



Why Potash Corporation of Saskatchewan Inc. Shares Surged on Tuesday

Description

For years, **Potash Corporation of Saskatchewan Inc.** (TSX:POT)(NYSE:POT) has claimed that low potash prices will force higher-cost supply out of the market. The company seemed to prove its own point on Tuesday morning when it shut down the Picadilly mine in New Brunswick. Strangely enough, the company's shares have responded well to the move.

So what exactly is going on here? Is this actually a good sign for Potash Corp.?

Some nice cost savings

The decision to mothball Picadilly was not taken lightly. The mine had nameplate capacity of 800,000 tonnes per year, and shutting it down will cost more than 400 people their jobs.

But on the bright side, this move will save Potash Corp. \$40-50 million in cost of goods sold in 2016. It will also save the company \$50 million in capital expenditures this year and another \$135 million in the following two years.

The decision also allows Potash Corp. to focus more on its lower-cost operations. And it shows shareholders that Mr. Tilk, the president and CEO of Potash Corp., is putting profitability above size, a philosophy that has been critical to Potash Corp.'s success over the past 20 years.

A sign of the times

While investors may be cheering Mr. Tilk's decision, Tuesday's news is another reminder of Potash Corp.'s precarious state.

Like most commodities, potash is facing sluggish demand growth. The strong U.S. dollar is one factor, as is a new fertilizer tax imposed by the Chinese government. In fact, demand actually fell in 2015.

Meanwhile, supply remains very robust. One reason is that Potash Corp.'s chief rival is based in Russia, a country whose currency has plummeted in recent years. It's no surprise that potash prices have plunged, leaving Potash Corp. at a serious disadvantage.

Potash Corp. has responded the only way it can—by shutting down high-cost production. But this fall in production could easily be filled by competitors. If nothing else, Potash Corp.'s move could encourage them to keep producing based on the belief that their Canadian competitor will fold first.

A risky stock

Potash Corp. now is the highest-yielding stock on the **S&P/TSX 60**, which is often the sign of a company in trouble. At the very least, a dividend cut is probably in the cards.

So if you're looking for some nice reliable income, don't be fooled by Potash Corp.'s high yield and disciplined strategy. The company is facing some serious headwinds, and there are better options elsewhere.

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