The Stock Picker's Guide to Agrium for 2014

Description

Agrium (TSX:AGU)(NYSE:AGU) shares may have ended 2013 with 4% losses, but it was among the best performers for the year in a badly bruised fertilizer industry. Better known as a fertilizer company, not many know that Agrium gets a major portion of revenue from other agricultural products like seeds and crop protection. That also explains why it wasn't hit as hard as **PotashCorp** (TSX:POT)(NYSE:POT) and **Mosaic** (NYSE:MOS) last year when fertilizer prices slumped.

Given the backdrop, will Agrium continue to outperform the industry in 2014, or will the ongoing weakness in the fertilizer markets spill over to its other business and eat into its profits?

The big problem
Agrium's revenue should continue to grow in 2014 since nearly three-quarters of its sales comes from its retail business, comprising crop protection, nutrients, and seeds. Demand for these products is relatively inelastic. The problem lies in Agrium's wholesale, or fertilizer business.

Agrium deals in three key fertilizers – nitrogen, potash, and phosphate. While potash prices slumped after the sudden breakup of the Uralkali-Belaruskali cooperative last year, a spurt in urea exports from China drove nitrogen prices lower. Phosphate continued to suffer as demand from key international markets, particularly India, remained soft.

Uncertainty remains
As of now, none of the nutrient markets are showing any signs of turning around, though potash prices may have found a bottom after Uralkali's recent contract with China. However, the price is still too low to boost Agrium's profits. PotashCorp projects a double-digit (up to 34%) drop in its 2014 earnings, and is even shutting plants to reduce costs. Last year, Agrium also dropped earlier plans to expand nitrogen capacity by 30%, fearing oversupply even as peer **CF Industries** (NYSE:CF) announced plans to spend $3.8 billion through 2016 on new nitrogen facilities.

The problem is that Agrium's fertilizer business has traditionally been more profitable than the retail side. That doesn't fit well in the present situation when fertilizer prices are low and the price of the key input, natural gas, is on the rise. That's why Agrium's gross and net profits for the nine months ended

September 30, 2013, dropped 9% and 16%, respectively, despite flattish revenue. In other words, until the fertilizer market picks up, Agrium's bottom line will remain under pressure.

Two positive signs
All's not bad, though. There are two bright spots for Agrium investors for 2014. First, the company became Canada's largest agriculture retailer after acquiring grain and seed-handling company Viterra last year. Having added 210 farm stores, Agrium should see the benefits of the acquisition rolling in this year. With Statistics Canada pegging 2013-2014 to be the biggest-ever crop year for Canada, Agrium should benefit.

Second, with capital expenditure coming down, Agrium's free cash flow should increase, encouraging it to raise dividends and repurchase shares. Agrium has increased its dividend 27-fold since 2011, and returned nearly $1.7 billion in share repurchases since October 2012. Agrium's current dividend yield of 3.4% is way better than CF Industries' and Mosaic's yields of 1.7% and 2.2%, respectively. Only PotashCorp yields above 4% currently, but Agrium is playing catch-up. I believe investors can expect more rewards from Agrium in 2014 and beyond.

Foolish takeaway
While 2014 could be a volatile year for Agrium, its diversity makes it a compelling long-term bet in the agriculture space. As population grows and arable land declines, demand for fertilizers and seeds should increase, and Agrium is well poised to take advantage of the opportunity. So prudent Fools shouldn't panic, and instead consider any dip in Agrium shares this year as an opportunity.

CATEGORY

1. Investing

TICKERS GLOBAL

1. NYSE:MOS (The Mosaic Company)

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