The Skeptical Advisor
JUNE 2006 Skepticism is the First Step Toward Profit.

A Latin American Giveaway Now Available North of the Border

For every Google, there are a hundred Amazons.

For every successful trailblazing company — that goes after its market in a completely different way or creates value in new and surprising ways — there are a heap of companies with business models that failed to launch.

It took Amazon six years to turn a profit. Had investors not been in love with the *idea* of Amazon, it would have fallen by the wayside long before finally finding the ability to grow.

Trailblazers are usually exciting and sexy and create a lot of buzz ... until they go under.

Give me, instead, the boring followers. They see something that works and repeat the same formula. The best followers refine the formula and do better than the companies they follow.

The kind of company I have for you today couldn't come up with an original idea if you put a gun to its collective leadership. But there's not a better follower around.

Not only that, it operates in an industry that has been down so long that it was the poster child for beat-up industries everywhere. But that's ancient history.

And to add insult to injury, its main markets aren't in the U.S. Though they are in North America ... and further south. And these markets are growing faster than the U.S. market.

So — what's so special about a steel company operating in Mexico and South America that's not doing anything the industry hasn't seen before?

What this company lacks in pizzazz it more than makes up for in fundamentals and efficiency.

For example, its operating margin is an eye-popping 42%. That's eye candy. The S&P 500's average operating margin is 21.3%. The steel industry's average is 14.7%.

Margins are so critical to a company's survivability, it's always the second thing I look at. (I'll tell you the first thing I look at in just a moment.)

Fat margins will see you through thick and thin. And in the cyclical steel industry, where prices worship the Blood, Sweat, and Tears ditty — "What goes up must come down" — big margins is the body armor steel companies must wear to merit serious investment consideration.

With margins three times those of your average steel company, the risk of investing in this company is largely removed.

What you may not know is that the steel sector has been on a tear for the past three years. The Dow Jones steel index has gone up 450% since 2004.

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Inside This Month

So what is a steel company with bulging margins in a fast-rising market worth?

Well, if you invested in this company now, you'd be getting its business for free with a 100%-300% gain on your investment right around the corner.

How Can a Profitable and Growing Business Be Free?

I know. I know. This sounds too good to be true.

Or I'm holding back on some terrible news about the company.

How can this make sense?

Before I tell you the name of this company, let me explain how you can get its business for free.

The net asset value or "book" value of the company is $4.8 billion. It's easy to figure out. When you subtract its liabilities, that's how much this company's assets are worth.

Its stock goes for $3.8 billion, or $1 billion (and 20%) less than the net value of its assets.

For every dollar of investment in this company, you get a 20% discount off the value of its assets.

<u>You get 20% of its assets ... plus all its business for free</u>.

These aren't junky assets either. These are the same assets that are generating 42% margins.

So, if it's not the assets that are flawed, maybe it's the steel business ... maybe it's so little valued these days that it's going for free.

Sorry. That's not it either.

For every $3.84 you invest in other steel companies, one dollar covers the assets and you pay on average $2.84 for the steel business.

And those other steel businesses muster up only one-third of the margin that this company has.

So you should be paying at least $2.84 for this company's steel business.

But really you should be paying even more than that because it's generating outsized margins.

But you're not paying $2.84. You're not even paying $0.84. You're paying absolutely nothing for this company's steel business.

This stock is shouting at the top of its lungs: "SALE!"

I'm shouting at the top of my lungs: "BUY!"

This is one of the best-run steel companies in the world. Its price — just compared to its earnings — should be at least double what it is right now. But if you look at the overall performance and assets of the company, its price should be closer to four times what it's now going for.

And it's a minor miracle that it's not.

The New Steel Is the Old Plastic

There's one more thing you should know before I tell you the name of this company. You need

The **Skeptical** Advisor

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to understand how the steel industry has made its comeback.

I witnessed its road back to operational health firsthand, when I was selling mostly American steel — very high quality steel at that — to Asia.

At the time, steel was abundant in Asia and cheap — but only Japan made the good stuff and its steel was as expensive as the U.S.'s.

So my competition was Japan, yes? You would think so ... but no. It was Korea. POSCO's steel was just half-a-notch below what I was offering from the U.S., but much cheaper. And they were very aggressive in selling it. Korea was my competition and made my price negotiations in Asia — should I say — "challenging."

