



Should You Invest in Agrium and PotashCorp?

Description

One year ago the global potash market was rocked by the announcement that Russia-based Uralkali and Belarus-based Belaruskali were terminating their joint marketing agreement.

The breakdown of the cartel sent shares of **PotashCorp** (TSX: POT)(NYSE: POT) and **Mosaic** (NYSE: MOS) down 23% in two days. **Agrium** (TSX: AGU)(NYSE: AGU) fell nearly 10% over the next five trading days.

Spot prices for potash fell from \$400 per tonne down to about \$300.

The three North American companies sell potash to offshore markets through their joint ownership of Canpotex, which competes with global potash producers, including the ones from Russia and Belarus.

The producers reacted by reducing costs and PotashCorp announced in December 2013 that it was cutting 18% of its workforce.

In January, Uralkali's deal to sell potash to China for \$305 per tonne confirmed the new global rate and put a floor under the price.

In April, both Uralkali and Canpotex sealed deals with India for \$322 per tonne.

PotashCorp's stock price has slowly battled back and currently trades close to where it was before the big announcement. Mosaic still trades lower and Agrium has managed to rebound and climb higher over the course of the past 12 months.

So, should investors buy PotashCorp and Agrium now?

The case for PotashCorp

PotashCorp has started calling back some of the staff it laid off, and its Q2 earnings report came in better than expected.

The company now expects full-year profits of \$1.70 to \$1.90 per share. This is up from the previous

guidance of \$1.50 to \$1.80. The adjustment is due to better-than-expected Chinese demand.

The company said domestic demand for fertilizer products was very strong in both Canada and the U.S. during the second quarter.

It also said rail constraints that had hindered shipping to Vancouver in Q1 had been alleviated and that the company was able to deliver more of its products to overseas customers during the second quarter.

The case for Agrium

Agrium is a much more diversified company than PotashCorp. Its retail division normally softens the blow every time there is a shock in the wholesale markets. This is why its share price was more resilient last year.

Agrium also gets more of its income from nitrogen than potash, although it plans to increase its potash production by about 40% beginning in Q4 2014.

Agrium's nitrogen business depends on the cost of natural gas. In its Q1 earnings report, the company said high natural gas prices had impacted margins.

Looking forward, Agrium said it has approximately one third of its 2016 to 2018 gas needs hedged at a cost of \$3.50/MMBtu. This is similar to its Q1 2013 average net natural gas cost of \$3.54/MMBtu and much better than the Q1 2014 cost of \$4.29 /MMBtu.

Natural gas inventory levels reached an 11-year low in March 2014 but record production has quickly rebuilt supplies through the second quarter. Natural gas prices have fallen dramatically since the winter high, hitting an eight-month low of \$3.75/MMBtu on July 28.

This trend should continue and will help Agrium's nitrogen margins.

Agrium reports Q2 earnings on August 6. Based on PotashCorp's report, Agrium should also provide solid Q2 results. Strong demand from North American farmers and improved rail transport between Saskatchewan and Vancouver are beneficial to Agrium as well as Potash.

The bottom line

For long-term investors looking to take a position for at least five years, I think Potash and Agrium are good bets at this point in time. The fundamentals appear to be improving in both the North American and global markets, and both companies pay attractive dividends that should gradually increase as profits continue to improve over the next couple of years.

CATEGORY

1. Investing

TICKERS GLOBAL

1. NYSE:MOS (The Mosaic Company)

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