

# Cal-Maine Foods, Inc (CALM)

Continuing to Execute

July 28, 2008

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## Investment Highlights

- *Cal-Maine is very attractively priced, trading at 4.99X forward earnings*
- *129% of free float is sold short*
- *Industry egg supply will be constrained due to new cage requirements*
- *Cal-Maine will earn \$7.50 per share in FY 2009 at \$7.50 full-year corn prices*

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## Executive Summary

Cal-Maine Foods, which is buy-rated with a \$46.00 price target.

This morning Cal-Maine Foods reported earnings of \$1.54 per basic share on revenues of \$235.6 mln, inline with our estimates of earnings per share of \$1.55 on revenues of \$235.5 mln. Cal-Maine also announced that they expect to pay a cash dividend of \$.49 per share for the quarter, based on their dividend policy of paying out 33% of operating income.

The number of egg-laying chickens, or “layers”, has declined by 2.46% year to date. As we have highlighted before, we believe it takes a 1.5% *increase* in the number of layers in a given year to reduce egg prices year over year. Since 1988, there have been only 3 occasions where the number of layers has declined, according to the USDA - 1989, 2003 and 2007, during which the price of eggs increased by 40.37%, 29.81% and 55.17% respectively. As we approach the beginning of the peak demand season, November through Easter, we expect that egg prices to approach \$1.40 to \$1.50 (depending on corn prices) and Cal-Maine shares to perform very well!

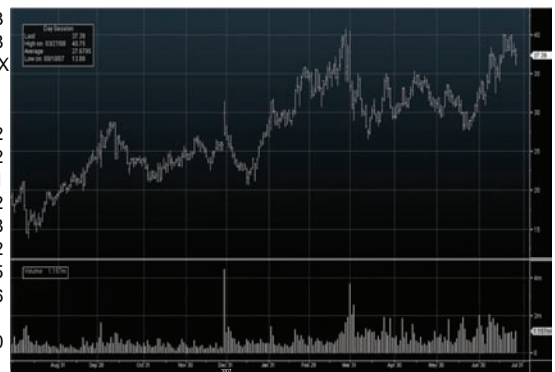
For more details, or to receive a copy of our March 24 initiation report, contact Nathan Weiss at 857-233-4902 or nweiss@uniteconomics.com.

## Financial Summary and Statistics

Current Price: \$37.39	Book Value/Share:	\$11.63
Price Target: \$46.00	Sales/Share (ttm):	\$38.68
Market Cap: \$887mln	Forward PE (e):	4.99X

	FY 2007	F2008e	F2009e
Revenues	\$ 598,128	\$ 915,939	\$ 1,098,512
Cost of Sales	\$ 479,504	\$ 617,383	\$ 755,222
Gross Profit	\$ 118,624	\$ 298,556	\$ 343,291
SG&A	\$ 60,394	\$ 74,920	\$ 80,672
Operating Income	\$ 58,230	\$ 223,636	\$ 262,618
Other	\$ (1,969)	\$ 4,887	\$ 10,852
Taxes	\$ 19,605	\$ 79,530	\$ 95,715
Net Income	\$ 36,656	\$ 148,993	\$ 177,756

