1 Glaring Truth Every Agrium Inc. Investor Should Know

Description

Agrium Inc. (TSX: AGU)(NYSE: AGU) beat Street estimates on its top and bottom lines for the second quarter, but the market isn't impressed — the stock dropped nearly 3% last Wednesday after the company announced its numbers, and analysts firms, including Canaccord Genuity, CIBC, and Susquehanna have been quick to lower their respective price targets on Agrium stock post earnings. So what's going on?

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Top line's growing, but…

Agrium appears to be doing a great job at first blush. Its largest division, retail, which sells seeds, crop nutrients, and crop protection products, reported *record* second-quarter sales worth $6.4 billion. That was up an impressive 15% year over year. It's worth noting that retail accounted for nearly 86% of Agrium's total Q2 sales.

Furthermore, retail gross profit jumped 18% and earnings before interest, taxes, depreciation, and amortization, or EBITDA, surged 28% year over year.

With such statistics, Agrium should have swept Bay Street with bumper profits, isn't it? Unfortunately, Agrium's total Q2 net income *fell* 18% year over year on 6% higher revenue. How is that possible? One chart will perhaps answer that for you.

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Source: Agrium Q2,2014 Earnings Presentation
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As you can see, Agrium ended its second quarter with lower year-over-year total EBITDA despite a substantial jump in retail's contribution to EBITDA. Simply put, retail maybe Agrium's biggest revenue generator, but its profitability depends heavily on its wholesale business, which comprises of fertilizers like nitrogen, potash, and phosphate. Unfortunately, this is bad news for investors.

…profits are hard to come by

Even as fertilizer markets are showing signs of improvement, Agrium is struggling with production disruptions. For instance, an unexpected shutdown at its Carseland plant resulted in 18% lower nitrogen sales volumes in Q2. In sharp contrast, **PotashCorp** (TSX: POT)(NYSE: POT) boosted production and reported 13% higher year-over-year nitrogen sales volumes during its last quarter. The outage was one of the major factors that drove Agrium’s Q2 profits down, especially since nitrogen makes up the bulk of its fertilizer sales and profits.

Unfortunately, Agrium suffered another blow a couple of weeks back when its only potash mine at Vanscoy, Saskatchewan suffered a mechanical failure. As a result, the plant will be shut for an additional four weeks, aside from the planned turnaround of 14 weeks pertaining to expansion activities. This will result in a production loss of at least 500,000 tonnes of potash. To put that in context, Agrium produced 1.7 million tonnes of potash in full financial year 2013.

Pressure from all sides

If outages are hurting Agrium’s production volumes, the company is also struggling with higher costs. Agrium expects “significant upward pressure” on costs associated with its Vanscoy potash expansion project during the second half of the year, thanks to labour shortages and issues with the contractor. Investors may recall that Agrium had already projected its spending on the program to increase 25% in its 2013 annual report.

Higher input cost is another concern for Agrium. Its average natural gas cost in Q2 rose to $4.49 per MMBtu, compared to $3.67 per MMBtu a year ago. Higher gas cost, coupled with outages, drove the company’s nitrogen gross profit down 66% in Q2. Natural gas is a key input for nitrogen fertilizer; and with its prices on the rise, Agrium’s cost pressures will likely continue.

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Why you should be cautious

Agrium may want to pacify investors by highlighting its strong retail performance, but investors know that a strong fertilizer business is the key to the company’s growth. With the fertilizer markets on soft patch and the added burden of plant turnarounds, Agrium will have to work harder to maintain its margins.

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