



5 Reasons to Be Bullish on Agrium Inc.

Description

Since Q3 2014, \$17 billion activist investment firm ValueAct Capital has been slowly increasing its position in **Agrium Inc.** (TSX:AGU)(NYSE:AGU), and shareholders have been taking notice. ValueAct bases its investment strategy around acquiring stakes in undervalued companies that are fundamentally good businesses, but suffering from weak valuations due to a whole host of correctable or temporary problems.

Agrium fits this description perfectly, and for this reason ValueAct recently upped its ownership in Agrium by 22%, from 5.2 million shares to 9.72 million shares. This, in turn, represents 6.8% of the company and is one of ValueAct's largest holdings. Although Agrium shares have skyrocketed 40% since October 2014, ValueAct's decision to add more shares now is no coincidence as the company still has plenty of upside due to multiple bullish factors working its favour. Here are five of the biggest factors.

1) Agrium's business model gives it a competitive advantage

In 2014 Agrium's gross profit came 82% from its retail segment, which sells crop nutrients, crop protection products, as well as seeds and services. The remainder of Agrium's gross profit comes from its wholesale segment, which sells nitrogen, potash, and phosphate.

It is the integration between Agrium's very stable retail segment with its more volatile wholesale segment that provides it a competitive edge. Retail earnings are largely stable and have grown annually despite variation in corn and potash prices. This provides Agrium with plenty of cash during weakness in nutrient and grain markets. In addition, because Agrium is the largest agricultural retailer in the world, its retail segment has significant purchasing power.

2) Agrium has a visible growth trajectory

The CEO of ValueAct Capital, Jeffrey Ubben, expects Agrium to grow its earnings before interest, taxes, depreciation, and amortization by 15-20% annually over the next two years, which makes the stock seem undervalued.

This growth is driven by two main factors. The first is the completion of its Vanscoy potash mine expansion, which just completed and is expected to increase annual potash production by one million tonnes. Second, Agrium's nitrogen plant expansion at Borger is expected to be completed by the second half of 2015, and should add 610,000 tonnes of urea production, and 145,000 tonnes of ammonia production.

3) Agrium will see exploding free cash flow

The combination of production growth and revenue growth from its Vanscoy and Borger expansions, coupled with the massive reduction in capital expenditures due to both projects being completed, should result in Agrium's free cash flow increasing rapidly.

In 2014 Agrium's free cash flow was negative \$808 million due to over \$2 billion in capital expenditures and a \$430 million dividend. This is poised to rapidly change as capital expenditures fall annually, and analysts at **RBC** are expecting \$616 million in free cash flow for 2015, and \$1.4 billion in free cash flow by 2018. This is in line with Agrium's estimates, as the company expects \$10 per share of free cash flow by 2017, or \$1.4 billion.

4) Agrium's dividend will increase with free cash flow

There are multiple different ways to use Agrium's impending free cash flow, and the company has made dividends a priority by increasing their payout ratio to 40-50% of free cash flow. Using \$10 per share of free cash flow by 2017, this would result in a \$5 per share dividend, up from \$3.50 currently.

This has the potential to end up much higher, especially if Agrium continues buying back shares, which is a distinct possibility given the company's large amount of surplus cash.

5) The short and long-term macroeconomic picture for Agrium is strong

In the short term, Agrium is expected to benefit greatly from improving corn prices. Improving corn prices means farmers will plant more to take advantage of strong pricing, and therefore use more crop nutrients as well as purchase more farming supplies. Corn inventories are expected to tighten up this year.

Over the long term, Agrium will benefit from rising populations, growing food demand, and higher caloric intake from emerging markets. This growth combined with less arable land will boost demand for Agrium's products.

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