Why Investors Should Ignore the Agrium Inc. Earnings Warning

Description

Agrium Inc. (TSX: AGU)(NYSE: AGU) announced on October 1 that it will report lower-than-expected earnings for Q3 2014. Instead of the $0.68 per share expected by analysts, the company said third-quarter earnings will be in the range of $0.45 to $0.55 per share.

The stock initially dropped more than 4% on the news.

When a company warns on earnings, investors need to look carefully at the reason to determine if it is a short-term issue or one that will affect growth and profits for an extended period of time.

In the case of Agrium, the earnings warning is primarily the result of lower potash production due to the temporary shutdown of its Vanscoy, Saskatchewan mine.

Agrium is in the process of tying in an expansion project at the Vanscoy site. The earnings shortfall shouldn't be a surprise to investors, and the production delay is not a long-term concern. Agrium said earnings for the fourth quarter should be about $0.72 per share, on par with its Q4 2013 results, but lower than the $1.03 per share the market has been expecting.

The drop in Agrium's shares should be seen as a buying opportunity for the following four reasons:

1. Greater free cash flow

The Vanscoy expansion is a $2 billion capital project. Now that it is moving from development to production, Agrium will have significantly more free cash available to buy back shares and increase the dividend.

2. Potash prices are increasing

Global demand for potash is expected to hit record levels in 2014, according to a statement from Uralkali, the world's largest potash producer. Uralkali also expects to get as much as 10% more for its potash when it signs a new supply deal with China in 2015. The Uralkali deal with China will set the benchmark price for the entire industry.

Agrium expects production at Vanscoy to increase by 40% as the expansion ramps up to capacity. The extra production and higher realized prices will also boost the company's cash flow.

3. Strong retail earnings

Agrium's integrated business model sets it apart from other crop-nutrients miners. The company operates the largest network of agricultural stores in North America, and provides more than 500,000 growers worldwide with seed, fertilizer, and crop-protection products.

Above-average crop production in the U.S. this year should support earnings for Agrium's retail division. Agrium also operates stores in Canada, Australia, Argentina, Chile, Uruguay, and Brazil.

The retail unit continues to grow. Agrium purchased Viterra's Canadian and Australia retail assets in 2013. The company sees annual earnings contributions from the deal to be in the range of $75 million to $90 million once the stores become fully integrated into the network. Agrium expects the majority of the $15 million to $20 million in synergies to be realized in 2015.

As retail earnings continue to grow, Agrium's revenue stream will become more predictable, and the market should reward the company with a higher multiple. The company currently trades at about 16 times earnings, significantly lower than its peers.

4. Dividend growth

Agrium pays a US$3.00-per-share dividend. As cash flow increases in the next couple of years, investors should see healthy increases to the distribution. In the meantime, you get a nice 3.5% yield.

The bottom line?

Long-term investors should look beyond Agrium's Q3 warning and take advantage of the weakness in the stock to add the company to their portfolio. Agrium is one of those rare stocks you can buy and hold for decades.

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aswalker