The Dividend Investor's Guide to Agrium Inc.

Description

Agrium Inc. (TSX:AGU)(NYSE:AGU) has recently made headlines with several key announcements, signifying its transition into a dividend-oriented company with a focus on returning cash to shareholders.

The recent announcement by management to increase its target payout ratio from the original 25-35% of free cash flow to 40-50% of free cash flow is perhaps most significant, as it is indicative of both Agrium's confidence in future cash flows and its commitment to using these cash flows to reward shareholders.

For Agrium shareholders, this means potential triple-digit dividend growth over the next five years and an industry-leading yield. If you are an investor considering Agrium for the yield, here is everything you need to know about the dividend's past, present, and future.

Agrium's history as a dividend payer

Before 2011, few would've mentioned the words "Agrium" and "dividend investment" in the same sentence, and rightfully so. From 2002 to 2010, Agrium's dividend remained unchanged at US$0.11 per share. Since Agrium's share price fluctuated greatly during this eight-year period, its dividend yield also varied, with the yield topping out at around 0.8% in 2002 and falling to 0.10% in 2010 as shares rose.

Compared to Agrium's main competitor, **Potash Corp./Saskatchewan Inc.** (TSX:POT)(NYSE:POT), this is a weak performance. Between 2002 and 2011, Potash Corp. increased its dividend on four separate occasions, representing a 127% increase. In addition, Potash Corp. had a significantly higher payout ratio. During this period, Agrium paid out, on average, only 3.51% of earnings, with Potash Corp. paying out 8.3% on average.

Fortunately, in 2011, things changed for Agrium, and Agrium began increasing its dividend at a much faster rate. In fact, between 2011 and today, Agrium has hiked its dividend an impressive 27x, from US$0.11 to US$3.00 per share.

Why did this happen? There are three major reasons. First, Agrium's retail business finally reached a size where it could begin paying a dividend, and Agrium had been looking to its stable retail division for a source of dividends, as opposed to its more volatile wholesale division. Second, Agrium was looking to play catch up with its peers, who were also increasing dividends, and finally, Agrium was under pressure from activist investors JANA partners at the time.

Agrium's transition to a dividend-focused company

One would think increasing a dividend by 27x would mean a company has become a dividend-focused company, but for Agrium, this growth is just the beginning. Over the next two years, Agrium is anticipated to grow its earnings before interest, taxes, depreciation, and amortization by an impressive

15-20%, and at the same time, Agrium is expecting to see its capital expenditures drop substantially, resulting in an explosion of free cash flow.

This drop in capital expenditures is due to Agrium finishing several large capital projects. First, its Vanscoy potash expansion, which began in 2012, just finished in December 2014 and is expected to increase annual potash production by 1 million tonnes.

In addition, Agrium's nitrogen expansion at Borger, which began in March 2014, is expected to be complete in 2015 and is expected to add 635,000 tonnes of urea production. Once both of these expensive capital projects are complete, Agrium is expecting its capital expenditures to drop from $1.8 billion in 2014, to as low as $700 million in 2015, and significantly lower going into 2016.

The result? Agrium has ample room to boost its dividend, and CEO of Valueact Capital Jeffrey Ubben estimates Agrium could have a US$6.00 per share dividend by 2016, representing a 100% upside.

The future of Agrium's dividend

With capital projects coming to a close, earnings expected to grow on greater production and retail growth, and Agrium raising its target payout ratio, the future for Agrium's dividend seems bright.

Analysts at **RBC** are predicting free cash flow of $1.3 billion in 2017, which would mean $681 million available for a dividend if a 50% payout ratio is used. With 130 million shares (analysts are predicting share buybacks), this would result in an impressive dividend of US$5.24.

With dividend growth and stability like this, investors can't go wrong with Agrium.

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