In sourcing American steel, I visited dozens of steel plants. At first sight and smell, they were grungy and oily. But the furnaces were relatively new and more efficient than previously. And floor managers boasted of automated processes ... of more precise calibration of chemical injections ... of the breakthroughs in material applications ... and of more rigorous quality control.

From: The Skeptical Advisor (SA)
Sent: Monday, May 15, 2006, 8:49 AM
To: Andrew Gordon
Subject: What Sets Steel Apart?

Steel is steel. Isn't its upside limited?

"Bankrupt mills that were about to be taken over were going for \$80-\$100 per ton. Now they're going for \$500 to \$800 per ton. In the next six months, this increasingly used metric will fuel the price growth of steel companies everywhere as valuation finally catches up to the new realities of the marketplace. And leading the charge up the charts will be this company — the most underpriced steel company of them all."

And there was an air of optimism in these places. They had done the hard work of retrenching, upgrading technology, and becoming more efficient. They knew the market was coming back to them.

And it has.

The U.S. steel spot-market hit a low of \$435 per ton of hot rolled coil (a common product used in washing machines and autos) last August before rebounding to \$550 per ton in December as mills restocked. (And prices have remained steady in the early months of this year as production cuts by leading steel producers stabilized prices.)

Prices may be a little jumpy, but the demand for steel has never been greater, fed by China's need to build up infrastructure in its rapidly expanding cities. China's economy is booming. Its banks are pouring billions of Remnibi *every month* into construction projects. And there's no end in sight to this hyper economic activity.

If it took Japan and Korea a decade and a half to modernize their economies, it should take China 2-3 times that long AT LEAST ... by which time India should be ready to step in and take up the slack. But that's another story.

The point is, steel is NOT merely enjoying a little upswing. It has entered into a unique period of sustained expansion.

The steel market will be handing out generous rewards to those suppliers in a position to take advantage of fast and growing global sales opportunities.

And standing in the front of the queue is **Ternium S.A. (TX:NYSE)**, a steel company that got its start in 1993 when The Techint Group from the Netherlands took over the steel operations of Somisa in Argentina and renamed the company Siderar.

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From: The Skeptical Advisor (SA)
Sent: Tuesday, May 16, 2006, 7:11 AM
To: Andrew Gordon
Subject: Investing in Latin America

You make a fairly strong case for this company. But there's something worrisome about where its operations are — Argentina, Venezuela, and Mexico. These countries' economies go up and down like a yo-yo. Leftist governments also seem to be on the rise. Maybe that's why the company is so cheap. And why it's riskier than you let on.

"Ternium is better off in the U.S. market and the up-and-coming economies of South America than in slower-growth Europe. Besides, costs — such as work force and energy rates — are also lower in Latin America. And let's not confuse oil with steel. Ternium's operations in Venezuela are safe and thriving. The government has no intentions of going after it."

Five years later, it took over Sidor in Venezuela. And in 2005, a Mexican company — Hylsa — joined Ternium.

Siderar is Argentina's largest steel company. Sidor is Venezuela's leading steel producer. And Hylsa is Mexico's flagship steel company. Together, they form one of South America's biggest steel companies.

The company is based in Luxembourg…it makes all of its products in Latin America…and it sells its products just about everywhere — in South and Central America, of course, but also in North America, Europe, and other countries.

Starting February 1, 2006 Ternium SA began trading in the New York Stock Exchange (NYSE) via American Depository Shares (each ADS is worth 10 originally issued common shares).

Building a Mini-Empire of Steel

Before Techint Group began eying underpriced steel assets in Latin America, there was Lakshmi Mittal.

He spent the 1980s and into the 90s scooping up cheap steel mills all over the globe: in central Europe, Kazakhstan, Indonesia, Trinidad, Mexico and Africa. They were old and dirty. Their owners were more than happy to offload these dilapidated mills at a time when steel was cheap and plentiful.

And Mittal was more than happy to take them off their hands. He knew the steel market would bounce back ... and that when it did, his collection of mills would be ready to supply the market with steel at a very low cost structure.

When steel did rebound, Mittal's stock climbed 8,000% up the charts.

Nobody had ever built capacity quite like that. He showed the way and proved that it could work.

Techint is located in Luxembourg. Lakshmi Mittal was wheeling and dealing from neighboring Rotterdam. It's like a company in NYC peering over its shoulder to see what a maverick entrepreneur in Chicago is up to.

Now, it could just be coincidence that Techint began to do in Latin America what Mittal was doing in central Europe and elsewhere. That's what Ternium said when I asked them this question.

