



Take Stock – No, This Is Not the End of the Potash Story

Description

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Dear Fellow Fools,

If you own shares of **Potash Corp.** (TSX:POT,NYSE:POT), as I do, then this has been a tough week.

The stock declined a touch after the company reported disappointing earnings last week, but it really hit the fan on Tuesday when Uralkali, one of the world's largest potash producers with about 20% of global production, announced its decision to stop selling through the Belarusian Potash Company (BPC) and direct all of its export volumes through Uralkali Trading.

The back story

The BPC was a joint agreement that accounted for about 43% of the global potash market. The other big share of the global potash market (~25%) is controlled by Canadian-based firm Canpotex — a marketing operation that is jointly owned by Potash Corp., **Agrium** (TSX:AGU), and **Mosaic** ([NYSE:MOS](#)).

Combined, these two entities (aka cartels) controlled about 70% of global potash supply. Historically, the two have worked in concert to maintain prices well above the marginal cost of production by refraining from flooding the market.

Commenting on Uralkali's decision, Bernstein analyst Jeremy Redenius told the Financial Times, "This is as if Saudi Arabia left OPEC — for the potash sector, this is huge."

With Uralkali pulling out of the BPC, this cozy, two-entity market essentially just gained a new supplier. Uralkali's move essentially introduces another independent party into the potash market. What was two is now three.

Which is why, also in the Financial Times, BMO Capital Markets analyst Joel Jackson indicated that the breakdown of the BPC cartel market marked “the end of the potash world as we know it.”

The outlook

The end of the potash world as we know it!?

And yet, I still own my stake in Potash Corp. Here's why.

As often happens, this news was met with a short-term panic. Don't get me wrong — there are considerable implications for the industry and all stocks therein. But the analyst community and media have latched onto the remarks of Uralkali's CEO that indicated the [price of potash could tumble to \\$300/tonne](#) by the end of this year as his company cranks up production. This price has been in the \$400/tonne neighborhood of late.

For long-term-focused investors, however, the price of potash at the end of this year should be meaningless. Potash Corp. and its producing peers are stocks for the long run. They're a play on the global reality of shrinking arable land and a growing population. To feed this growing population, the arable land that exists needs to become more productive. Fertilizer is at the root of this need and potash is fertilizer. Potash helps increase the productivity of the land. Nothing about this week's announcement impacts this part of the equation.

The context

Everything about the announcement relates to the supply-side of the equation. But the thing is, the supply side has been under scrutiny for some time. Though the producers that form both BPC and Canpotex have had the market more or less to themselves for a number of years, evidence suggests that their level of control has been slipping.

Other suppliers are knocking on the industry's door — more than 200 potential potash projects that involve potential capital expenditures of \$50 billion have been proposed in the world.

The granddaddy of them all is **BHP Billiton's** ([NYSE:BHP](#)) \$14 billion Jansen project located in Saskatchewan. Jansen is a massive undertaking that has the potential to produce 8 million tonnes of potash per year — about 15% of 2012 potash supply. The final decision to go ahead with Jansen has not been made, but BHP has already sunk \$2 billion into it.

Keep in mind, the potash industry has been built on controlling supply and convincing the world it needs this product. What better way to keep new supply out than making — at least temporarily — the economics of the industry appear unappealing? As illustrated by the \$14 billion price tag on the Jansen project, building a new potash mine takes a lot of money upfront. You better be certain you understand the industry dynamics before wading in ... and the industry's dynamics appear to have just gone kaboom!

By cranking up production and potentially flooding the market with supply, thus temporarily stomping on the price of the commodity, there's at least a fighting chance that the majority of these new entrants will be sent packing. New supply will be held at bay.

Moreover, current producers that exist outside of the big cartels, such as Germany's **K+S**, are relatively high-cost. Bernstein Research indicates the company's cash cost to be around \$300/tonne — the big North American and Russian operations tend to have cash costs below \$100/tonne. In a temporarily lower price environment, current producers will also get squeezed.

Keep new supply out and pinch current, high-cost suppliers: In one fell swoop, at the expense of a short-term blip, Uralkali has potentially allowed the old, tightly knit system of supply management to remain in place for a much longer time than it otherwise would have had potash prices remained relatively buoyant and the industry's economics more favourable.

Over the long term, this week's announcement may not have changed the supply side of the equation after all!

To be sure, this week's news is a setback. But it's not the end of the potash story that some are making it out to be, and long-term, it may ensure that the industry remains supply-side controlled — an attractive dynamic for investors.

In the meantime, Potash Corp. now offers a dividend yield of about 4.5% and with its recently announced \$2 billion buyback program, at current levels the company can now acquire 7% of shares outstanding over the next 12 months.

Bottom line: This may have been a bad week, but long-term investors need not be shaken.

'Til next time ... happy investing and Fool on!

Sincerely,

Iain Butler

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Motley Fool Canada

Fool contributor Iain Butler owns shares of Potash. The Motley Fool does not own shares of any companies mentioned at this time.

CATEGORY

1. Investing

TICKERS GLOBAL

1. NYSE:MOS (The Mosaic Company)

Category

1. Investing

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