



The End of Potash As We Know It?

Description

By Gaurav Seetharan

Investing is about trying to read the future, or at least make an educated guess at a company's future earnings. But to be really good at it requires a repression of other human instincts. One such instinct is the desire to make a good thing last. If you've been riding high on a company's success, you begin to feel a kinship with that stock and after a while you'll feel reluctant to let it go. But markets are fluid, and when simple deduction tells you that a company or industry is fading, you need to drop it without a second thought.

Here at the Fool, we're big on value investing. That means examining the intrinsic value of a company and its long term outlook, but it also means looking at the state of the industry. Take, for instance, the potash industry and its key players. If you're unfamiliar with this market, here's [my primer on everything potash\[G.S.1\]](#).

To sum up, Uralkali exited the Belarusian Potash Company and threw the entire, supply constrained industry into pandemonium. **Mosaic** ([NYSE:MOS](#)), and **Potash Corp. of Saskatchewan** (TSX:POT, NYSE:POT) both took significant hits, while **Agrium** (TSX:AGU, NYSE:AGU) was able to ride out that tidal wave more or less unscathed.

Bay Street analysts agree that Uralkali is launching a price war that will cut everyone's profit margins, just so it can grow market share. And you know what? In business, that's fair game. But I was a little confused at how they're going to pull it off, so I did some research and here's what I found.

Research shows that "[potash] spot prices were steadily declining during the last 2 years driven by the growing inventory levels and widening supply/demand imbalance". So this isn't entirely Uralkali's fault. The economics of their industry have changed in recent years and they are trying to move ahead of the pack while they still can.

[potash stats](#) no stats for type unknown

In addition, as the table below demonstrates, Uralkali is the low cost producer in the industry. Therefore, they can remain profitable at a lower potash price far more easily than all of its industry

competitors.

[potash cost curve](#)

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“Lower labour costs are what makes it cheaper in Russia. We’ve seen rising labour costs in North America, and that significantly raises the costs,” said AltaCorp Capital’s John Chu in a telephone interview. Mr. Chu is a sell-side analyst who specifically covers the Canadian potash industry.

But what about logistics? Didn’t BPC coordinate their entire supply chain?

“Remember, Belaruskali and Uralkali have two separate sites, so their infrastructure is less coordinated than Canpotex,” continued Mr. Chu. “All Canadian potash companies are located in one province, which led to a lot of integrated investments.”

It’s true. To transport their products, Uralkali uses the ports in St. Petersburg and Novorossiysk; while Ventspils, Klaipeda, and Nikolaev are Belaruskali’s ports of choice.

With over 8,000 specialized railcars, a shipping terminal capable of loading 6.2 million tonnes of potash, and a storage capacity of 640,000 tonnes of potash, Uralkali is more than equipped to meet short to medium-term demand.

So what’s my point?

My point is that executives at Uralkali realized that the industry’s supply/demand dynamics have shifted, and given their low-cost advantage, deemed it a good idea to alter their course and try to amass as much market share as possible. In that light, Uralkali’s volume-over-pricing strategy for revenue growth makes sense.

Deciding to vertically integrate was an important step for the company. By controlling the entire distribution process, they can minimize supplier risk, and optimize quality control. When asked if Uralkali’s strategy will be successful, Mr. Chu said “It all depends on whether or not they lock in contracts.” Earlier this week the Wall Street Journal reported Indian importers had negotiated a 12% discount on existing contracts covering one million tonnes of potash. It’s clear that a new normal is being established in the potash industry, but it’s less certain that Canpotex can keep up.

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