



Why Agrium Inc. May Be Headed for a Rough Quarter

Description

Current and potential **Agrium Inc.** (TSX:AGU)(NYSE:AGU) shareholders would wise to keep an eye on the recent results of other fertilizer sector names. In its recent Q3 report, **Potash Corporation of Saskatchewan Inc.** (TSX:POT)(NYSE:POT) lowered its full-year earnings forecast as well as its potash sales volume guidance.

To make matters worse, crop prices remain generally lower than the previous quarter, pressuring farmer income. Here's what Agrium shareholders can expect from its main segments going forward and why Agrium may have a chance of doing better than its peers.

Agrium's nitrogen segment

Unlike Potash Corp., Agrium is primarily a nitrogen player (comprising about half of Agrium's wholesale volumes last quarter). In Potash Corp.'s recent earnings release, they reported a 10% decline in nitrogen prices from the same quarter last year and a 4.5% decline from last quarter.

Since both Potash Corp. and Agrium primarily sell nitrogen to the North American market (Potash Corp. sells 84% of into North America compared to 100% for Agrium), they are affected by similar market forces, and Agrium can therefore expect further pressure on prices this quarter.

Much of this pricing pressure is because of insufficient domestic nitrogen production. North American needs to import half of its nitrogen, and China is a key exporter. China has been expanding its nitrogen exports rapidly, exporting nine million tonnes of urea (a type of nitrogen fertilizer) in 2014, with up to 12 million expected this year.

In addition, low crop prices have caused many farmers to switch from corn to soybeans (which require less nitrogen fertilizer), which will put further pressure on nitrogen revenue.

Agrium's potash segment

Potash represents only a small part of Agrium's wholesale volumes, but Agrium can expect further price pressure this quarter, since Potash Corp. saw its average potash price fall 11% from last year.

Most of this weakness was in North America, and this is bad news for Agrium since it sells the majority of its potash to North America (compared to Potash Corp., which sells the vast majority of its potash overseas where demand has been stronger).

Weak farmer incomes in the U.S. means that farmers will have less to spend on potash. Offshore, currency weakness in China and Brazil means that farmers there will be able to spend less on potash (which is priced in U.S. dollars).

The supply picture is also competitive, with large eastern European producers producing at near full-capacity to gain market share.

Agrium's retail segment

Most of Agrium's revenue comes from its retail segment, and while this segment is typically fairly stable (farmers will still spend on crop protection products, seeds, and essential nitrogen fertilizer), it is still exposed to farmer spending.

Crop prices for key crops like corn, soybeans, and wheat have fallen throughout the year, and as a result the USDA is estimating that farmer income will fall 36% year over year, which is the largest decline since the 1980s. Part of this is from low crop prices as well as from production that has fallen due to weather issues.

Why Agrium could still do better than its peers

Despite these headwinds, Agrium could still post better results than its peers. In the last quarter, Agrium posted huge increases to its nitrogen gross margins, with gross margins actually doubling levels noted last year.

Even though nitrogen prices were falling, Agrium was able to post huge volume increases due to its reliable operations and low natural gas costs. In addition to this, while nitrogen prices may post some weakness, there should still be good opportunity for volumes since nitrogen demand is fairly stable as farmers must apply it each year.

Combine this with the stability of Agrium's retail operations, and Agrium may be able to generate better results in this weak market.

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