



Is Potash Corporation of Saskatchewan Inc. a Buy After it Withdrew its \$11 Billion Bid for K+S AG?

Description

Earlier in the summer, **Potash Corporation of Saskatchewan Inc.** (TSX:POT)(NYSE:POT) made an \$11.4 billion bid for German potash producer K+S AG. The opportunity could have been huge for Potash Corp. If the acquisition was successful, Potash Corp. would have controlled about 27% of global potash production, up from 20%.

While the deal certainly could have been positive for Potash Corp., recent changes in global equity markets and fertilizer prices made the deal far too expensive. Without the weight of a potentially overpriced deal on its shoulders, Potash Corp. now has the resources to explore other avenues for shareholder returns.

It is for this reason that investors should seriously consider purchasing Potash Corp.

Potash markets have changed for the worse since the bid was made

Potash Corp.'s original bid for K+S was made in June for 41 euros per share, which works out to about \$11.4 billion in total. Unfortunately, major changes to both potash markets and equity markets have occurred since the initial bid was made.

To start, prices for key crops like corn, wheat, and soybeans have hit a five-year lows due excessive supply thanks to several years of record-setting yields. These low crop prices put major pressure on farmer's incomes, which in turn limits the amount they can spend on fertilizers like potash.

In addition to this, the recent devaluation of China's currency combined with the strengthening U.S. dollar means that Chinese potash customers will be able to afford less potash. China is also currently sitting on large potash stocks, and the end result is that Potash Corp. could see reduced prices in their upcoming negotiations with China.

While these factors will weigh on demand, supply is perhaps a bigger issue as several new potash projects are coming online, and as eastern European producers keep production at near-full capacity to gain market share. These producers are low cost, and currency weakness will only keep costs lower

and support more production.

The end result is that both global potash prices and global potash forecasts have plunged since Potash Corp. made its initial offer for K+S. Potash in South America has dropped from \$360 a metric ton over the summer to \$310 today, and analysts at Macquarie see potash demand decreasing 8% next year, with supplies at record highs.

Potash Corp.'s withdrawal was the right choice

Given these conditions, Potash Corp.'s withdrawal was a smart choice. Potash Corp. saw its shares decline by almost 24% since the deal was made, which means that if Potash Corp. were to issue equity to fund its purchase of K+S (which it almost certainly would), it would need to issue far more shares since its shares are worth less. This would reduce the chances of the acquisition being accretive to earnings.

In addition, Potash Corp.'s offer of 41 euros per share was considered by many analysts to be generous when it was initially made. In fact, it represented about 17 times its 2016 earnings. This is compared to Potash Corp. which is trading at about 13.20 times its 2016 earnings.

With many analysts downgrading both their 2016 estimates for potash prices, as well as estimates for potash demand, it is possible that K+S could see earnings downgrades for 2016, which would make Potash Corp.'s already generous offer extreme.

The prospect of a value-destroying acquisition has been weighing on Potash Corp. shares, and the withdrawal on the whole represents a positive for the business.

Potash Corp. has options going forward

Dropping the bid for K+S also leaves Potash Corp. with a good problem to have; that is, how to deploy its excess capital. The company is expected to have \$400-500 million annually of free cash flow after 2015 (after subtracting the company's current dividend).

The company is also sitting on around \$500 million of cash as of Q2 2015, and has been discussing the sale of its equity stakes in SQM and Israel Chemical Minority stakes, which could be worth up to \$3 billion.

The result is that Potash Corp. now has plenty of resources to spend on share buybacks, dividend increases, or a potential acquisition—all of which can create value for Potash Corp. shareholders.

CATEGORY

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