



Why Potash Corp./Saskatchewan Inc.'s Latest Potential Acquisition Is a Win for Shareholders

Description

Potash Corp./Saskatchewan Inc. (TSX:POT)(NYSE:POT) shareholders were in for a surprise recently when the company announced a huge CAD\$10.7 billion bid for German potash company K+S AG. For Potash Corp., this is a sizeable acquisition, and could increase the company's 2017 potash production capacity by 41%.

Since K+S is currently the world's fourth-largest producer of potash, and the world's largest producer of salt, acquiring K+S would simultaneously solidify Potash Corp. as the world's largest producer—with the combined company controlling 26% of global potash supply by 2016—and diversify the business.

Unfortunately, K+S AG rejected Potash Corp.'s CAD\$10.7 billion bid on the grounds that it undervalued the company's existing potash and magnesium businesses, as well as the company's \$4 billion Legacy potash project in Saskatchewan. Despite this, many experts think with a slighter higher bid, an agreement could come together. If so, there would be a few huge benefits to Potash Corp.

The deal would likely be accretive to earnings

Depending on how Potash Corp. chooses to finance the deal, it could be quite accretive to earnings. The initial bid was for 41 euros per share, or approximately US\$45 dollars. While this deal was rejected, one of K+S's top shareholders suggested that 43 euros could be the basis for a deal. At US\$48 per share, this would bring the purchase price for K+S up to \$9.1 billion.

According to analysts at **RBC**, purchasing K+S would add about US\$523 million to Potash Corp.'s 2016 earnings of \$1.8 billion, bringing the combined earnings up to \$2.287 billion. If the company were to finance the deal with 50% cash and 50% shares (as some suggest), the company would need to issue approximately 142 million shares. This would bring the share count up to 979 million from 837 million, and based on the combined earnings, would produce earnings per share of US\$2.33.

This is above the projected \$2.27 for 2016, which means the deal would be about 3% accretive. However, analysts at **RBC** suggest the company may need to issue only \$2 billion of equity to fund the

purchase, which would lead to a very significant 12% earnings growth. This is because Potash Corp. has numerous options to fund the purchase; for example, it could sell its equity stakes in SQM and Israel fertilizers, which would yield proceeds of \$3.2 billion. With higher 2016 earnings per share, Potash Corp. would be trading below the average for its peer group, which could lead to shares being revalued upwards.

The deal will give Potash Corp. more control over global supply

One of the biggest rationales for Potash Corp.'s purchase of K+S is that it would allow the company to control a large amount of the global supply, which could give the company control over pricing.

For many years, global potash producers pursued a price-over-volume strategy, where they coordinated production to ensure the highest possible prices. Unfortunately, in 2013 the BPC cartel comprised of Russian producer Uralkali and Belarusian Belaruskali broke up, and both producers began producing at near full capacity, which led to a huge boost in supply, and a massive drop in potash prices.

Going forward, this is set to worsen, with Belaruskali producing at near full capacity to gain market share, **BHP** potentially coming online with its eight million tonne Jansen project, Eurochem opening new mines, and **Agrium's** Vanscoy expansion entering into production.

By purchasing K+S, Potash Corp. will gain control over K+S's current supply, as well as the potential four million tonnes that will be coming online from its Legacy project in Saskatchewan, which is set to begin production in 2016. Controlling this extra supply will allow Potash Corp. to have a say over pricing, and to regulate to supply by controlling output from the Legacy project or from K+S's other mines.

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