EPS (Diluted)	\$ 1.56	\$ 6.28	\$ 7.50
Shares out	23,569	23,733	23,714



Graph Courtesy of Bloomberg



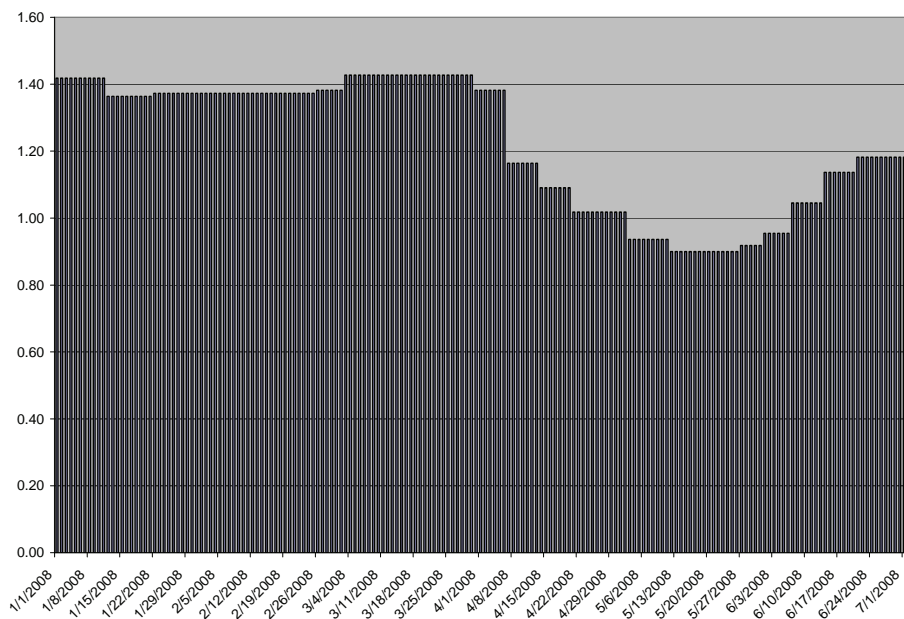
Unit Economics LLC

## Earnings Update

This morning Cal-Maine Foods reported earnings of \$1.54 per basic share on revenues of \$235.6 mln, inline with our estimates of basic earnings per share of \$1.55 on revenues of \$235.5 mln. Cal-Maine also announced that they expect to pay a cash dividend of \$.49 per share for the quarter, based on their dividend policy of paying out 33% of operating income. We estimate that Cal-Maine received \$1.23 per dozen eggs during the quarter, down from \$1.48 in the previous quarter. Feed costs likely increased from \$.499 per dozen last quarter to \$.531 this quarter.

This quarter was a very controversial quarter as many short sellers believed that Cal-Maine Foods was below break-even levels for egg production in late April and May, as wholesale egg prices fell from \$1.40 to \$.90 post-Easter. The following chart shows the progression of our estimated wholesale egg prices so far in 2008:

Wholesale Egg Prices YTD



Unit Economics estimates, BLS and USDA data

Over the course of July, our estimates of wholesale egg prices received by Cal-Maine fell from \$1.18 to \$.85. Our estimated egg production costs for Cal-Maine fell by \$.14 over the same time period, largely due a decline of nearly \$1.50 in per bushel corn prices in July, offsetting (or causing) much of the decline of egg prices. Further complicating the calculation of earnings estimates for the coming quarter, Cal-Maine's acquisition of Zephyr Egg company was completed on July 1st. The Zephyr acquisition includes the production assets of



the company and 'about 2 mln' laying hens (vs roughly 23 mln at Cal-Maine prior to the acquisition). We will provide updated estimates for the next quarter earnings in late August when more information about both the Zephyr acquisition and egg prices and feed costs for the quarter are available. In a shameless bout of promotion, we would like to highlight that our clients (or potential clients if you would like a trial) may call at any time for ongoing estimate revisions, including our current unofficial earnings estimates for the coming quarter.

