Agrium Inc. Shares on Sale: 2 Reasons to Buy Now

Description

On October 1, major fertilizer producer and agricultural retailer **Agrium Inc.** (TSX: AGU)(NYSE: AGU) revised its guidance for Q3 earnings downward and projected mediocre Q4 earnings. Consequently, its shares dropped sharply from roughly 98$ per share to $95.77 by market close the next day.

As Warren Buffett often says "The market is there to serve you, not to inform you." He also thinks investors should not use sudden price swings to make investment decisions, but rather capitalize on them to acquire shares at discount prices, provided that a solid analysis checks out.

I believe the recent weakness in Agrium shares represents the market overreacting to bad news, as it often does, for a company with already-undervalued shares.

Causes of the decline

Why did Agrium shares drop? Firstly, Agrium guided its Q3 earnings downward to $0.45-$0.55 per share, away from the analyst consensus estimate of approximately 0.64 per share for the same period and roughly in line with the Q3 2013 results.

Secondly, Agrium is predicting both its retail and wholesale EBITDA for the second half of 2014 to be similar to last year. This is a result of its Vanscoy potash mine being down to tie in its major expansion, its Redwater nitrogen facility temporarily offline to replace a major piece of equipment, and lower grain prices and crop protection product sales due excellent growing conditions across the U.S this summer.

These developments, though not positive, represent an opportunity to buy Agrium at a discount. Here are two reasons why:

1. The fundamentals remain strong

The conditions that resulted in Agrium's price drop are due to temporary production issues (like the shutdown of the Vanscoy mine), and temporary macroeconomic conditions (such as poor grain prices), and do not speak heavily to the company's long-term fundamental earnings power.

Although Agrium claimed in its latest release that stronger nitrogen results will offset the losses from the shutdowns, these temporary closures are partially responsible for poor Q3 wholesale results. Once these facilities are running again, it will not only serve to recover Agrium’s earnings per share, but increase it. The Vanscoy mine shutdown, for example, is for a $1.8 billion capital expansion project that will add 50% to Agrium’s potash production capacity and drive future earnings.

In addition to the poor wholesale results, Agrium is expecting no growth in its retail operations for the second half of 2014 due to a record growing season, putting pressure on grain prices and farmers’ income. These record conditions are unlikely to last into next year, and the long-term fundamentals on grain prices are good as projected demand for food is expected to rise. According to Agrium’s September 2014 presentation, it is still on target to hit its $1.3 billion 2015 retail EBITDA target through organic growth and capitalizing on its recent acquisition of 210 Vitera outlets.

Agrium is not a short-term trade, but rather a long-term investment and a play on inevitable rising demand for food.

2. Agrium is currently trading at a discount

Agrium shares were undervalued before the price decline, but they are now trading at an even larger discount. Its current price-to-earnings ratio is 17.66, and its forward price-to-earnings ratio is now around 13, an extremely low level, based on very conservative estimates.

With **Potash Corp./Saskatchewan** (TSX: POT)(NYSE: POT) trading at a price-to-earnings ratio of 20.8, despite facing similar macroeconomic conditions, Agrium shares would need to rise substantially based on current — and especially based on forward — earnings to be equally valued.

With a projected growth rate of 10% compared to Potash Corp.’s 7%, Agrium shares should not be trading at such a discount. Now is a good time to pick them up at a good value.

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