Potash Corporation of Saskatchewan Inc.: Is the 7.4% Dividend a Safe Income Pick?

Description

Potash Corporation of Saskatchewan Inc. (TSX:POT)(NYSE:POT) is down 35% since the start of the year, and that has driven the stock's dividend yield above 7%.

Income investors are looking at the payout with hungry eyes, but pundits are split on whether or not the distribution could be at risk.

Let's take a look at the current situation to see if Potash is a safe dividend bet.

Earnings

Potash reports all of its financials in U.S. dollars. The company delivered Q3 2015 earnings of $282 million, or $0.34 per share. For the first nine months of 2015, the company earned $1.1 billion, or $1.28 per share.

Operating cash flow for Q3 was $358 million and $1.7 billion year-to-date.

The company lowered its full-year 2015 guidance and now expects earnings for 2015 to come in at $1.55-1.65 per share.

Potash gross margins came in at $294 per tonne in Q3, essentially the same as last year. The average realized price dropped from $281 to $250 per tonne, but the company also saw its cost of goods sold drop by 14%.

Gross margins in the nitrogen unit dropped 31% compared with Q3 2014 as lower sales and weaker prices hit the broader market. The cost of goods sold was flat for the quarter.

Market outlook

The second half of 2015 has been tough on fertilizer companies. Weak crop prices in the U.S. have pinched the wallets of farmers, and a global battle for market share is putting pressure on potash spot prices. Volatile currencies in emerging markets are also wreaking havoc in the sector.

Despite the difficult conditions, global potash demand remains robust, and Potash is adjusting to the changing market.

The company is going to fast-track the shutdown of an older mine in New Brunswick and implement temporary production cuts that will reduce Q4 output by about 500,000 tonnes.

Weak prices are expected to extend into 2016.

Dividend safety

Potash pays a quarterly dividend of US$0.38 per share that yields about 7.4%. The current environment is pretty tight, but Potash is generating enough cash flow that the distribution should be safe.

Management recently abandoned its US$8.7 billion bid to purchase German producer **K+S AG**. That means the company won't have to take on debt or issue new equity, which would have put pressure on the dividend's sustainability.

Potash carries little debt on its balance sheet and is coming to the end of a major capital program. These two factors should also be supportive of the dividend as the company navigates through the low point in the fertilizer cycle.

Should you buy?

The stock has come down so much that the downside risk looks limited at this point. Weak market conditions should persist through 2016, but the long-term outlook for wholesale fertilizer sector is compelling, and Potash is one of the world's low-cost producers.

The payout should be safe barring a total meltdown in the space. If you have some cash on the sidelines, it might be a good time to start a position in the stock.

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