Could Agrium Inc. Shares Gain 30+% This Year? These Analysts Think So

Description

Investors who were curious if it's too late to join in on the **Agrium Inc.** (TSX:AGU)(NYSE:AGU) were given the go ahead by analysts at both **RBC** and **TD Bank**—both banks rated Agrium a buy with a $164 price target.

This would represent an approximately 30% upside from the current price and a continuation of the rally which began in October 2014, which has already added 43% to Agrium's share price.

More important than the price target, however, is the rationale for the price target. Agrium currently has at its disposal three high-probability catalysts that should serve to materialize the 30% in gains being predicted by analysts. Here are the three factors driving Agrium's bullish target.

1. Rapidly expanding EBITDA and free cash flow

In order for a company to experience sustained share price appreciation, it ultimately needs only one thing—corresponding earnings growth. Agrium is prepared to deliver on this front.

Over the next three years, Agrium management is expecting to grow earnings before interest, taxes, depreciation, and amortization (EBITDA) by a potential 65%. In 2014 EBITDA was approximately US$1.7 billion, and management is anticipating US$2.6-2.9 billion by 2017.

This EBITDA growth will be mirrored by growth in free cash flow, which is perhaps the best measure of the success of a business, since, unlike EBITDA or earnings, it factors in a business's capital expenditures to give a proper measure of how much cash a company is actually generating. In this regard, Agrium is expected to grow its free cash flow from $-511 million in 2014, to $1.15 billion in 2015.

What's underpinning this increase in cash flow and EBITDA? It is largely three factors. First, Agrium completed expansion at its Vanscoy potash project in December 2014, and ramp-up is expected to occur during 2015. This expansion is expected to add 1 million tonnes to Agrium's potash capacity, which should add to sales volumes and top-line growth. Second, as Agrium's expansions are completed, capital expenditures will fall, contributing to free cash flow growth. Third, Agrium will experience growth from its retail segment as it continues consolidating the agricultural retail market.

2. Agrium will potentially see a doubling of its dividend

EBITDA and free cash flow growth certainly drive share price, but so does a strong dividend payout ratio, yield, and growth rate. This is especially true in the current low-growth environment, and even more so in currently volatile markets as investors gravitate towards secure names with stable and growing dividends. A strong commitment to returning capital can often award a company with a premium valuation, and can serve to attract and maintain shareholders.

Agrium is poised to benefit in this regard, as it has recently increased its target payout ratio from 25-35% of free cash flow to 40-50%. With an increased payout ratio and rapid free cash flow growth, Agrium is poised to see its dividend potentially double by 2017, especially if Agrium continues its share buyback program, which would reduce the current float and thereby increase the dividend per share.

3. Agrium's current share price does not factor in its growth

Currently, Agrium is actually trading at a premium to both **Potash Corp./Saskatchewan** and **Mosaic Inc**., its closest competitors, who are collectively trading at a price-to-earnings ratio (P/E) of 17.75.

However, due to the fact that Agrium has a much better growth profile over the next three years than either of its peers, this slight premium is justified. This becomes clear when looking at Agrium's forward P/E ratio, which is a low 13.5 compared to 16 for Potash Corp.

With 2015 earnings of $8.04 per share expected, Agrium would end up with a share price of $161 if it simply traded in line with Potash Corp.'s P/E, and much higher if it trades in line with its average P/E of 17.2 for the broader peer group.

Knowing this, the recent pullback in Agrium shares is a great opportunity to participate in the second half of its impressive rally.

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Date
2025/08/26
Date Created
2015/04/01
Author
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