Earnings Preview: Agrium Inc.

Description

Agrium Inc. (TSX: AGU)(NYSE: AGU) will report its second-quarter earnings on Wednesday. The company had a difficult first quarter and investors will be looking for a rebound in profits, as well as an update on the recently announced shutdown at Agrium's Vanscoy potash mine.

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Agrium Inc. is an integrated supplier of agricultural products and services. Its retail division serves markets in North America, South America, and Australia. Its wholesale operations produce nitrogen, potash, and phosphate for the global market.

Agrium, **Potash Corp. of Saskatchewan** (TSX: POT)(NYSE: POT), and **Mosaic Co.** (NYSE: MOS) sell potash to the global wholesale market through their marketing and distribution company, Canpotex Limited.

Low wholesale prices for crop nutrients have hurt profits at all the fertilizer producers. Agrium has suffered less than its peers because its retail division represents about half of its EBITDA.

Let's take a quick look at what happened in the first three months of 2014 and see if things have improved during the second quarter.

A tough first quarter

In Q1 2014, Agrium reported lower year-over-year results. Gross profit came in at $556 million, a 21% drop from the Q1 2013 earnings of $705 million.

Lower benchmark and realized sales prices for all of Agrium's major crop nutrients hit the company's wholesale division.

Another factor that impacted Q1 earnings was the extremely cold North American winter. Agrium's nitrogen business is its largest wholesale segment, and natural gas is the core input cost for nitrogen production. Natural gas prices spiked in Q1, driving Agrium's nitrogen cost of product sold up to $324 per tonne from the Q1 2013 cost of $300 per tonne, a jump of 8%.

The company also struggled with port and rail transport constraints, which hindered Agrium’s ability to move its products to various markets.

What to expect from Agrium Inc. in its Q2 report

Agrium provided a diluted earnings per share guidance for the second quarter of $3.85 to $4.35.

Analysts are expecting $4.12 per share.

Based on the Q2 reports from Potash Corp. of Saskatchewan Inc. and Mosaic Co., investors should expect Agrium to report good numbers.

Farm demand

Potash Corp said North American farm demand was very strong through the spring planting season, up 28% from Q2 2013 levels. Agrium’s numbers should also be solid given its strong position in the North American market.

Rail transport issues

Potash Corp also said the rail transport situation improved in the second quarter. All of the crop nutrient producers had been affected, so Agrium’s earnings should reflect the benefits of greater product movement along the supply chain.

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Natural gas prices

The price of natural gas remained high through the first half of 2014, but has come down significantly since the middle of June.

Agrium’s nitrogen production costs for Q2 will probably come in near the levels reported in Q1, which were an adjusted $4.29/MMBtu. Current prices are about $3.80/MMBtu.

NYMEX Natural Gas Prices

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Source: NASDAQ

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Mosaic said nitrogen demand and prices were strong through the second quarter, so Agrium's largest crop nutrient division should deliver decent Q2 numbers. Looking forward, the recent drop in natural gas prices will help nitrogen margins in Q3.

Potash prices and inventories

Global prices for potash appear to have bottomed. In April, India signed deals with Canpotex and Uralkali for $322 per tonne. Just last week, Uralkali's head of sales, Olev Petro, said the company's 2014 deal with China at $305 per tonne will likely increase by 10% in 2015.

In its July *Crop Input Market Report*, Agrium reported bullish potash stats:

North American Potash Inventories

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Source: Agrium Inc.

North American potash inventories fell for the fifth straight month in June 2014. Inventories were 24% below those of June 2013 and 19% less than the five-year average.

Agrium also reported that North American potash production increased by 9% year over year in June 2014, even as inventories continued to fall.

The report said that North American domestic potash shipments were strong in June 2014, jumping 80% versus June 2013.

Risks for Q3 2014

Agrium said on July 31 that a mechanical failure on Vanscoy's main hoist system has resulted in the shutdown of the potash facility. The company has decided to bring forward the tie-in of a planned capacity expansion at the site but the operation will remain shut down until the tie-in is complete.

Investors should pay careful attention to the conference call to get a sense of how the shutdown at Vanscoy will affect production and sales for Q3 and Q4.

In 2013, wholesale potash sales represented about 24% of Agrium's gross profit.

The market doesn't seem to think the shutdown is an issue as Agrium's stock barely moved on the news.

The bottom line

Look for Agrium to report solid Q2 results. Its guidance will depend on how big an impact the outage at Vanscoy is likely to have on Q3 and Q4 earnings.

The company is currently trading at 14.2 times earnings (TTM) per share and at least one analyst thinks this is too low.

Ben Isaacson of Scotiabank Global Banking and Markets recently told the *Wall Street Transcript* that he thinks investors will reward Agrium with a higher multiple in the future as its retail business continues to grow, providing a more stable free cash flow.

Isaacson said Agrium can grow free cash flow to $1 billion by 2015 and $1.5 billion by 2016. This would give the company ample cash to continue buying back shares and increase the dividend from $3 to $4 over the next two years.

CATEGORY

1. Investing

TICKERS GLOBAL

1. NYSE:MOS (The Mosaic Company)

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