But I'd be bowled over with a feather if Techint hadn't at least been aware of Lakshmi's under-the-radar buying spree and intrigued by what they saw. And I wouldn't blame them. Buying beat-up assets on the cheap in a notoriously cyclical market while the market is down is a brilliant plan.

Mittal went bottom fishing. Many of his steel finds were real fix-me-uppers.

Techint bought underpriced assets of major modern steel producers.

They weren't quite as cheap, because their assets weren't as old or in as bad shape. But they were great buys, because Techint went on its buying spree when the steel market was down.

Techint snapped up iron ore mines, too, when it bought Mexico-based Hylsa.

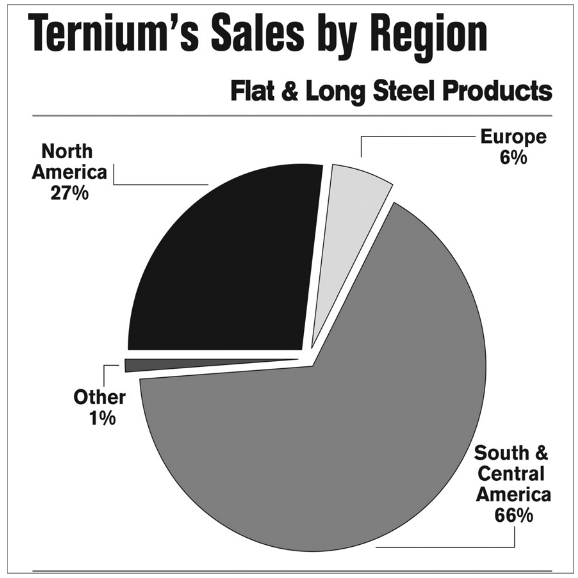
Owning its own mines keeps its costs down, as iron ore prices continue to go up aggressively.

Just how good a deal did Techint get with its Latin American purchases?

Well, at the time Techint was buying these companies, bankrupt mills that were about to be taken over were going for $80-$100 per ton. Now they're going for $500 to $800 per ton.

For example, Mittal's bid for Arcelor is pricing Arcelor's production at roughly $580 per ton. And many people think this is a cheap bid.

Remember when I said that you get Ternium's business for free because the stock price covers 100% of the value of the assets ... and then some?



That's the "paid" price of the assets ... not the "fair market" price.

The "fair market" price is now at least 5-8 times what Techint paid for these mills.

At fair market prices, for every dollar invested in this company, you're getting at least 80% of the assets ... and 100% of the business for free.

But the BIG IDEA behind Mittal's and Techint's buying spree is the same: Buy low-priced assets in low-cost countries and sell the steel in big-consuming, high-priced countries — western Europe for Mittal (but also China and other places) and North America for Techint.

No Headlines, Just Incredible Value

So what if Techint wasn't the first out of the gate with this idea. Techint has done a better job of executing basically the same strategy as Mittal's. Consider:

Which assets are easier to stitch together — Mittal's creaky, mini-mill sized facilities (for the most part) ... or Ternium's much larger, more modern assets?

THE CLEAR CHOICE: TERNIUM'S.

Where would you rather be exporting to: slower-growth Europe or the up-and-coming economies of South America (like Brazil and Argentina)?

THE CLEAR CHOICE: TERNIUM'S AMERICAN MARKETS.

Where are costs lower: in central Europe or in Latin America?

THE CLEAR CHOICE: TERNIUM'S LATIN AMERICAN COUNTRIES HAVE A CHEAPER WORKFORCE AND ENERGY RATES.

Plus Ternium has iron ore mines in Mexico. Ternium can't be accused by Chavez of plundering Venezuela's natural resources. It can be accused of making Venezuela's steel industry more efficient, however.

Let's not confuse oil with steel. Ternium's operations in Venezuela are safe and thriving. The government has no intentions of going after it.

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I bet you're just a little curious to see how Ternium sizes up against Mittal. Take a look.

	TERNIUM	MITTAL STEEL	STEEL SECTOR
Market Cap	$3.9B	$24.7B	
Trailing P/E	6.09	7.03	14.09
Price/Sales	0.85	0.87	1.38
Price/Book	0.8	2.41	3.84
Enterprise Value/EBITDA	2.48	6.0	xx.x
Operating Margin	42.2%	13.6%	14.7%
Return on Equity	23.2%	33.9%	30.4%
Price/CF	3.7	6.1	10.9

As you can see, Mittal Steel may do a lot better than other steel companies, on average. But Ternium does a lot better than Mittal Steel.

