Agrium Inc.: Activists at the Gate

Description

Despite record global grain yields **Agrium Inc.** (TSX: AGU)(NYSE: AGU) delivered quarterly results that at best could be described as mixed with annual profits heading for a 20% decline.

A mixed quarterly result… as expected

Agrium announced adjusted earnings per share from continuing operations of US$0.63 for the third quarter, which was 17% higher than the comparable quarter last year. For the first nine months of the year, earnings per share declined by 23%. On an unadjusted IFRS basis, including discontinued operations, earnings per share declined by 33% for the quarter.

Revenue for the quarter was 4% higher than the year before as a result of the inclusion of the Viterra business acquired in October 2013 and higher nitrogen and phosphate volumes and prices. As a result of higher sales costs, expenses jumped by 17% during the quarter resulting in a compression of the EBIT margin from 5.2% to 3.6%.

The Retail division, with main products crop nutrients and crop protection, had a poor quarter with EBIT declining by 44% mainly as a result in much higher selling costs although the year to date result improved with a 14% EBIT increase.

The Wholesale division had excellent nitrogen and phosphate sales but lower potash sales with a net result of a small EBIT increase. Potash production was impacted by mechanical failure and advanced expansion tie-in at the Vanscoy facility detracting from what otherwise could have been a good quarter for this division. The year-to-date result was rather poor with a 14% decline in sales revenue and a 47% decline in EBIT with profits of all major product lines lower than the year before.

The decline in the profitability of the Agrium business over the past 4 quarters is illustrated by the four-quarter rolling return on capital employed, which declined from 14% at the end of the third quarter 2013 to 8% by the end of the same quarter in 2014.

Poor cash flow but a sound balance sheet

Agrium consumed cash of US$466 million during the quarter mainly as a result of additional working capital requirements. The business only managed to convert 2.5% of sales to operating cash flow (US$332 million) during the first nine months of the year. This was not nearly enough to cover the capital expenditures of US$1.5 billion resulting in a negative free cash flow so far this year and a requirement to raise considerable additional short-term debt of US$1.1 billion. The balance sheet remains in reasonable shape with net debt of US$4.7 billion representing a manageable 40% of total capital.

Agrium's board also announced a 4% increase in the dividend to US$0.78 per share for a total dividend of US$3.12 per share on an annualized basis. No shares were repurchased from the market so far this year compared to the almost US$500 million spent last year.

Outlook for the full year unchanged

Agrium is providing guidance of adjusted earnings per share of US$0.45-$0.75 per share for the fourth quarter, which would bring the full year profit to US$5.67 per share (based on the midpoint of the fourth quarter estimate) — equating to a 21% decline from last year.

Agrium will have to work hard to improve shareholder value

ValueAct Capital, a San Francisco-based fund manager recently acquired a 5.7% equity interest in Agrium and in the process become the second largest shareholder — clearly with the objective to improve shareholder value.

Based on consensus estimates, Agrium is valued on a 13 times price/earnings ratio and 7.9 times EV/EBITDA, roughly in line with its nutrient producing peers. Whether ValueAct will push for a separate listing of the Retail division is unclear but this possibility was rebuffed by the Agrium Board less than 18 months ago. Agrium is in a weaker position now to convince shareholders that the current strategy is the right one.

CATEGORY

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