

Investors Are Betting Against Potash Corp./Saskatchewan; Should You?

Description

Potash Corp./Saskatchewan (TSX:POT)(NYSE:POT) is an impressive stock. It returned a market-trouncing 29% in 2014, and has continued its upside into 2015 so far, returning nearly 16%. These returns are only enhanced by the companies 3.45% yield—the highest among its fertilizer peers.

It may serve as quite a surprise then, that Potash Corp. is currently one of the most shorted stocks on the TSX, which means investors are betting the stock will move downwards. From January 15 to January 30, Potash Corp. had the largest increase in shares being sold short—increasing from 5.5 million to 22 million. From January 30 to February 13 it jumped again, from 22 million to 23 million, making Potash Corp. the seventh most shorted stock on the TSX.

Why is this, and as a current or potential Potash Corp. shareholder, what should you do?

Why Potash Corp. is being shorted

Potash Corp. has had an impressive run. In November 2014, Uralkali—a major Russian potash producer responsible for 20% of global production—noted a massive inflow of brine into its Solikamsk-2 mine, which resulted in the mine flooding and needing to be shut down. The site produced about 2.3 million tons of potash a year, and it is possible the mine may not reopen.

This has been incredibly good news for Potash Corp. With a 2.3 million ton supply shortage caused by the closure, Potash Corp. is perfectly suited to assume the extra production. Potash Corp. currently holds a 54% of the Canoptex sales allocation (the North American marketing firm for potash, comprising **Agrium Inc.** and **The Mosaic Company**).

Since Canoptex will likely assume the lost production, and Potash Corp. has several million tons of additional capacity, the shutdown represents an enormous opportunity for Potash Corp., and its shares responded accordingly, jumping up 18% since November on the news.

The problem—and the reason the stock is being shorted— is that Potash Corp. now seems expensive. Shares are trading at their highest price since 2011, and Potash Corp. is posting an expensive price-to-earnings (P/E) ratio of 26.53. In fact, this is the highest P/E ratio Potash Corp. has traded at since 2009.

The story gets worse when Potash Corp. is compared to its peers. Potash Corp. is currently one of the most expensive fertilizer stocks, and with a P/E of 26.53, is far more expensive than the industry average P/E of 19.3. This is despite the fact that Potash Corp has a similar growth rate to its peers—particularly Agrium.

The stock's expensive valuation — and the fact that at the current price of around \$46, the stock is at a multi-year high — is making investors panic and bet on a major pullback.

What should you do?

It is true that Potash Corp. does seem expensive, and it is possible the stock will have limited growth going forward unless it continues to post very impressive earnings figures. However, this is not a reason to sell.

Potash Corp. remains an excellent investment, but investors need to be focused not on the stock's near-term prospects, but rather its prospects on a 10- to 20-year horizon. Potash Corp. is expected to grow its free cash flow substantially over the next few years as capital projects wind down, and this will allow the company to create value through dividend increases and share buybacks.

In addition, Potash Corp. is a low-cost producer, and has been successful in hitting the first milestone of its multi-year cost reduction program. These factors allow Potash Corp. to create value even in weak fertilizer markets.

The long-term trends for fertilizer are incredible, with emerging economies expecting to consume 12% more kilocalories from cereals, and 11% more from beef before 2022. This should increase crop demand, and fertilizer is the best way to improve crop yields.

Investors may be betting against Potash Corp's short-term prospects, but for investors in it for the long haul, it represents a great play.

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