

Global Agriculture & Agflation

Agflation has begun

Food prices are rising, putting upward pressure on producer and consumer inflation. Agflation has begun. Given the expanding constraints on food supply, the changing demand for food, and the entrance of the energy business as mass consumers of food products it is not surprising to see food prices rapidly putting upward pressure on overall inflation.

This can be good news for the food companies who are attempting to pass along those higher food input prices to the consumer. They are maintaining or expanding margins and they are hopeful that the constraints on food supply and the changing and expanding global demand for food products will continue to put upward pressure on prices.

Investment Strategy | Global
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“Thematic Investing” highlights 5-10 year investment opportunities that are suited for longer-term, risk-oriented investors.

Table 1: Prior Issues In Thematic Investing

Title	Date
The ABCs of digital media convergence	April, 2007
The Next Space Race	March, 2007
The Fountain of Youth - Update	February, 2007
Global Agriculture	January, 2007
Themes in the news	January, 2007
National Security: a Global Issue	October, 2006
Vaccines Get a Shot in the Arm	August, 2006
The Fountain of Youth	June, 2006

Source: ML ISG

Table 2: Stocks that represent the ML Global Agriculture & Agflation Themes

Company:	Bloomberg Ticker	ML Ticker	ML Rating	Market Cap (A)	Price (A)	Country	Description
1 Agrium	AGU	AGU	C-1-7	\$ 5,553	\$ 41.59	Canada	Global supplier of nitrogen, potash, and phosphate.
2 Archer-Daniels-Midland Co	ADM	ADM	B-1-7	\$ 25,503	\$ 39.07	US	Sells ag commodities; processes oils, corn, & grains.
3 Associated British Foods	ABF LN	ASBFF	A-2-7	GBP 7,327	GBP 926	US	Processes & manufactures food products, refines sugar.
4 Bayer AG	BAY GR	BAYZF	B-1-7	EUR 39,119	EUR 51.18	Germany	Agricultural & biotech products; animal health products.
5 Bunge Limited	BG	BG	B-2-7	\$ 9,268	\$ 77.09	US	Agribusiness & food; manufactures foods & fertilizers.
6 CF Industries Holdings Inc	CF	CF	C-1-7	\$ 2,377	\$ 43.08	US	Manufactures & distributes fertilizers.
7 CNH Global N.V.	CNH	CNH	C-2-7	\$ 10,351	\$ 43.75	Holland	Manufactures & sells agricultural equipment.
8 Danisco A/S	DCO DC	DNSOF	A-3-7	DKK 21,626	DKK 442	Denmark	Produces & markets food ingredients, sugar, animal feed.
9 Dean Foods Co	DF	DF	B-3-9	\$ 4,664	\$ 36.17	US	Food & beverage company, especially dairy.
10 Deere & Co.	DE	DE	B-2-7	\$ 25,460	\$ 112.23	US	Manufactures agricultural equipment.
11 Dow Chemical	DOW	DOW	C-2-7	\$ 43,565	\$ 45.42	US	Biotechnology agricultural products; crop protection.
12 Du Pont De Nemours	DD	DD	A-1-7	\$ 45,920	\$ 49.69	US	Crop protection & animal health solutions.
13 Fresh Del Monte Produce Inc	FDP	FDP	B-2-9	\$ 1,142	\$ 19.80	US	Produces & markets fresh produce.
14 General Mills Inc	GIS	GIS	A-1-7	\$ 20,810	\$ 60.08	US	Manufactures & sells consumer food products.
15 Hain Celestial	HAIN			\$ 1,212	\$ 30.74	US	Natural & organic food company.
16 Kellogg Co	K	K	A-1-7	\$ 21,124	\$ 53.08	US	Markets ready-to-eat cereals & other grain-based products.
17 Monsanto	MON	MON	B-1-7	\$ 32,819	\$ 60.30	US	Global leader in biotech agricultural products; crop protection.
18 Northern Foods PLC	NFDS LN	NTFOF	B-3-7	GBP 635	GBP 129	UK	Manufacturer of fresh food products for grocery stores.
19 Potash Corp of Saskatchewan	POT	POT	B-1-7	\$ 19,542	\$ 186.02	Canada	Produces potash, phosphate, & nitrogen.
20 Smithfield Foods Inc	SFD	SFD	B-2-9	\$ 3,393	\$ 30.27	US	Processes pork & produces hogs; sells food products.
21 Suedzucker AG	SZU GR	SUEZF	A-3-7	EUR 2,865	EUR 15.13	Germany	Makes sugar, artificial sweeteners, starch, bakery additives.
22 Syngenta	SYT	SYT	A-2-7	\$ 20,866	\$ 40.11	Switzerland	Leader in ag biotech; crop protection.
23 Tate & Lyle	TATE LN	TATYF	A-2-7	GBP 3,065	GBP 626	UK	Makes sweeteners, starches; food manufacturing.
24 Terra Industries Inc	TRA	TRA	C-1-7	\$ 1,864	\$ 20.10	US	Makes nitrogen fertilizer, crop protection products;
25 The Mosaic Co	MOS	MOS	C-1-9	\$ 13,710	\$ 30.75	US	Makes nitrogen fertilizer and crop protection products.
26 Tyson Foods Inc	TSN	TSN	B-1-7	\$ 7,532	\$ 21.20	US	Sells beef, chicken & pork products.
27 UAP Holding Corp	UAPH	UAPH	C-1-7	\$ 1,426	\$ 27.71	US	Distributes crop protection, chemicals, fertilizer, & seeds.
28 Wal-Mart	WMT	WMT	A-1-7	\$ 199,376	\$ 48.34	US	World's largest retailer, leading food retailer.
29 Whole Foods Market Inc	WFMI	WFMI	XR VW	\$ 6,679	\$ 47.51	US	Owns & operates natural food supermarkets.
30 Wild Oats Markets Inc	OATS	OATS	XR VW	\$ 539	\$ 18.04	US	Operates natural food supermarket chains.

