



3 Reasons Why PotashCorp's Stock Rally Will Fizzle

Description

PotashCorp. (TSX: POT)(NYSE: POT) shares are trading near the 52-week high reached just about a month ago. The stock has been on the downtrend fairly consistently since reaching that apex, and unless the company stuns with its second quarter earnings due later this week, the current market forces will leave the company's stock in a rut through the remainder of the year. Although I see the great long term for PotashCorp., here are three reasons why the stock could trade sideways through 2014.

1. Increased competition

Rio Tinto ([NYSE: RIO](#)) recently announced its intent to enter the potash market through a joint venture with **Acron OAO**. Rio Tinto is the second mining giant planning to enter the potash market due in part to the sector's healthy margins. **BHP Billiton** ([NYSE: BHP](#)) is currently expanding into potash and plans to make the commodity a pillar of its long-term growth.

Historically, there have only been a few producers of potash, as the high cost of starting a mine served as a high barriers to entry. Both Rio Tinto and BHP are major miners with deep pockets, and they will definitely be new competition for PotashCorp. While their entrance into the potash business is still years away, the timing of Rio's announcement is cause for a downside push on Potash Corp.'s stock.

2. Stable demand

Stable demand is a good thing, but not a great thing. For PotashCorp's stock to see another upside rally I think it needs a major catalyst, either on the supply or demand side. However, according to the company's latest monthly market update, the chance for a demand side catalyst is fairly bleak.

Looking at the company's expectations for potash sales through the year, PotashCorp has already placed a fairly hefty demand expectation, looking for global shipments of 55-57 million tonnes, well above the 53 million tonnes achieved in 2013. The company is expecting most of the sales to occur in the first half of the year, so potash sales are a metric to scrutinize in the company's upcoming earnings. For PotashCorp stock to see upside momentum on potash sales volumes, the figure reported this week will have to show that shipments are on track to handily beat forecasts.

In terms of the company's other major products, the nitrogen market remains volatile with Chinese exports of urea on track to hit a record in the first half of the year. The company's phosphate sales will be challenged in the second half of the year by new exports from Morocco.

3. Stable supply

There is a direct correlation between fertilizer prices (PotashCorp's main products) and crop prices. So far this year the crop outlook for corn, wheat, and soybeans is good, and the prices are relatively low. While the conditions for crops can deteriorate quickly (due to weather) we are right in the middle of the key pollination and grain filling period of July and August.

Once we make it past August we will largely be out of the woods for any supply side shocks to the grains market. A rise in grain prices, usually due to lower yields, encourages farmers to lock down fertilizer purchases for the next year, an occurrence we saw happen a few years ago when arid conditions sent many crops to record highs. This year a shock to grain supplies is looking unlikely.

Caution: earnings on the horizon

The one major factor that could shake up PotashCorp.'s stock is the upcoming earnings. The company is slated to report on July 24. In addition to the broader market fundamentals, in terms of metrics analysts polled by Capital IQ are looking for earnings of \$0.45 per share on revenues of \$1.7 billion. In the first quarter, the company earned \$0.38 per share on revenues of \$1.5 billion. The result was a miss on revenue, but a beat on EPS. The revenue miss was largely due to a decline in grain prices.

If PotashCorp stuns with impressive earnings this Friday, it would give the stock reason to ascend, but given the company's recent business updates, and the performance of the company's peers, a huge upside surprise in earnings would exactly that, a surprise.

CATEGORY

1. Investing

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1. NYSE:BHP (BHP Group)
2. NYSE:RIO (Rio Tinto plc)

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