



Why Potash Corp./Saskatchewan Is a Better Play on Fertilizer Than Agrium Inc.

Description

Over the next 30 years, the United Nations predicts a *doubling* in current production food will be required to meet growing demand, and most of this demand will be coming from the growing population and improving diets of developing nations like China and India.

Developing countries combined will consume 12% more kilocalories from cereals, 11% more from beef, and 23% more from chicken by 2022. How will the world meet this growing demand? The answer is simple: fertilizer.

Arable land is limited, and 80% of future food production is expected to come by increasing crop yields, which is done through fertilizers. While **Agrium Inc.** (TSX: AGU)(NYSE: AGU) is a great, diversified business thanks to its retail sector, its wholesale business cannot compete with **Potash Corp./Saskatchewan's** (TSX: POT)(NYSE: POT). Potash Corp.. is better prepared to profit from coming growth. Let me explain.

Potash Corp. has a better allocation between fertilizers

Potash Corp. is better prepared to capitalize from coming growth because its revenue composition is geared toward high-margin, low-cost, and high-barrier-to-entry fertilizers. In 2013, Agrium received 34% of its gross profits from nitrogen, 14% from potash, and 3% from phosphate. Potash Corp. made 57% of its sales from potash in 2013, 32% from nitrogen, and 11% from phosphate.

From this, it is clear Potash Corp. gets most of its business from potash sales, whereas Agrium is focused heavily on nitrogen. Potash Corp.'s focus on potash instead of nitrogen gives it a strong competitive position for several reasons.

Firstly, potash has incredible potential for long-term demand growth. In fact, demand for potash is expected to exceed demand for nitrogen and phosphate. Developed farming countries apply potash at far greater rates than developing countries like China, and grow more potash intensive foods like fruits and vegetables instead of grains. As countries like China begin to mimic developed countries, potash use will grow.

Secondly, because potash deposits are concentrated in a few areas, there are very few potash players. This allows the few major players, like Potash Corp., which produces 20% of the global supply, to control pricing to an extent. There are also very high barriers to entry in the potash industry, giving producers an economic moat. There are limited deposits worldwide, and it is estimated to cost \$6 billion and a minimum of seven years to get a potash mine running. This is triple the cost of a nitrogen plant. Once these mines are running, though, they are lower-cost, higher-margin businesses.

This focus on potash instead of nitrogen gives Potash Corp. a major advantage over Agrium. Nitrogen is a highly competitive industry with many players, prices are volatile, and costs to produce and transport can be very high. Margins also depend on natural gas prices (since natural gas is an input), and high natural gas prices are bad news for companies like Agrium.

Potash Corp. is a lower-cost, higher-margin producer

Not only is Potash Corp. more focused on the right fertilizers but it also has some competitive advantages over Agrium for each fertilizer. With potash, Potash Corp. is currently a much lower-cost producer than Agrium. Potash Corp. currently produces potash for less than \$120 per tonne, with this expected to drop to around \$90 per tonne by 2016 as Potash Corp. closes production at one of its high-cost mines and shifts production to lower-cost facilities. In Q2/2014, Agrium's cost of product sold for potash was \$182 per tonne.

Potash Corp. also gets better margins than Agrium on each fertilizer. Potash Corp. had margins 1.1% higher for nitrogen, 5.2% higher for potash, and 4.5% higher for phosphate in 2014.

These low-costs and high-margins will allow Potash Corp. to profit more from increasing demand. Potash Corp. also has the lowest operating rates in the industry, which gives it a huge capability to increase sales volumes as demand rises.

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