(A) As of 4/27/07.

Source: ML Investment Strategy, ML Analysts

The table above contains a list of stocks that are representative of the theme of this report. There may be some stocks in the list on which Merrill Lynch does not offer an opinion. The table is not intended to represent a series of purchase suggestions but is offered as a reference list.

HAIN: One or more analysts responsible for selecting the securities in the above table own such securities.

Cross Reference

[Global Agriculture](#)
[Thematic Investing, 24 January 2007](#)

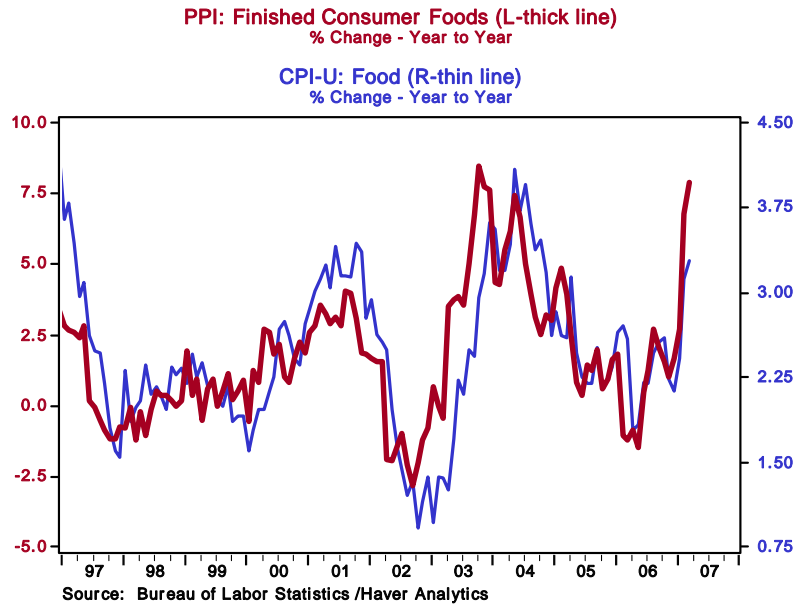
Agflation: rising food prices are putting upward pressure on overall inflation, which is bad news for the consumer.

