



Is Agrium's Revised Outlook a Bigger Concern Than You Think?

Description

Agrium (TSX:AGU)(NYSE:AGU) started 2014 on a positive note, with shares holding strong until last week, when the company revised its fourth-quarter outlook and Agrium stock lost 4% through the week.

That may have left investors worried, considering that Agrium is more diversified than pure-fertilizer players **PotashCorp** (TSX:POT) (NYSE:POT) and **Mosaic** ([NYSE:MOS](#)), which is also why its shares [weren't hit as hard](#) as those of peers in 2013. So does Agrium's outlook hint at more trouble ahead for the company and its shares, or is the market overreacting?

The troublesome nutrient

Agrium expects to earn \$0.80 per share in its fourth quarter. Hold your breath: It earned \$2.16 per share in Q4 2012, so that's a massive 63% slump in earnings year over year. The persistent weakness in the nutrient market is largely to blame.

Global potash prices have hit multi-year lows since the breakup of the Uralkali-Belaruskali cooperative in the middle of last year. Some days back, Uralkali contracted to supply potash to China at \$305 per metric tonne, representing roughly 25% lower prices compared to last year. Moreover, per PotashCorp's latest market data, December potash sales for North American producers slipped 22% year over year and 26% sequentially. Agrium is a part of Canpotex – the three-member group also comprising of PotashCorp and Mosaic – that controls potash exports out of Saskatchewan.

Bigger challenges ahead?

Meanwhile, demand for phosphate from key global markets India and China hasn't picked up yet, so the nutrient continues to be a drag for fertilizer companies. Mosaic, which specializes in phosphate, projects an 11% fall in its Q4 volumes at the lower end. Nitrogen is the most profitable nutrient among the three — it accounted for 61% of Agrium's total gross profit from the wholesale (fertilizer) business last year. Unfortunately, headwinds maybe getting stronger even on the nitrogen side.

Agrium mentioned lower volumes of nitrogen compound urea ammonium nitrate among the reasons for the lower guidance, suggesting that demand for UAN may be slowing down. More importantly, the price of natural gas — the key input for nitrogen fertilizer — has gone up in recent months, which could

hurt Agrium's fourth-quarter bottom line substantially. Falling demand and rising costs also bode ill for Agrium going forward.

The good news that isn't that good

There was a bright spot in Agrium's outlook, though. Agrium gets nearly three-quarters of its revenue from its retail business, which primarily sells crop protection products and seeds. Demand for these products remains robust, with Agrium even projecting a record fourth quarter for the business.

You may wonder why the company's profits should fall so drastically if its largest revenue-generating business is doing so well. It's essentially the cost factor – Nearly 67% of Agrium's adjusted operating earnings in 2012 came from its wholesale business. So even if robust retail demand offsets lower fertilizer sales, Agrium's profits can't grow much. In other words, Agrium may not be a pure-fertilizer player, but its bottom line growth largely depends on the fertilizer business.

What lies ahead

Moving forward, while rising natural gas prices can dent Agrium's fertilizer business' margins, Uralkali's contract with China could also [indicate the bottoming of potash prices](#). In fact, Canpotex also just signed a contract with China, suggesting that demand for potash could be picking up. So while Agrium's fourth quarter may be a disaster, things could soon turn around. Agrium should also start [enjoying the benefits](#) from its Viterro acquisition this year, which should further boost retail sales.

Foolish bottom line

Agrium's outlook may disappoint, but long-term investors shouldn't panic since demand for fertilizers and seeds should only increase with growing population and declining arable land. And as a diversified agricultural company, Agrium could be a major beneficiary of a recovery.

CATEGORY

1. Investing

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1. NYSE:MOS (The Mosaic Company)

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