Potash Corporation of Saskatchewan Inc.: The Top 3 Reasons This 7% Dividend Is Safe

Description

This year has not been a good one for **Potash Corporation of Saskatchewan Inc.** (TSX:POT)(NYSE:POT). Potash prices have been under pressure all year, and the company's stock price has fallen by more than 30% as a result.

Yet Potash Corp. has actually raised its dividend once this year, and because the company's share price has fallen so far, the stock now yields roughly 7%. This brings up an obvious question: Just how safe is the company's dividend?

Well, the good news is that we're unlikely to see a dividend cut anytime soon. We look at the top three reasons why below.

1. Some of the headwinds are temporary

The potash market looks a lot different than it did three years ago. The biggest change has been the breakup of the alliance between Uralkali and Belaruskali, which has made the market far more competitive.

This year has brought further pain. Global economic uncertainty has been a big headwind, as has weaker currencies in many emerging markets (which makes potash imports more expensive for them). The weakness in the rouble has been especially problematic, since it makes input costs less expensive for Uralkali. And despite falling prices, supply has remained strong.

Looking ahead though, there are reasons to believe the market will stabilize. The price is well below what is needed to justify new supply, and economic uncertainty should eventually settle down. Over in Russia, either sanctions will start to hurt Uralkali's productivity or the rouble will likely recover. Either way, you shouldn't expect potash prices to fall much further.

2. The balance sheet is strong

Investors weren't thrilled when Potash Corp. bid US$8.8 billion for German producer **K+S**, but now that the offer has been withdrawn, Potash Corp. is in solid financial shape.

To illustrate, the company has roughly US$3.8 billion in long-term debt, not much for a company valued at US$18 billion by the market. This should allow Potash Corp. to keep paying the dividend at least until markets stabilize. It may also allow the company to buy back stock, which, of course, would decrease the dividend burden.

3. The dividend isn't too large

In the energy patch, we're used to seeing companies pay out more in dividends than the cash flow they generate. But Potash Corp. does not follow that example.

To illustrate, the company's annual dividend burden amounts to roughly US$1.3 billion, and the company will need to invest US$700 million annually to keep itself going (from 2017 onward). So, that means the company needs to generate US$2 billion annually in order to maintain the dividend.

And even if the potash price sinks to US$200 per tonne (it averaged US$273 last quarter), then Potash Corp. can still generate this much cash. So, there's no need to worry if you hold the shares; this dividend looks very safe.

CATEGORY

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