



3 Things Headlines Didn't Say About Potash Corp./Saskatchewan Inc.'s Earnings Miss

Description

Potash Corp./Saskatchewan Inc. (TSX:POT)(NYSE: POT) shares are down in trade today after the company delivered its first-quarter numbers this morning. Not only did the fertilizer maker miss analysts' estimates by a gaping margin, it also fell short of its own expectations and has guided lower for the full year. While that sounds bad, you must know why the company lowered its outlook and why you shouldn't be worried.

Why the market is disappointed

Potash Corp. earned US\$0.44 per share in the first quarter. While that's a 10% improvement year over year, the company was expecting a much stronger first quarter as evidenced by its own projected Q1 EPS range of US\$0.45-0.55. The fact that Potash Corp. couldn't meet even the lower end of its projected range is worrisome.

As a result of a muted first quarter, Potash Corp. has downgraded its full-year earnings outlook to US\$1.75-2.05 per share, compared with US\$1.90-2.20 projected earlier. First, let's understand the reasons behind the reduced guidance.

Higher tax burden and lower volumes pain

As I highlighted in a [recent article](#), an outlook downgrade shouldn't come as a surprise. With the Government of Saskatchewan unexpectedly changing provisions of the potash royalty scheme last month, Potash Corp.'s provincial mining and other taxes will go up. So, it will now have to pay nearly 20-22% of its potash gross profits in taxes compared with the 15-17% before the government changed rules.

Meanwhile, softness in nitrogen and phosphate markets, triggered partly by a slow start to spring planting season in the U.S., will likely result in lower sales volumes this year. Closure of one of its plants is also hurting phosphate volumes. Combined, the two factors have compelled Potash Corp. to lower its 2015 nitrogen and phosphate gross profit range to US\$1-1.2 billion from US\$1.1-1.3 billion

predicted earlier.

Additional blow

There's another reason why Potash Corp. has lowered its profit outlook. The company has investments in several potash producers across the globe. As their shareholder, Potash Corp. enjoys share of profits and losses as well as dividend income from these companies.

One such potash company, Israel Chemicals Limited (in which Potash Corp. has 14% stake) is battling major labour issues that have affected its operations. Meanwhile, low potash prices are hurting producers, including the ones Potash Corp. has stake in. As a result, Potash Corp. now expects to earn US\$180-200 million from these equity investments versus US\$195-205 million projected earlier.

While the overall impact may not be big, investors should be aware that any adverse developments at companies that Potash Corp. has stake in could dent its income.

Why you should stay bullish

Let's not forget that Potash Corp. may have missed estimates in the first quarter, but its earnings have improved year over year. More importantly, its key potash business is performing well.

Despite flat sales volumes, Potash Corp.'s gross profit from potash surged to US\$428 million from US\$300 million a year ago, driven by higher selling prices and lower costs. Potash Corp. is optimistic, hoping to earn US\$1.5-1.8 billion in potash gross profit for the full year. That's big improvement over US\$1.4 billion it earned in 2014, which is encouraging.

Ultimately, Potash Corp. gets a major portion of revenue and income from its namesake nutrient. So, as long as potash prices continue to trend higher and the company continues to control costs, it should keep growing. Even if Potash Corp. hits the midpoint of its 2015 earnings projection, it will have ended the year with 4% higher earnings over 2014, which is certainly not bad considering the several macro headwinds that the company is facing.

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