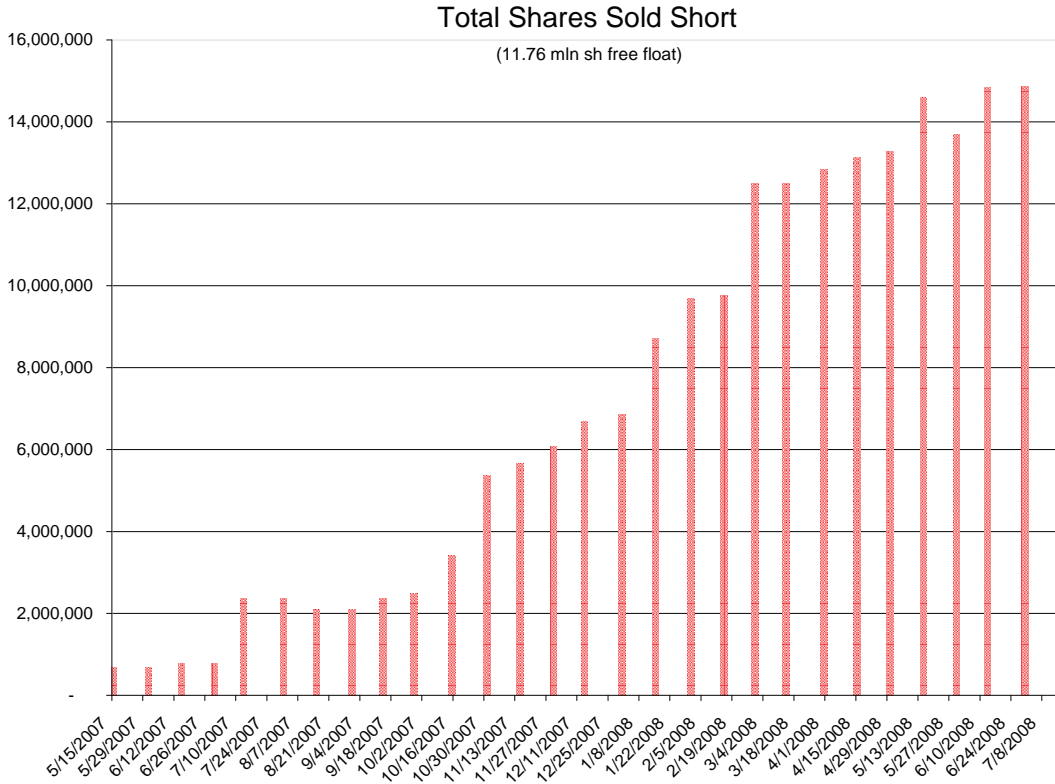
Cal-Maine suffers from relatively simplistic analysis by the short sellers. They ignore the fact that feed costs are only 43% of revenues, and thus a 50% increase in feed costs is offset by a 21.5% increase in egg prices. In addition, not only is Cal-Maine one of the lowest cost producers in the business, according to our research, but Cal-Maine's business model is different than most. Cal-Maine has historically bought and resold approximately 25% of their eggs from third-party egg producers. This is due to the national distribution agreements with large retailers that require Cal-Maine to deliver eggs in areas where they do not have production. Cal-Maine makes a positive margin on these sales, regardless of the level of profitability of the underlying egg producer. Based on a historical level of 25% of eggs sold produced by third-parties and last quarter's total sales of 174.1 mln eggs, this means that Cal-Maine bought roughly 43.5 mln eggs from resellers in the March quarter. Assuming a \$.04 per egg margin, Cal-Maine would have earned \$1.74 mln on egg sales from third parties, regardless of their underlying egg production profitability. This provides roughly \$.05 per quarter of fully taxed EPS.

In addition, Cal-Maine sells specialty and organic eggs. Roughly 7% of Cal-Maine's egg sales are dedicated to branded and specialty eggs which achieve a price premium of 85% to 100% versus 'regular' eggs. Costs in this business are likely only slightly higher than that of traditional eggs. With 7% of the previous quarter's 174.1 mln sales being sold at an 85% premium, Cal-Maine earned \$14.26 mln in pre-tax margins on specialty eggs, or \$.375 per quarter of fully taxed EPS, assuming traditional egg operations were running at breakeven levels.

These ongoing earnings streams of \$.425 per quarter are an important part of the Cal-Maine story. We do not feel the market understands this, and thus does not give Cal-Maine credit for these continuing earnings streams. A 15X earnings multiple on these stable earnings sources, specialty and third-party egg sales, would be valued at \$25.50 per share of Cal-Maine!

The number of egg-laying chickens, or "layers", has declined by 2.46% year to date. As we have highlighted before, we believe it takes a 1.5% *increase* in the number of layers in a given year to reduce egg prices year over year. Since 1988, there have been only 3 occasions where the number of layers has declined, according to the USDA - 1989, 2003 and 2007, during which the price of eggs increased by 40.37%, 29.81% and 55.17% respectively. Our full year estimate for Cal-Maine egg prices of \$1.31 based on the seasonality seen so far in 2008 calls for a 28.43% increase in egg prices. As we approach the beginning of the peak demand season, November through Easter, we expect that egg prices to approach \$1.40 to \$1.50 (depending on corn prices) and Cal-Maine shares to perform very, very well!

Finally, no update on Cal-Maine is complete without an update on the short position. The SEC is making new efforts to examine short selling, not just in financials but for all securities. Cal-Maine could easily become a beneficiary as the short interest is now 15.22 mln shares, up 426,000 shares in the past two weeks alone. The total shares short represents 129.43% of the float! The chart on the following page shows the development of the short interest on Cal-Maine.