Agflation

Food prices are rising, putting upward pressure on producer and consumer inflation. Agflation has begun. In January we published a Thematic Investing report entitled *Global Agriculture* in which we analyzed the changing currents in the world of the global food business. In that report we suggested that given the constraints on food supply, the changing demand for food, and the entrance of the energy business as mass consumers of food products, it would not be surprising to see food prices rapidly putting upward pressure on overall inflation.

That phenomenon is already underway and we call it Agflation. While inflation has become a concern for the financial markets, it has even led some economists to suggest we may be facing a period of stagflation again. What concerns us is not the cyclical rise we have seen in inflation, but a secular price rise we have seen in the global agricultural business that may be more long-lived, or Agflation.

Chart 1: Food prices are on the rise, for producers and consumers alike.



Source: BLS, ML ISG

Agflation is good for the food companies as long as they can pass along the higher food input costs to the consumer.

Agflation is bad news for the consumer, already under pressure from higher energy prices. For the food companies, however, it could be good news as many companies have been able to pass along those higher costs to the end user. According to Merrill Lynch food analysts Diane Geissler and Eric Serotta higher food input prices may result in higher food prices for the consumer, as the pressure is widespread across product categories and geographic regions.

Chart 2: Food input prices are putting more upward pressure on producer inflation than at any point since the early 1980s.

PPI Finished Goods Ratio: Foods/Core PPI



Source: BLS, ML ISG

Chart 3: Food input price pressures for the consumer have not been this severe since the early 1990s.

CPI Price Ratio: Food CPI/Core CPI



Source: BLS, ML ISG

The increased demand for corn due to the energy factor has pushed prices upward for various products. According to ML's Geissler, the result in the protein business, especially poultry, has been that higher input costs (i.e.: corn) have

resulted in lower production. This, in turn, has cut the available supply of poultry, therefore raising prices for that product. Those higher prices, according to Serotta, who follows the packaged food companies, have been successfully passed through to the consumer.

Prices of other products have risen as well. Wheat and wheat products have risen in price as farmers have begun to shift production to corn from wheat. Dairy prices are up across the board as higher grain prices to feed the cattle have pushed up input costs. These higher input costs have resulted in higher prices at the supermarket as companies have been able to maintain or even expand margins.

China's inflation rate more than doubled in 2007 due to food inflation - or Agflation.

This is not just a US-centric story. China recently alarmed the financial markets by posting an 11% growth rate in the first quarter of 2007. What spooked the markets even more was the fact that the Chinese inflation rose at a 3% rate in March – more than double the 1.5% CPI advance of 2006.

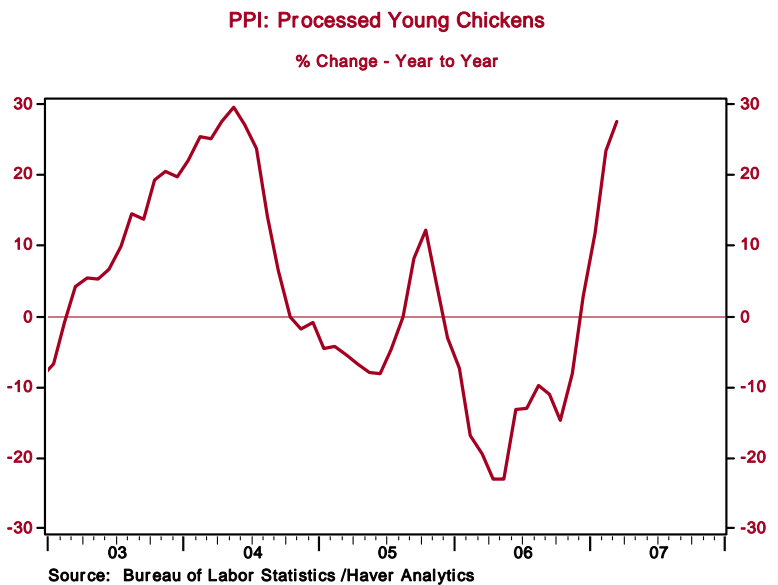
In the US, the USDA forecasts food inflation rising to 3.5% in 2007, up from only 2.3% in 2006.

