Should You Buy Potash Corporation of Saskatchewan Inc. for the 7% Yield?

Description

Potash Corporation of Saskatchewan Inc. (TSX:POT)(NYSE:POT) is down 31% since the start of the year, and the dividend now yields more than 7%.

A recent bounce in the stock could be an indication the shares have bottomed, but investors are wondering if the distribution is safe. Let's take a look at the current situation to see if Potash Corporation is a good bet right now.

Takeover stress

Potash Corporation just cancelled its US$8.7 billion offer to buy German producer **K+S AG**. The deal had been a source of debate among pundits right from the get-go.

Fans of the move said the acquisition would have given Potash Corporation control of nearly 30% of the global market as well as K+S's Legacy development located in Saskatchewan.

Ideally, Potash Corporation could have rolled Legacy into its marketing partnership, Canpotex, thus removing one more competitive source from the market.

Critics of the deal said it was too expensive at a time when potash prices were weak, and that it didn't make sense because K+S is a high-cost producer and the market is currently oversupplied.

Investors are breathing a sigh of relief now that the balance sheet won't be loaded up with debt to pay for an overpriced acquisition.

Earnings concerns

Potash Corporation reports all of its financials in U.S. dollars.

Earnings for Q2 2015 came in at $0.50 per share. Operating cash flow was $836 million, and the company generated free cash flow of $532 million. Potash Corporation paid out $312 million in dividends during the quarter, so there was more than enough money to cover both the capital program and the distribution.

Spot prices have dropped and Potash Corporation now expects Q3 earnings to be $0.35-0.45 per share. Full-year earnings are targeted at $1.75-1.95 per share.

Potash Corporation had an average realized potash price of $273 per tonne in Q2, which was actually up from $263 per tonne in 2014. The nitrogen unit was the weak link, with the average realized price dropping to $334 from $393 in the same period last year.

If prices for both commodities continue to slide into next year and stay low, earnings are going to take a hit.

Demand outlook

Global demand for potash hit 61 million tonnes in 2014, and sales remain strong despite the drop in prices. The long-term trend looks strong as crop demand is expected to rise in step with population growth.

Dividend safety

The company is completing a large capital program, and the move from development to production should free up more cash flow to cover the dividend. With the K+S takeover off the table, shareholders also don’t have to worry about a large stock issue or bond sale, which would have meant less cash available for existing shareholders.

Potash Corporation pays a quarterly dividend of $0.38 per share. For the time being, the distribution looks safe, even at the low end of current earnings forecast. If potash and nitrogen prices really fall out of bed and stay that way through next year, the dividend could get trimmed.

The stock is a very attractive long-term holding, but investors should buy it for the growth prospects, not for the size of the payout.

CATEGORY

1. Dividend Stocks
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