**Financials**

**Model Inputs**

Dozens of eggs sold (in millions)  
 Adj Market Egg Price  
 Feed Cost/Dozen (75% corn, 25% soymeal)

Change these variable to calculate earnings

	175.2	174.1	173.2	174.2	172.0	174.1
\$	1.348	\$ 1.500	\$ 1.460	\$ 1.360	\$ 1.230	\$ 1.377
\$	0.631	\$ 0.700	\$ 0.700	\$ 0.650	\$ 0.531	\$ 0.499

**Income Statement**

	FY08 End							
	Q4 (May 09) (e)	Q3 (Feb 09) (e)	Q2 (Nov 08) (e)	Q1 (Aug 08) (e)	Q4 (May 08)	Q3 (Mar 08)	Q2 (Dec 07)	Q1 (Sep 07)
Net Sales	262,712	290,608	281,476	263,716	235,628	278,017	223,696	178,598
Cost of Sales	182,569	195,601	192,876	184,175	163,586	173,115	147,664	133,018
Gross Profit	80,143	95,006	88,600	79,541	72,042	104,902	76,032	45,580
Selling, General and Administrative Expense	20,253	20,200	20,143	20,077	19,999	19,244	17,029	18,648
Operating Income	59,890	74,807	68,457	59,464	52,043	85,658	59,003	26,932
Other Income (expense)								
Interest Expense, net	1,898	1,308	718	128	-	(676)	(1,377)	(1,647)
Other	200	2,200	2,200	2,200	-	2,905	3,744	1,938
INCOME (LOSS) BEFORE TAXES	61,988	78,315	71,375	61,792	54,911	87,887	61,370	27,223
Income tax Expense (benefit)	21,696	27,410	24,981	21,627	18,353	30,704	21,216	9,257
Net Income (loss)	40,292	50,905	46,394	40,165	36,558	57,183	40,154	17,966
Net income (loss) per share								
Basic	1.701	2.150	1.959	1.696	1.542	2.412	1.696	0.761
Diluted	1.699	2.147	1.956	1.694	1.539	2.408	1.693	0.757
Weighted avg Shares Outstanding								
Basic	23,681	23,681	23,681	23,681	23,714	23,712	23,681	23,599
Diluted	23,714	23,714	23,714	23,714	23,751	23,744	23,714	23,724
Dividend Per Share	0.561	0.708	0.646	0.559	0.508	0.804	0.013	0.013

**Balance Sheet**

Assets	Q4 (May 09) (e)	Q3 (Feb 09) (e)	Q2 (Nov 08) (e)	Q1 (Aug 08) (e)	Q4 (May 08) (e)	Q3 (Mar 08)	Q2 (Dec 07)	Q1 (Sep 07)
Current Assets:								
Cash And Equivalents	118,215	100,573	87,628	82,771	94,858	85,798	28,535	23,117
Investments	-	-	-	-	-	-	59,250	46,951
Trade and Receivables	68,305	75,558	73,184	68,566	50,223	63,977	68,888	45,051
Recoverable Income Taxes	-	-	-	-	-	-	-	-
Inventories	97,277	104,493	102,876	95,991	76,766	74,703	69,403	66,310
Other	-	-	-	-	-	-	-	-
Prepaid Expenses and Other	1,500	1,500	1,500	1,500	2,418	1,068	881	1,596
Total Current Assets	285,297	282,124	265,188	248,828	224,265	225,546	226,957	183,025
Notes Receivable and Investments	59,142	59,142	59,142	59,142	-	59,142	9,893	8,373
Goodwill	4,195	4,195	4,195	4,195	-	4,195	4,195	4,195
Other Assets	7,476	7,476	7,476	7,476	70,478	7,461	7,476	2,944
Property, Plant and Equipment	242,430	233,631	224,709	215,664	206,493	403,933	393,155	383,788
Less Accumulated Depreciation	12,063	8,862	5,784	2,829	-	199,329	192,656	187,627
TOTAL ASSETS	586,477	577,706	554,927	532,476	501,236	500,948	449,020	394,698
							1.31%	0.88%
Liabilities and Stockholder's Equity								
Current Liabilities								
Accounts payable and Accrued Expenses	78,505	84,109	82,937	79,195	67,952	74,488	75,581	62,127
Dividends Payable	13,296	16,799	15,310	13,254	10,358	19,059		
Current Maturities of Purchase Obligation	10,756	10,757	10,758	10,758	-	10,758	10,758	6,769
Current Maturities of Long-Term Debt	6,842	8,192	9,542	10,892	11,470	11,717	11,661	13,126
Deferred Income Taxes	12,136	12,136	12,136	12,136	12,935	11,745	12,136	12,633
Total Current Liabilities	121,535	131,992	130,683	126,235	102,715	127,767	110,136	94,655
Long-Term debt, Less current maturities	50,680	60,680	70,680	80,680	85,680	90,220	92,572	97,437
Minority Interest	888	888	888	888	-	1,707	888	1,194
Purchase obligation, less current maturities	9,600	9,600	9,600	9,600	-	9,600	9,437	5,848
Other non-current liabilities	2,200	2,200	2,200	2,200	37,161	2,240	2,210	2,180
Deferred Income Taxes	19,867	19,867	19,867	19,867	-	19,855	19,867	19,879
TOTAL LIABILITIES	204,770	225,227	233,918	239,470	225,556	251,389	235,110	221,193

**Stockholders Equity**



## Critical Accounting Policies

From FY2007 10K:

**Critical Accounting Policies.** The preparation of financial statements in accordance with U.S. generally accepted accounting standards requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates.