In the US, according to the US Department of Agriculture (USDA) food inflation at the retail level is expected to surge 3.5% this year, after rising only 2.3% in 2006. In the first three months of the year, food prices rose at an annualized rate of 7.3%.

Higher feed costs = higher protein prices

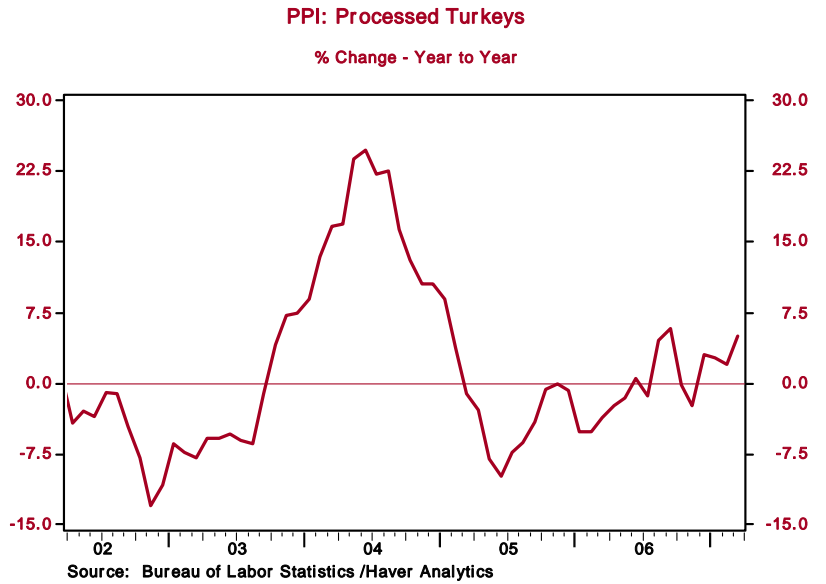
In early March, Tyson Foods' CEO stated that higher corn prices will continue to drive up the price of meat and chicken due to higher feed costs. Tyson, the largest buyer of corn in the US, said that higher feed costs led to a 41% drop in poultry profits in its fiscal first quarter. Expect them to try to pass along higher input prices to the consumer.

Chart 4: Higher grain costs have driven up the price of chickens...



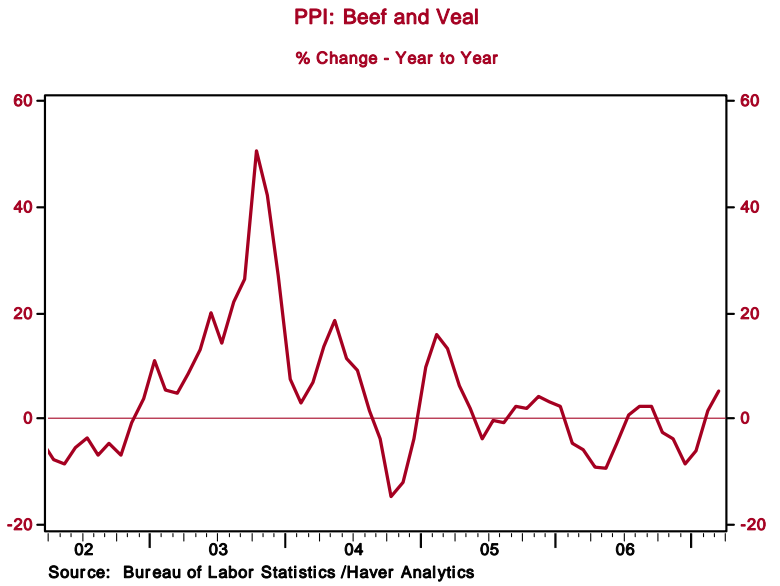
Source: BLS, ML ISG

Chart 5: ... turkeys, ...



