Why Canada's Best Dividend Stocks Are in the Fertilizer Sector

Description

Investors seeking top-quality dividend names would be wise to consider the fertilizer sector. Over the past five years **Agrium Inc.** (TSX:AGU)(NYSE:AGU) has seen its dividend grow by 118%, and **Potash Corp./Saskatchewan Inc.** (TSX:POT)(NYSE:POT) has grown its dividend by 72%.

These are impressive growth statistics, some of the best on the TSX, but it gets better—both of these dividends are also very stable. Agrium currently only pays out about half its earnings in dividends, whereas Potash Corp. currently pays out about 80% of its earnings.

With yields of 3.5% and 6.4%, respectively, Agrium and Potash Corp. also pay excellent yields. While past dividend performance is always important to consider, the real strength of both of these companies comes in the form of their future ability to deliver high and stable dividend growth.

Agrium and Potash Corp. will both see massive free cash flow

While the dividend stories for both of these names differ, they are both driven by one common factor—*free cash flow*. Free cash flow is basically a measure of how much cash a business has left over after its operating and capital expenditures are paid, and this is cash that can be allocated towards paying dividends, making investments, or buying back shares.

The main factor driving the free cash flow for both of these companies is the completion of several multi-year, multi-billion dollar capacity-expansion projects. Both companies have been ramping up their ability to produce potash, nitrogen, and phosphate in order to meet global demand

Once these expansions are complete, cash flows will increase, and capital expenses will drop considerably, leaving plenty of room for dividend expansion.

Agrium just completed a $1.8 billion potash expansion at its Vanscoy mine, which should boost potash capacity by over 50% and add one million tonnes of additional annual production. The company is currently in the midst of expanding its Borger nitrogen plant, and this $720 million expansion will be complete at the end of 2016, which will drop Agrium's capital expenditures down to very low sustaining levels.

Potash Corp. is in a similar situation. Potash Corp. has been in the midst of massive potash capacity-expansion projects for over 12 years now. Starting in 2003, Potash Corp. embarked on an $8.4 billion initiative, and the company has fully completed $3.1 billion of this spending through expansions at four different sites.

Potash Corp.'s two largest projects—its $3 billion Rocanville mine expansion and its $2.2 billion New Brunswick expansion—are nearing completion, with both projects expected to be done by mid-2016.

How will these completions affect dividend growth at both companies?

Agrium expects its capital expenditures to drop from $2.02 billion in 2015 to about $800 million in 2016 and lower afterwards. At the same time, Agrium is expected to see its cash flow rise from $1.3 billion in 2014 to $1.8 billion in 2016.

The end result? Agrium will see its free cash flow grow from negative $700 million in 2014 to nearly $1 billion by 2016. In addition, Agrium recently announced a new dividend policy, which involves raising its dividend payout as a percentage of free cash flow from 35% to 50%.

The rising payout ratio combined with rising free cash flow will allow its dividend to grow at a comfortable double-digit rate for the next few years.

There is a similar situation at Potash Corp. Potash Corp. estimates its capital expenditures will drop from $1.2 billion in 2014 to around $900 million in 2016. While Potash Corp. is paying out nearly all of their free cash flow as dividends now, analysts at **TD Bank** expect the company to generate $2.5 billion in cash flow by 2016.

This would generate around $1.6 billion of free cash flow, and Potash Corp.'s current dividend of $1.2 billion annually gives the company room to comfortably boost its payout ratio. In addition, Potash Corp. has ample opportunity to increase its dividend going forward in the event that potash prices improve and as production volumes increase.

CATEGORY

1. Investing

Category

1. Investing

Date
2025/08/25
Date Created
2015/09/22
Author

amancini