financial services consolidation, in large part due to share price volatility and low valuations. Effectively, the crisis in financial services made it virtually impossible for a company that might be acquired to realize a price that recognized the true value of the business, and was acceptable to shareholders. With increased stability and improving valuations, that equation has changed. In short, the Contrary Investor is looking for the "urge to merge" to return.

There are clearly risks and challenges facing firms on both sides of the deal, chief among them the uncertainty surrounding commercial real estate loans on the balance sheets of banks, and derivative products packaged and traded by investment houses.

But the credit crisis of 2007-08 has hastened the trend toward financial industry mergers, albeit lately in a forced fashion. Weakened firms have had to merge with stronger rivals. In particular the remaining large independent securities firms have ceased to exist as such, either by being absorbed by large banks or by reorganizing themselves as bank holding companies. These include Bear Stearns, Lehman Brothers, Merrill Lynch, Morgan Stanley, and even the mighty Goldman Sachs. Two massive, yet troubled, banks have been absorbed by other already-huge competitors (Washington Mutual and Wachovia). Additionally, Fannie Mae, Freddie Mac and AIG are now under federal control.

Add to these, and other credit crisis-related mergers the possibility of new deals that participants *want*, not *have* to do, and there is potentially a lot of activity on the horizon. The advantages of the non-distressed merger have not changed: cross-selling opportunities, expanded distribution, vertical integration and increased diversification, to name a few. To be sure, any such transactions will be carried out within a regulatory environment far tighter and different than before. But we believe they will continue to happen, and happen more frequently.

Another interesting facet of consolidation is the cross-border consolidation that has taken place in Europe over the past 10 years or so. We'll leave that for a different discussion!

The Contrary Investor does not advise investing in a company simply or even primarily because it might be the target of a merger or takeover. However, there will be winners and losers as this trend plays out. As Louis Brandeis once said, "Size, we are told, is not a crime. But size may, at least, become noxious by reason of the means through which it was attained or the uses to which it is put." In 2000, the top five U.S. banks held 11 percent of all deposits. By 2008, that figure had grown to 37 percent. We believe financial services companies will not stop looking to grow stronger and more innovative — and bigger.

❑ Alex Seagle

## Don't Think I Even *Begin* to Understand Women!

A couple of years ago, a new catchphrase entered our lexicon: "Womenomics". The term refers to the dramatic rise in the economic power of women across a broad spectrum of issues. Women have huge power in the marketplace and the workplace, and the trend shows no signs of slowing down. The good news is that an investor doesn't need to understand women (which, as my wife will attest, the Contrary Investor does not). An investor instead needs to focus on the companies that do — those that "get it."

First, the marketplace. Women control 83 percent of consumer spending in the U.S., according to a host of studies conducted by respected think tanks and market research firms. They buy more cars and consumer electronics than men. They buy over 80 percent of all healthcare products, and influence, if not determine almost 100 percent of home buying as well as home improvement products' purchases.

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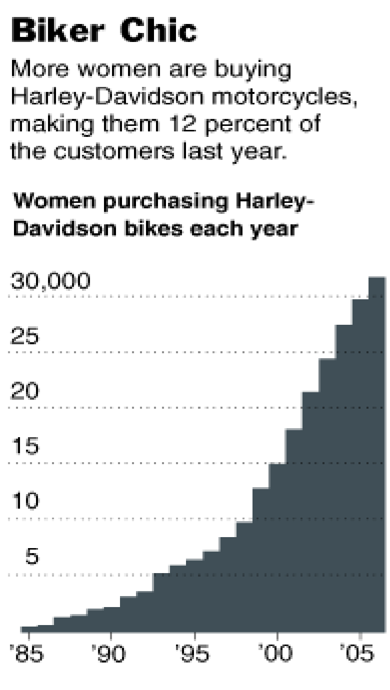
**More will be announced as they confirm their availability.**

Virtually from birth, American women and men are raised to view and spend money quite differently. While most experts agree that the generalizations are breaking down to a degree, the money paradigm most of us have is similar:

- Women view money as a means to create a lifestyle and spend on things that enhance day-to-day living.
- Men view money as a means to capture and accumulate value. Men don't want something, they need it.

The companies that understand how and why women spend, and develop strategies that successfully address these issues will most certainly come out ahead of those still scratching their heads. A great example of this, and one I didn't expect, is motorcycle maker Harley Davidson. Turns out few companies are doing more than Harley in reaching out to women. From sales of essentially zero twenty years ago, women now make up over 12 percent of their sales. In addition to motorcycles, Harley is also doing a brisk business in logo clothing. Here, they made changes designed to appeal to women including bright colors with rhinestones, and the skull motif became wings and flowers. This is clearly a company that "gets it", and is benefitting.




Now for the workplace. The most telling statistic comes from a 19 year Pepperdine University study of Fortune 500 companies. It, and other studies, found that those companies with the best record of promoting women outperformed the competition by anywhere from 41 to 116 percent in the best yardstick of all: making money for shareholders. In short, companies with more female managers make more money. And it is not terribly difficult for an investor to see which companies have women in senior management.

Women's management style is increasingly seen as valuable, not soft. Their right-brain skills like inclusiveness, a focus on compromise, and aversion to risk are necessary for a profitable business. According to one report from the World Economic Forum in Davos, Switzerland, after looking at the dearth of women in investment banks, the not-so-tongue-in-cheek opinion was that "a Lehman Brothers with a few sisters on board might have contained the economic crisis."

Should our economy ever get back to hiring again, there is a looming talent shortage. The younger generations are smaller in number than the Baby Boomers, and the Economic Policy Foundation estimates there will be a 6 million person gap between college graduates and people needed to cover job growth. Highly educated employees will be in big demand, and guess which sex earns more college and advanced degrees?

But employers will need to understand and address women's preferences when it comes to who they will join in the workplace. Perhaps most importantly for women, time is the new currency, and money is often secondary. Companies need to recognize that flexibility is key to hiring women and improving employee productivity and morale. Early adopters like Capital One have no mandatory office time for their managers. They made the move to improve morale, but found a huge uptick in productivity too.

Remember, the Contrary Investor started this

## Words to Consider

Whatever women do they must do twice as well as men to be thought half as good. Luckily, this is not difficult.

~ Charlotte Whitton

Women really do rule the world. They just haven't figured it out yet. When they do, and they will, we men are all in big trouble.

~ www.drleons.com

I have an idea that the phrase "weaker sex" was coined by some woman to disarm some man she was preparing to overwhelm.

~ Ogden Nash

Everywhere is within walking distance if you have the time.

~ Steven Wright

I think my favorite sport in the Olympics is the one in which you make your way through the snow, you stop, you shoot a gun, and then you continue on. In most of the world, it is known as the biathalon, except in New York City, where it is known as winter.

~ Michael Ventre

The best way to succeed in life is to act on the advice we give to others.

~ Unknown

*Continued from Page 5*

article by saying he does not claim to understand women. But there are those who do, and investors would do well to take notice. At the end of the day, womenomics — and successful investing — is all about the bottom line.

❑ Alex Seagle

*More Words to Consider*

What is bought is cheaper than a gift.

~ Portuguese Proverb

Man is rated the highest animal, at least among all animals who returned the questionnaire.

~ Robert Brault

The guy who invented poker was bright, but the guy who invented the chip was a genius.

~ Unknown

I don't give a damn for a man that can only spell a word one way.

~ Mark Twain

A government that is big enough to give you all you want is big enough to take it all away.

~ Barry Goldwater

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