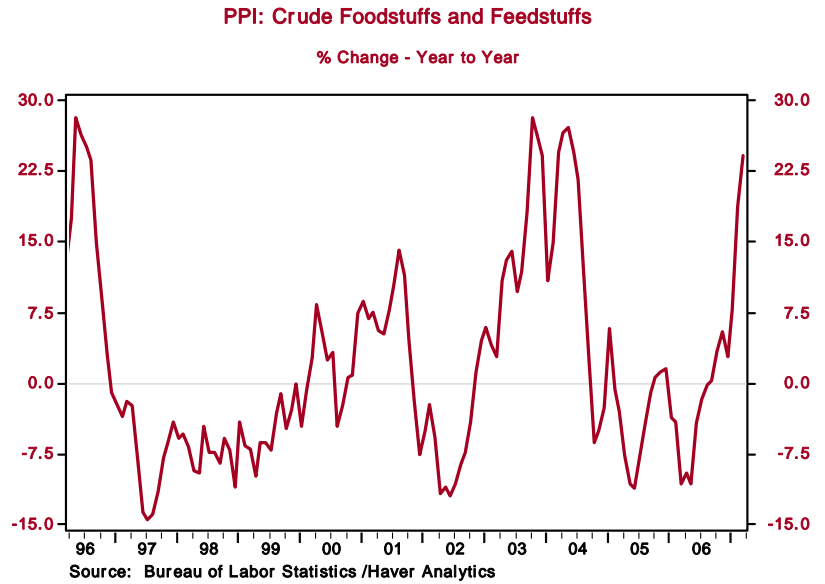
Source: BLS, ML ISG

Chart 6: ... and beef.



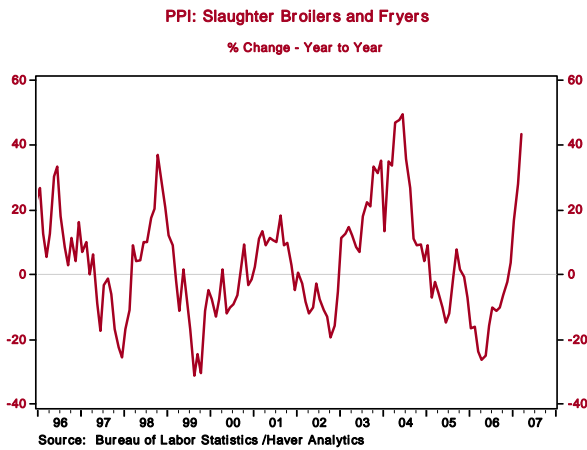
Source: BLS, ML ISG

Chart 7: Overall, crude food prices are rising more than 20%



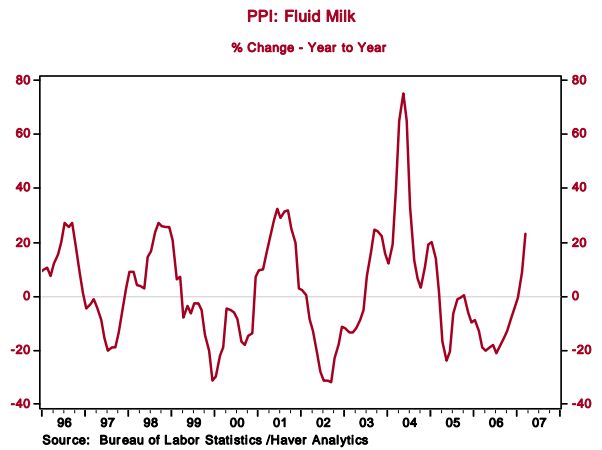
Source: BLS, ML ISG

Chart 8: The prices of poultry...