So, to me it's funny that Mittal Steel gets a lot more respect from investors than does Ternium. Its P/E is 15% higher. Its P/B is more than double Ternium's.

But that's GREAT NEWS for you. It means Ternium is selling at a huge discount over what Mittal is selling for.

Yet, Ternium's margins are more than three times bigger than Mittal's. And Ternium also throws out much more cash than Mittal, compared to the size of their market cap.

And you can't ignore another important number (the first number I look at in a company): company's enterprise value (commonly referred to as its takeover value) compared to its EBITDA, or earnings before interest, tax, depreciation, and amortization. (In other words, its operational earnings.)

Ternium's is less than half of Mittal's.

Ternium's enterprise value (EV) of $4.57 billion — calculated by adding the total stock price of the company to its debt and subtracting its cash value — should be in the $9 billion range.

Compared to Mittal, you're getting this stock for at least half-price ... if you invest right now.

M&As Will Sweep in Higher Prices

Sometimes it takes months ... sometimes years ... for Mr. Market to recognize the true value of a company. But — fortunately — that's not going to be the case here.

Soon ... very soon ... Ternium's real worth is going to be recognized — thanks in large part to none other than Mittal Steel.

You see, Mittal Steel's hostile bid for rival Arcelor is spurring new valuations for steel mills everywhere. Mittal's bid gives Arcelor a valuation of $500-plus per ton of steel.

But Arcelor doesn't make nearly as much per ton as Ternium does.

In fact, only a couple of steel companies out of the thousands around the globe are in the same class as Ternium when it comes to operational earnings per ton.

Ternium earned $271/ton in 2005 and $222/ton in first quarter 2006 (EBITDA). Tata Steel of India does slightly better (at $263/ton). And CCN of Brazil has been earning in the same range as Ternium.

That's it.

But neither of these companies enjoys Ternium's fat margins. And neither one is quite as efficient as Ternium is at translating sales into operating earnings.

Tata's sales, for example, as a percentage of earnings are 32%.. ... which is way above the industry average. (I guess that's why the World Steel Dynamics, the consultancy group, rates Tata as the world's strongest steel producer.)

Meanwhile, Ternium's sales as a percentage of earnings are 33%.

Ternium's numbers simply can't be beat.

And in Ternium's 2006 first-quarter results, its EBITDA margin stayed at 33%.

There's already been a flurry of smaller deals. And more deals are coming.

From: The Skeptical Advisor (SA)
Sent: Thursday, May 18, 2006, 3:03 PM
To: Andrew Gordon
Subject: Its Price Is Too Good to Be True

Why do you think Ternium is so cheap? Its price seems too good to be true.

"I wish I knew. To me, it's funny that Mittal Steel gets a lot more respect from investors than does Ternium. Mittal Steel may have a lot better numbers than other steel companies, on average. But Ternium's numbers are a lot better than Mittal's. But that's GREAT NEWS for you. It means Ternium is selling at a huge discount over what Mittal is selling for."

There's not a steel mill in the U.S. that isn't in play. And as steel mills and investors alike wonder who's going to be involved in the next takeover bid, this new $500-plus metric is rapidly becoming the new valuation standard of the industry.

In the next six months, this increasingly used metric will fuel the price growth of steel companies everywhere, as valuation finally catches up to the new realities of the marketplace.

And leading the charge up the charts will be Ternium — the most underpriced steel company of them all ... and with the biggest margins of any other steel producer.

It's possible that in the coming wave of consolidations Ternium could be taken over. But it doesn't have to be for its price to move up sharply.

As many of its peers with less impressive numbers get bought out with bids that value their assets higher than Ternium's, it should become crystal clear to investors just how incredibly undervalued this company is.

Ternium won't stay a secret forever. In fact, with the pending wave of acquisitions and mergers, its time as an under-appreciated company is rapidly running out.

Right now, only you and I and — I suspect — a few others know about this company. Pretty soon, we're going to be joined by the hot-money crowd, the mutual funds, pension plans, and hedge funds.

If you haven't invested in Ternium by that time, it'll be too late. Its price will most certainly have spiked.

Get in now ... while all the buzz is about Mittal and Arcelor ... with the best steel investment still lurking in the shadows.

