Agrium Inc.: Is it Time to Take Profits?

Description

Things have been far from boring over at **Agrium Inc.** (TSX:AGU)(NYSE:AGU) during the past few years.

After enduring a collapse in global potash prices, fending off activist hedge fund JANA partners from splitting the company, and dealing with two major shutdowns in 2014 due to mechanical issues, Agrium shareholders had little to be excited about.

However, after a fairly flat majority of 2014, Agrium shares rocketed up in mid-October from $94 per share to close 2014 at nearly $115 per share, on news of activist investors ValueAct increasing its position. Shares jumped again on January 22 on news of Agrium boosting its target payout ratio to 50% of free cash flow, setting a new 52-week high of $132.86 per share.

With shares appreciating an enormous 43% in the past three months, Agrium shareholders may be wondering, is it time to trim positions and take some profits, or hold for more upside? Let's take a look at the case for each.

The case for selling Agrium shares

Back in October when Agrium was at its 52-week low, shares seemed like a bargain, and the company was immersed in a cloud of negativity due to several factors. Agrium had just revisedits earnings guidance for Q3 2014 downward due to its Vanscoy potash facility being shutdown to tie-in its major expansion, and its Redwater nitrogen facility being shutdown to replace a major piece of equipment.

To make matters worse, potash prices were near a five-year low, and Agrium predicted its retail operation would see little growth in 2014 due to excellent growing conditions reducing grain prices and demand for crop protection products.

However, with the Vanscoy project estimated to boost potash production by 50% on completion, and the Redwater completion expected to solidify nitrogen production, production is set to rise hugely. Free cash flow and earnings would not only recover, but increase when these projects are done, making the depressed price seem like an opportunity.

With shares trading at $132.86, it seems much of this bargain has now evaporated, and shares are accurately reflecting Agrium's growth potential. This has prompted analysts at Miller Tabak to downgrade Agrium shares to a hold, citing margin pressures from the companies retail segment. These include record corn yields and crop production, which is reducing crop prices and putting pressure on growers' yields. This in turn reduces demand for fertilizer, as well as crop protection products.

With a current price-to-earnings ratio of 20.26, Agrium is currently trading at a premium to the industry average of 19.6, for the first time in years.

The case for holding

Despite shares being overvalued relative to peers, there is also a strong case that Agrium can support this valuation through its excellent growth profile, improving wholesale margins, and excellent dividend growth rate.

With Agrium restarting its Vanscoy potash mine, it is expected to ramp up to 2.8 million tonnes by 2017, adding 1 million tonnes to Agrium's potash production capacity, and reducing cash cost of production by $20 per tonne in the process. In addition, Agrium is expanding its Borger nitrogen facility, which will expand its urea production by 610,000 tonnes. This expansion will be complete in the second half of 2015.

As these expansions come to a close, Agrium will see its capital expenditures drop significantly, from $2.15 billion in 2014, down to $1.3 billion in 2015. With Agrium's current $2 billion EBITDA expected to grow by as much as $925 million by 2017 thanks to increased production, Agrium can expect its free cash flow to explode over the next few years.

This will only be enhanced by improving margins in the nitrogen segment due to natural gas prices reaching a two-year low, and a potential rebound in crop/fertilizer prices.

CEO of ValueAct Capital Jeffrey Ubben anticipates Agrium will grow its EBITDA by 15-20% annually over the next two years, and in this sense, Agrium shares do not seem so expensive.

The verdict?

With huge upcoming free cash flow, and a potential doubling of its dividend over the next few years (a move foreshadowed by the recent raise of Agrium's target dividend payout ratio), holding on to Agrium shares over the next several years seems to be the wisest choice.

CATEGORY

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2. Metals and Mining Stocks

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