Is Potash Corporation of Saskatchewan Inc. a Safe Income Pick?

Description

Potash Corporation of Saskatchewan Inc. (TSX:POT)(NYSE:POT) now yields more than 7.5%, and investors are wondering if the dividend is at risk.

Wholesale market woes

Global potash sales hit a record 61 million tonnes in 2014 and deliveries for 2015 are expected to be pretty close to that level.

Based on those numbers you would think potash is a healthy business to be in, but production growth and battles for market share have driven down prices this year, and Potash is feeling the pinch.

In the Q3 2015 earnings statement, Potash said it plans to bring forward the closing date for an older production facility and will temporarily reduce output at other sites. The result will be a 500,000 tonne reduction in production for the fourth quarter.

The lower output will definitely hit revenues, so investors should brace for weak numbers when the Q4 report comes out.

Beyond that, the outlook is still uncertain as conditions are not expected to improve materially in the first part of 2016.

Dividend safety

Potash pays a quarterly dividend of US$0.38 per share that yields about 7.6%. All of the company's numbers are reported in U.S. dollars.

Potash concluded Q3 with $78 million in cash and cash equivalents and carries $3.7 billion in long-term debt. The debt position is not a concern now that management has abandoned plans to buy out German producer **K+S AG**.

Had the deal gone through, Potash would have loaded up the balance sheet with debt and/or issued new stock to pay for the acquisition, which would have put the dividend at greater risk.

And profits?

Earnings have been on the slide this year. The first hit came as a result of a tax change in Saskatchewan that impacted the way Potash can expense capital outlays. The recent reduction is due to weaker-than-expected markets for potash and nitrogen.

Potash reported Q3 earning of $0.34 per share. Operating cash flow was $358 million and Potash spent $333 million on capital projects, so the funds from operations covered the investment program.

The company also paid $313 million in dividends, which means the shortfall had to be covered with cash on hand at the beginning of the quarter.

Earnings for 2015 are now expected to come in at $1.55-1.65 per share, significantly lower than the guidance issued at the beginning of the year.

Cash flow is not completely covering both capital expenditures and the dividend, so there is a risk the distribution could be cut next year if funds from operations don't increase. The company is wrapping up a multi-year capital program and that should mean lower capital expenditures going forward, but it is unclear right now if lower capex will be enough to protect the payout, especially if production cuts get extended.

Is Potash a safe investment?

The long-term outlook for the wholesale fertilizer market is strong and Potash is a low-cost producer. The company has already made most of the investments necessary to meet future demand growth, so a rebound in the commodity market should bode well for the stock.

Income investors shouldn't chase the name for the high yield because the distribution might get trimmed in the next year or two. However, the company looks attractive right now for buy-and-hold investors with an eye on long-term growth.

CATEGORY

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