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From: The Skeptical Advisor (SA)
Sent: Friday, May 19, 2006, 5:23 PM
To: Andrew Gordon
Subject: Calling My Broker Today

I love to buy underpriced companies. Doesn't everybody? But this recommendation seems particularly well timed. As this wave of acquisitions descends upon us, it seems unavoidable for the valuations coming out of these takeovers not to push up the price of those steel companies with assets that are still undervalued. Ternium doesn't have to prove or do anything at this point. As you said, the market will come to them. What a great opportunity for investors who invest in Ternium now. I'll tell you one thing — I'm investing. Thanks, Andrew, for a stock selection I can get excited about.

Action: *Buy* **Ternium S.A. (TX:NYSE)** at $22.26 up to $28.00.

THE SKEPTICAL ADVISOR PORTFOLIO

Prices as of May 23, 2006

	Symbol	Ref. Date	Ref. Price	Recent	Dividend	Action	P/L
Crescent Real Estate Equities Co.	CEI	May-19	$18.51	$17.91	$1.50	Buy	4.86%
Chunghwa	CHT	Jun-22	$21.39	$20.54	$1.48	Buy	2.95%
Dominion	D	Jul-18	$74.73	$72.40	$2.03	Buy	−0.40%
Gannett Co. Inc.	GCI	Sept-8	$73.05	$54.16	$0.87	Buy	−24.67%
Six Flags	PKS	Sept-22	$7.00	$8.65	$0.00	Buy	23.57%
Inco LTD	N	Nov-2	$41.08	$61.32	$0.23	Buy	49.83%
Verizon	VZ	Nov-22	$31.87	$30.87	$0.81	Buy	−0.60%
OMI Corp	OMM	Dec-19	$18.62	$18.43	$0.18	Buy	−0.05%
InfoSpace	INSP	Jan-17	$23.41	$22.93	$0.00	Buy	−2.05%
Republic Airways	RJET	Feb-17	$14.85	$14.86	$0.00	Buy	0.07%
BHP Billiton	BHP	Apr-3	$41.73	$42.92	$0.00	Buy	2.85%
Westell	WSTL	Apr-26	$3.98	$2.83	$0.00	Sell	−28.89%

Crescent: *The company's Funds From Operations were slightly down this first quarter, compared to last year's first quarter. Crescent expects its revenue will rebound before the year is out.*

Chunghwa Telecom: *Stock retaining recent gains past the company's first quarter report. EBITDA decreased 9% while cash flow increased 9%. Chunghwa is still working through its compensation arrangements with early retirees…this took a bite out of its first quarter income.*

Dominion Resources: *Slightly down but earnings this year going into the future are on track for impressive growth gains. Other good news: It recently discovered gas in the Gulf of Mexico.*

Gannett: *Over 400,000 more people read USA TODAY than any other newspaper. But its stock is still scraping bottom. It's a sliver away from our 25% sell-stop point. Keep an eye on the price. When it hits $53.92, you should sell. I still believe this stock has a rebound in it, but I see nothing on the horizon that would trigger one. We'll see.*

Six Flags: *Company reported a loss in the first quarter, but they beat analysts' expectations and their stock actually went up on the news…but has since dropped. Stock is still way up from our original buying price and big things are expected from the new management.*

Inco: *Up 50% over original buying price as it has increased its offer to buy Falconbridge while also the target of another company's takeover bid. Either way this works out, Inco's big price jump won't go away.*

Verizon: *A bit down with the rest of the market. Company is sticking to its plan of installing its high-speed fiberglass network nationwide.*

OMI: *A bit down. The company this first quarter didn't do as well as last year's first quarter but it still beat analysts' expectation. Its revenues went up. Analysts were expecting that they would go down in the first quarter.*

InfoSpace: *Its revenue grew in the first quarter even as earnings dropped. But they still beat analysts' expectations and the stock gained on the news of its first quarter report.*

Republic Airways: *Lots of developments with this company. Its price has lost ground as news filtered out that it may have lost its big contract with Continental over a dispute Continental is having with another airliner who wants to keep the jets it's leasing from it. Meanwhile, Republic increased revenues 23% this first quarter and income by 14%.*

BHP Billiton: *As commodity prices have fallen, so has the stock price of this company. It's a temporary correction. The commodity bull isn't over yet…not by a long shot.*

Westell Technologies: *Its earnings and revenue fell this past quarter compared to last year's first quarter, dropping the stock price like a stone. It's down over 30%. Time to close out on this stock. I had predicted a recovery over the last half of this year. But you should adhere to your 25% stop-loss point. If the company's recovery happens, we won't be a part of it.*