Source: BLS, ML ISG

Chart 9: ...and dairy products are soaring.



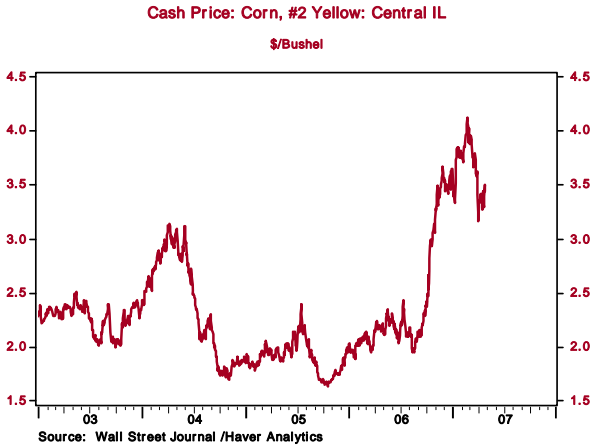
Source: BLS, ML ISG

Corn prices are up

After briefly breaking through the \$4 level, corn prices have dropped after a USDA announcement that corn plantings would rise 15% in 2007 to 9.5 million acres – the most since 1944. Despite the surge in corn plantings, prices for corn have remained high. Many agricultural experts fear that, given the increased demand for corn, especially for the production of Ethanol, there still may not be enough corn available. Weather may also play a role in this harvest as excessively wet weather in the Midwest has delayed the planting season which may put crops at risk.

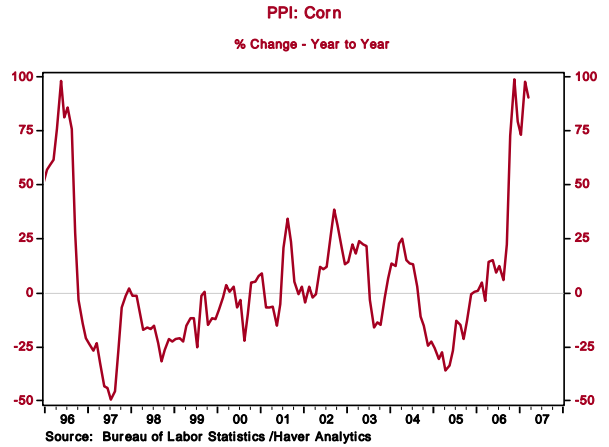
27 April 2007

Chart 10: Corn prices on the open market remain above the \$3 level and are up meaningfully from last year...



Source: BLS, ML ISG

Chart 11: ...causing the PPI for corn to soar.

