Why Now Is 2015’s Best Opportunity to Buy Agrium Inc.

Description

Agrium Inc. (TSX:AGU)(NYSE:AGU) has had a good year, with shares up nearly 9%, ahead of the TSX, which has been down 10%. Unfortunately for Agrium shareholders, returns were much higher until mid-September, where Agrium shares inexplicably plunged over 12%.

While certainly nerve-racking, current and potential shareholders should see this as the buying opportunity of the year, with shares pulling back to prices not seen since January. The current plunge makes Agrium shares appear undervalued, and there are numerous positive elements ready to push shares higher.

Most importantly, the plunge lacks any clear cause. In fact, Agrium CEO Chuck Magro and the large Agrium shareholder ValueAct Capital both purchased Agrium shares early in the month. Here’s why investors should buy before the opportunity passes.

Ample and stable growth opportunity

Agrium has a clear double-digit earnings growth trajectory for the next two to three years, with Jeffrey Ubben—CEO of ValueAct Capital—estimating compound annual growth in the range of 15-20%. This strong growth will provide support to Agrium shares and make any further price drops an increasing bargain.

The most important part of Agrium’s growth story is the fact that it is delivered by a very stable business model. Agrium’s business is roughly divided into two segments. The first, comprising about half the business, is an agricultural retail segment that sells seeds, merchandise, and crop nutrients to farmers. The other half is a wholesale business that manufactures nitrogen, phosphate, and potash fertilizers.

Agrium’s retail segment has maintained steady growth over time, despite large fluctuations in crop and fertilizer prices. This because regardless of what is happening to crop prices, farmers still need to protect their crops, buy seeds, and buy merchandise.

Within this stable segment, Agrium has a clear growth strategy. The company has been growing its retail segment by making dozens of acquisitions annually, and this strategy will continue to be successful due to the fact that 30% of the U.S. agricultural retail market is held by independent retailers. This means Agrium—the largest agricultural retailer—has plenty of room to consolidate the industry.

Agrium's wholesale segment also offers stable growth. Agrium just completed an expansion of its Vanscoy potash mine that will deliver one million tonnes per year. By the end of 2016, Agrium will have also completed a large expansion of its Borger nitrogen facility. Both of these projects will enhance sales volumes.

The majority of Agrium's wholesale segment is centred on nitrogen, which has the most stable demand of all the major fertilizers because farmers must apply nitrogen every season as crops quickly use it up. The other fertilizers are much more discretionary.

While nitrogen is a competitive industry, Agrium has access to worlds lowest-cost natural gas supplies (a key input for nitrogen), which provides it with a competitive advantage. The company has recently been increasing its utilization rates at its nitrogen facilities, and the result of these two factors is that Agrium's nitrogen profit increased 167% in Q2 2015 from the same period last year.

Strong seasonality and good value should drive shares higher

While the strength of Agrium's business model certainly provides a rationale to buy, Agrium is also entering into a period of seasonal strength, and this combined with the low valuation the shares are trading at will provide plenty of headwinds for a rebound.

Due to the fact that farmer spending typically increases towards the end of the year, Agrium has a period of seasonal strength from the beginning of October to the end of December. According to Equityclock.com, Agrium has returned an average of 9.4% in this period for the past 18 years.

After the recent plunge, Agrium shares are currently trading at a very low 10 times 2016 earnings, and seeing Agrium shares at these valuations is a rare occurrence.

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