Management suggests that our Summary of Significant Accounting Policies, as described in Note 1 of the Notes to Consolidated Financial Statements, be read in conjunction with this Management's Discussion and Analysis of Financial Condition and Results of Operations. We believe the critical accounting policies that most impact our consolidated financial statements are described below.

**Allowance for Doubtful Accounts.** In the normal course of business, we extend credit to our customers on a short-term basis. Although credit risks associated with our customers are considered minimal, we routinely review our accounts receivable balances and make provisions for probable doubtful accounts. In circumstances where management is aware of a specific customer's inability to meet its financial obligations to us (e.g. bankruptcy filings), a specific reserve is recorded to reduce the receivable to the amount expected to be collected. For all other customers, we recognize reserves for bad debts based on the length of time the receivables are past due, generally 100% for amounts more than 60 days past due.

**Inventories.** Inventories of eggs, feed, supplies and livestock are valued principally at the lower of cost (first-in, first-out method) or market. If market prices for eggs and feed grains move substantially lower, we would record adjustments to write-down the carrying values of eggs and feed inventories to fair market value. The cost associated with flock inventories, consisting principally of chick purchases, feed, labor, contractor payments and overhead costs, are accumulated during the growing period of approximately 22 weeks. Capitalized flock costs are then amortized over the productive lives of the flocks, generally one to two years. Flock mortality is charged to cost of sales as incurred. High mortality from disease or extreme temperatures would result in abnormal adjustments to write-down flock inventories. Management continually monitors each flock and attempts to take appropriate actions to minimize the risk of mortality loss.

**Long-Lived Assets.** Depreciable long-lived assets are primarily comprised of buildings and improvements and machinery and equipment. Depreciation is provided by the straight-line method over the estimated useful lives, which are 15 to 25 years for buildings and improvements and 3 to 12 years for machinery and equipment. An increase or decrease in the estimated useful lives would result in changes to depreciation expense. When property and equipment are retired, sold, or otherwise disposed of, the asset's carrying amount and related accumulated depreciation are removed from the accounts and any gain or loss is included in operations. We continually reevaluate the carrying value of our long-lived assets, for events or changes in circumstances, which indicate that the carrying value may not be recoverable from the estimated future cash flows expected to result from its use and eventual disposition. If the sum of the expected future cash flows (undiscounted and without interest charges) are less than the carrying amount of the asset, an impairment loss is recognized to reduce the carrying value of the long-lived asset to the estimated fair value of the asset.

**Investment in Affiliates.** We have invested in other companies engaged in the production, processing and distribution of shell eggs and egg products. Our ownership percentages in these companies range from less than 20% to 50%. Therefore, these investments are recorded using the cost or the equity method, and accordingly, not consolidated in our financial statements. Changes in the ownership percentages of these investments might alter the accounting methods currently used. Our investment in these companies amounted to \$6.4 million at June 2, 2007. The combined total assets and total liabilities of these companies were approximately \$24 million and \$11 million, respectively, at June 2, 2007. We are a guarantor of approximately \$4.8 million of long-term debt of one of the affiliates.

**Goodwill.** At June 2, 2007, our goodwill balance represented 1.2% of total assets and 2.7% of stockholders' equity. Goodwill relates to the fiscal 1999 acquisition of Hudson Brothers, Inc., the fiscal 2006 acquisition of Hillandale Farms, LLC, and the fiscal 2007 acquisition of Green Forest Foods, LLC. We adopted, as of June 3, 2001, Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets" (SFAS 142). Under SFAS 142, goodwill and indefinite lived intangible assets are no longer amortized but are reviewed annually or more frequently if impairment indicators arise, for impairment. An impairment loss would be recorded if the recorded goodwill exceeds its implied fair value. We have only one operating segment, which is our sole reporting unit. Accordingly, goodwill is tested for impairment at the entity level. Significant adverse industry or economic changes, or other factors not anticipated could result in an impairment charge to reduce recorded goodwill.



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