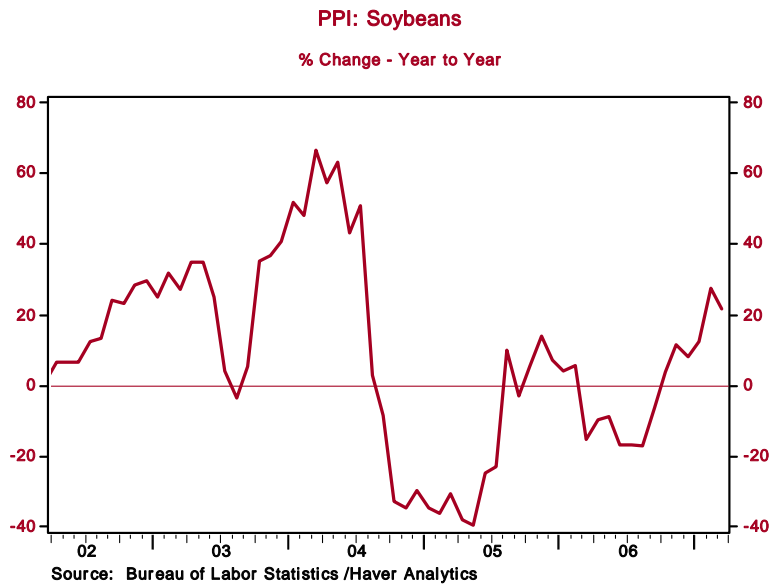


Source: BLS, ML ISG

Soybean plantings take a hit

The rise in corn plantings this year has come at the expense of several crops. The USDA expects soybean plantings to fall 11% this year to 67.1 million acres, an 11-year low. Harvests are under scrutiny as excessive rainfall in Brazil and Argentina may have damaged crops and may lead to a weaker harvest globally than initially expected.

Chart 12: Soybean prices have risen in anticipation of tightness in supply.

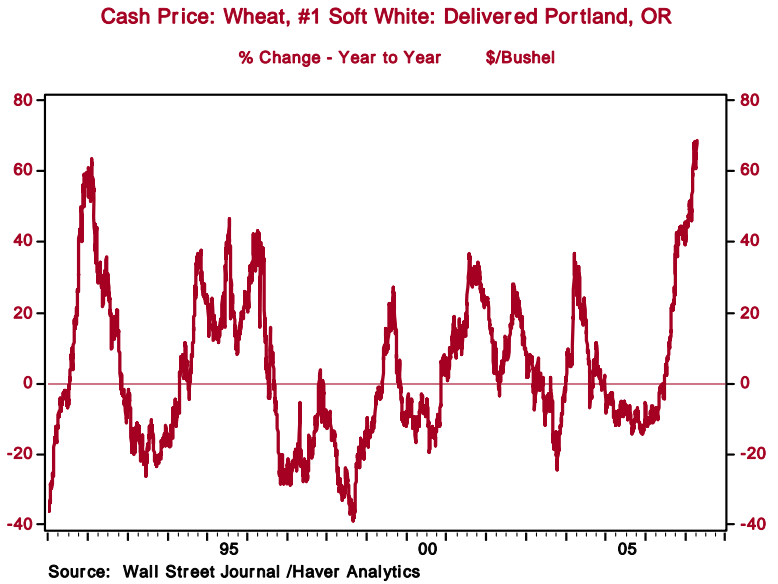


Source: BLS, ML ISG

Wheat

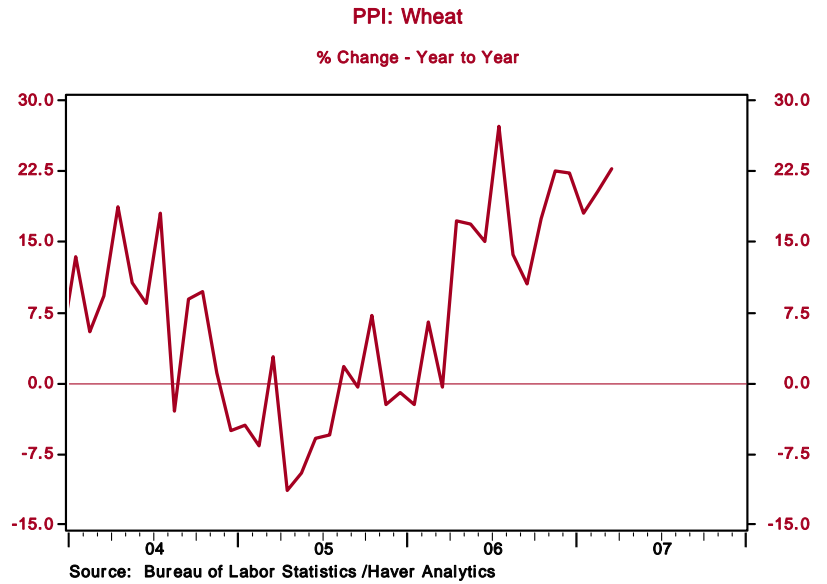
The price of wheat has risen as well. The USDA estimates that wheat plantings (of all varieties) will rise 5% this year to 60.3 million acres. However, that rise is from last year's very low levels which were the second lowest planting levels since 1972. Moreover, freezing weather conditions throughout the country have sent wheat prices soaring on speculation of a poor harvest.

