Is it Time to Sell Agrium Inc. Shares After a Disappointing Quarter?

Description

Agrium (TSX: AGU)(NYSE: AGU) delivered a better-than-expected first quarter, but Mr. Market isn't impressed – the stock's down about 3% in trading today, as of this writing. The problem is twofold: Agrium's year-over-year Q1 numbers were horrendous, and its guidance was muted. So does that mean investors could see more downside in the stock? I'll try and answer that for you.

No worries on its top line
Agrium's Q1 sales fell just about 2% year over year. Analysts were expecting a much bigger drop, given the way fertilizer prices plummeted dropped in recent months. In fact, peers **PotashCorp** (TSX: POT)(NYSE: POT) and **Mosaic** (NYSE: MOS) reported 20% and 13% lower revenue year over year in their respective first quarters. Once again, Agrium's diverse product portfolio came to its rescue.

While the fertilizer business may have hit a rough patch in recent quarters, seeds and crop protection products enjoy relatively inelastic demand. Hence, sales from Agrium's retail business, which contributes nearly three-quarters to its total revenue, climbed 4% in the first quarter. Comparatively, PotashCorp and Mosaic rely solely on fertilizers for revenue, hence their weak performances.

But why did Agrium's profits fall off the cliff?
Unfortunately, fertilizers are higher-margin products compared to seeds, which is why Agrium's profits almost always take a much bigger hit than its top line in weak business conditions. But its first quarter was unusually scary – Agrium earned only $3 million compared to $138 million a year ago. Yes, you read that right.

First, Agrium's Q1 gross profit tanked 21% year over year on the back of lower fertilizer prices. As I mentioned earlier, fertilizers are responsible for much of Agrium's margins. Second, Agrium's selling and other administrative expenses increased 8% year over year, largely on account of its Viterra acquisition. The double whammy cost Agrium heavily, wiping out its profits.

Where is Agrium headed?
After the disastrous first quarter, investors now want to know what lies ahead for Agrium. The company expects to earn between $3.85 and $4.35 a share in its second quarter. That translates into a 13%

decline even at the higher end of the projected range.

Agrium's future profits will continue to subject to the vagaries of the fertilizer markets, which aren't looking too great as of now. As if that wasn't enough of a concern, Agrium has another problem to deal with. One of its nitrogen facilities will be shut down later this month to fix an unexpected break down. The outage is expected to result in roughly 15% lower nitrogen sales volumes in the second quarter. That hurt the company substantially since nitrogen is also its most important fertilizer product. That also partly explains Agrium's tepid outlook.

In short, investors should keep their expectations from Agrium low.

So what should you do now?
Perhaps the only bright spot for Agrium investors is the company's good cash flows and dividends. Agrium ended its first quarter with record operating cash flow of $788 million, thanks largely to controlled inventory levels in the wake of weak demand. If Agrium's cash flows continue to grow, it could boost its dividends further this year after increasing its annual dividend by 50% in 2013. The stock yields 3.1% at current price, only second to PotashCorp's 3.8% dividend yield but far better than Mosaic's 2% yield.

That said, a dividend increase remains an uncertainty, and it may also not make much sense to some investors if Agrium's stock continues to weaken meanwhile. But these are just short-term fears, and fertilizer markets will recover sometime. So traders may panic after Agrium's weak numbers today, but long-term investors can rest assured they have a strong stock in hand.

CATEGORY

1. Investing

TICKERS GLOBAL

1. NYSE:MOS (The Mosaic Company)

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