



Will Potash Corp./Saskatchewan Inc. Successfully Acquire K+S Fertilizer?

Description

There has been no shortage of activity recently in the potash industry. The global potash market was once highly coordinated, with two dominant cartels—the North American-based Canoptex, and the Eastern European-based BCP, controlling 70% of global supply and therefore able to control pricing to maintain high operating margins.

In 2013, however, a fracturing began. The two major players in the BCP cartel—the Russian-based Uralkali and the Belarusian-based Belaruskai—split up, with each deciding to pursue a volume-over-price strategy to gain market share. This sent potash prices plummeting over \$100 per metric tonne, sharply reducing earnings of major potash players like **Potash Corp./Saskatchewan Inc.** (TSX:POT)(NYSE:POT).

Recently, Potash Corp. made an US\$8.7 billion bid for German potash producer K+S in a move to reconsolidate global potash supply. With 6% of global potash capacity, the acquisition would not only give Potash Corp. control of significant current and future supply, but also be accretive to earnings. Unfortunately, K+S rejected the bid. Will Potash Corp. continue pursuing the acquisition, or walk away?

Why Potash Corp. is bidding on K+S

The successful acquisition of K+S would be a significant advantage for Potash Corp. Although K+S does control a fairly substantial 6% of global supply, it more importantly controls new supply from their Legacy potash project in Saskatchewan. Legacy is a \$4 billion project that is expected to produce two million tonnes in mid-2016 when it ramps up, growing steadily to four million tonnes by 2035.

This represents a significant portion of capacity coming online over the next several years, and purchasing K+S would allow Potash Corp. to maintain control of additional capacity coming online. This would allow Potash Corp. to control 24% of the global supply in 2016-17, up from 18% currently, which could help alleviate the current oversupply of potash and maintain supply discipline to support prices. Potash Corp. could do this by controlling production from Legacy, or even closing mines if necessary. The end result could be higher potash prices.

With huge amounts of supply coming online over the next several years (potentially eight million tonnes

from BHP's Jansen project, new potash sites from Eurochem, and one million extra tonnes from **Agrium's** Vanscoy project), controlling additional supply will be central for Potash Corp.'s ability to maintain some form of the price-over-volume strategy it prefers.

Will K+S accept the deal?

There are several major hurdles for Potash Corp. Firstly, Potash Corp. offered K+S approximately US\$45 per share for the company—a premium of about 40% on K+S's trading price before the bid. K+S, however, stated that the bid undervalues both the company's existing production as well as the production coming online from the Legacy project.

K+S stated that a more reasonable price would be 50 euros per share, or US\$55. This would translate to a US\$10.5 billion acquisition price, a 20% premium to Potash Corp.'s original offer. This is a fairly large gap between buyer and seller, with most analysts agreeing that 43-46 euros per share would be a maximum reasonable bid. Any higher would greatly reduce any accretion for Potash Corp., and a 100% equity deal at K+S's ideal price of US\$55 could result in up to 14% dilution.

Even more troublesome than price are regulatory issues. In fact, in 1997 Potash Corp. attempted a purchase of K+S, but the purchase was blocked by German regulators, and with Potash Corp. controlling potentially 25-30% of global supply after the acquisition, Potash Corp. will likely need to address anti-trust concerns. This could involve approval by a variety of global authorities. Potash Corp. will also need to address concerns regarding job losses at K+S's German mines or offices.

Despite these concerns, given the importance of such an acquisition to Potash Corp., it is possible the company could raise their price and come to an agreement as well as present a plan to address anti-trust concerns. Potash Corp. has significant options available to fund the acquisition by divesting various equity stakes it owns without needing to issue excessive equity, and as a result, it is very unlikely negotiations are over at this point. With some analysts estimating accretion of 10-20% on a deal, Potash Corp. shares can expect a decent movement upwards in the event it is approved.

CATEGORY

1. Investing

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