Chart 13: Cash wheat prices have soared...



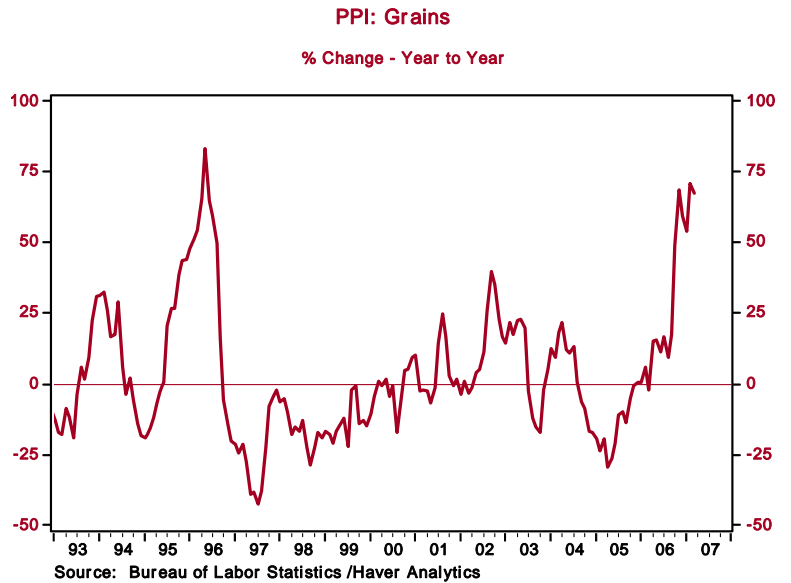
Source: USDA, ML ISG

Chart 14: ...resulting in higher wheat input costs.



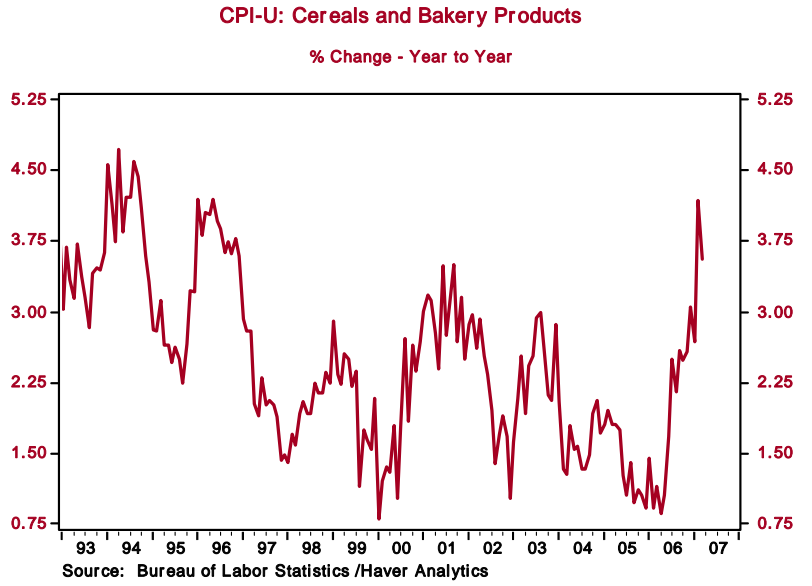
Source: BLS, ML ISG

Chart 15: Overall producer grain prices haven't risen this rapidly in 12 years



Source: BLS, ML ISG

Chart 16: The result has been the highest rise in cereal and bakery prices we have seen in a decade.



Source: BLS, ML ISG

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