Why Agrium Inc. Is up 19% But Potash Corp./Saskatchewan Inc. Is Down 3%

Description

When two stocks belonging to the same industry deliver contrasting performances, it's time to dig deeper to find out why. Fertilizer stocks **Potash Corp./Saskatchewan Inc.** (TSX:POT)(NYSE:POT) and **Agrium Inc.** (TSX:AGU)(NYSE:AGU) are perfect examples. While Agrium has jumped 19% year to date, Potash Corp. stock is reeling in the red. What gives?

Tale of optimism and setbacks

Surprisingly, numbers reported by both companies so far this year show negative correlation with the direction of their stock prices. So, while Agrium's Q4 net earnings nearly halved to US$51 million, Potash Corp.'s Q4 net income surged a staggering 77% year over year.

Perhaps the answer, especially compared with Agrium's big move, lies in its outlook for 2015. The company expects to earn between US$7-8.50 per share, a huge improvement over the US$5.51 EPS reported last year. It's worth noting that planned outages at some of its key facilities had a big role in Agrium's low Q4 earnings. With shutdowns behind it, the company is looking at higher production and sales volumes this year.

Potash Corp.'s guidance, though optimistic, offers little excitement in comparison. It expects to earn US$1.90-2.20 per share in 2015 versus the US$1.82 per share earned last year. The company suffered a setback last month when the Saskatchewan government made changes to the potash royalty scheme. These changes could wipe out $75-100 million from Potash Corp.'s 2015 pre-tax earnings. Not surprisingly, the announcement sent its shares tumbling because investors fear an outlook downgrade could be on its way when the company reports its quarterly numbers in coming weeks.

Agrium's big competitive advantage

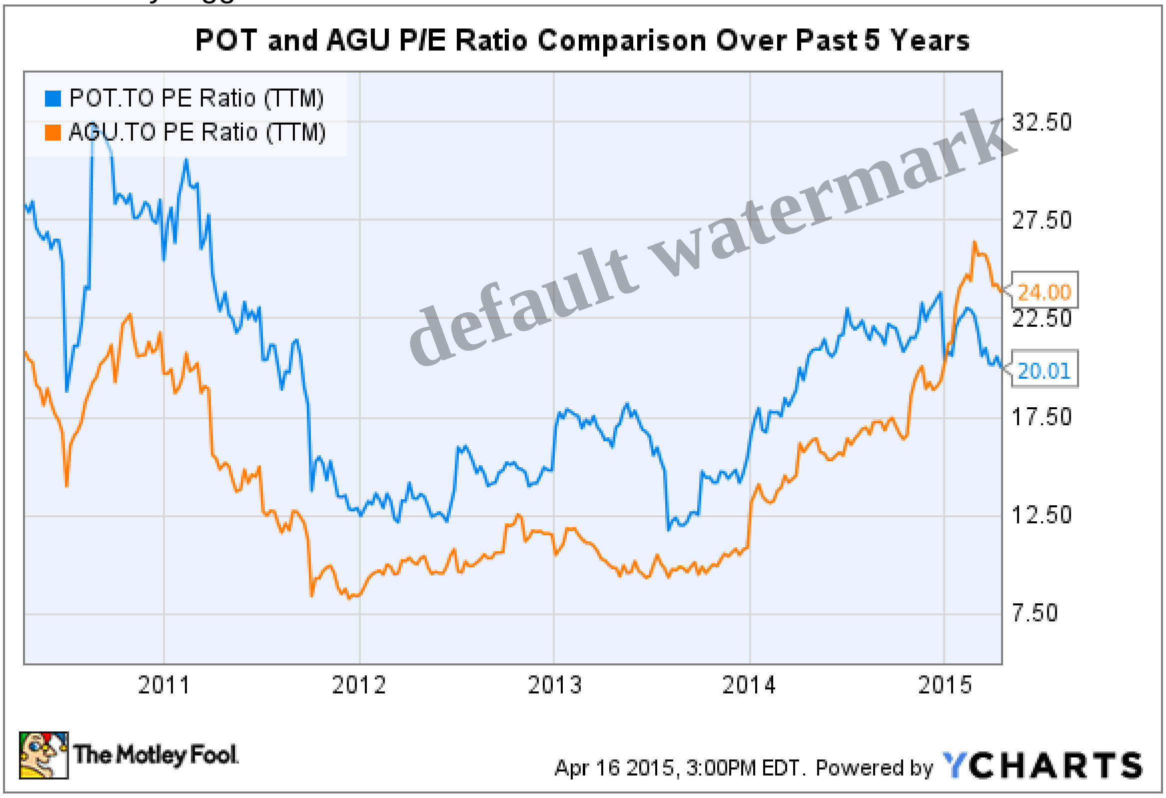
Remember, Potash Corp.'s margins are already under pressure. While both Potash Corp. and Agrium deal in all three key nutrients—potash, phosphate, and nitrogen—the former has greater exposure since it's a pure fertilizer play. Agrium, on the other hand, derives a major portion of its revenue from the retail side of its business, which constitutes seeds, crop nutrients, and crop protection products.

That's a huge competitive advantage considering that demand for seeds is a lot more resilient than demand for fertilizers.

Potash Corp.'s top line has suffered a major blow ever since potash prices tumbled after Russia-based Uralkali broke away from its cartel with Belaruskali that controlled more than 40% of global potash exports in 2013. With nutrient prices still way below peak, Potash Corp. may have a hard time maintaining its margins, the fear of which is reflecting in its stock price.

Too expensive for comfort

Aside from business-related factors, valuation also appears to have played to a key role in the way Agrium and Potash Corp. stocks have moved in recent months. Just when investors were happy to see Potash Corp. shares bounce back sharply in anticipation of a recovery in fertilizer markets after hitting a low of $35.24 last October, a string of negative news cut the rally short. But even at that low point, Potash Corp. shares were trading at considerable premium to Agrium in terms of earnings multiple, which likely triggered a sell off. Take a look.



POT PE Ratio (TTM) data by YCharts

While weak business conditions and premium valuation has resulted in Potash Corp. losing favour in recent months, Agrium's reasonable valuation and strong outlook has gained the market's attention.

Given the headwinds that Potash Corp. is battling, the stock may continue to remain weak, at least until the company's Q1 report gives investors more clarity about its outlook and prospects. Meanwhile, there's no reason why Agrium's stock shouldn't continue to trend higher, as long as the company strives to improve profits and shareholder returns.

CATEGORY

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