



Why I'm Finally Buying Potash Corporation of Saskatchewan Inc.

Description

If you've been looking for exposure to the fertilizer sector in the past year, you would have been much better off choosing **Agrium Inc.** (TSX:AGU)(NYSE:AGU), which has soundly outperformed **Potash Corporation of Saskatchewan Inc.** (TSX:POT)(NYSE:POT). Potash Corp. shares fell 50% in 2015, while Agrium shares gained 13%.

At current prices, however, Potash Corp. is starting to look interesting. Potash Corp. has been aggressively reducing both operating and capital costs to adjust to the new, weak potash-pricing environment, and if there is limited downside left in the potash market (which there is reason to believe), owning Potash Corp. is an opportunity to collect a solid dividend yield with the potential for some capital appreciation.

Potash Corp. is releasing their annual earnings on January 28, and while buying before earnings would be risky (especially since the company is set to comment on their dividend policy), buying afterwards may be wise. Here's why now is an excellent time to start building a small position in Potash Corp.

There is reason to believe potash prices have limited downside in 2016

It is impossible to talk about Potash Corp. without considering the fundamentals of its key product. Firstly, potash demand has proven to be strong and will continue to be strong in 2016. In 2015, for example, global potash demand was around 59 million tonnes. This is the second-highest demand on record.

It is important to know that this near-record demand occurred despite the fact that currencies of key potash importers, such as China and Brazil, have depreciated massively against the U.S. dollar (making potash expensive for customers). At the same time, key crop prices were down between 25-35% in 2015, putting pressure on farmer income. In the U.S., farmer income is at lows not seen since 1983.

This strong demand, despite some of the worst conditions historically, demonstrates how resilient potash demand is. In 2016, potash demand is expected to grow to between 60 million and 65 million tonnes, and Potash Corp. expects demand to hit 70 million tonnes by 2020.

The big concern is on the supply front, with 23 million tonnes of capacity planned between now and 2025.

Fortunately, for the next few years supply and demand should be relatively tight for several reasons. Firstly, **RBC** estimates that 61% of the capacity coming online in 2016 is from Potash Corp. Potash Corp. is a disciplined producer and has a strategy of matching supply with demand, which was evidenced by the fact that it took 800,000 tonnes of production offline permanently in the fall, along with 500,000 tonnes of curtailments in Q4 from temporary shut downs at other mines to reduce inventory.

Other producers have shown similar discipline with 1.8 million tonnes of curtailments occurring globally in Q4 alone. This behaviour should help support prices, and potash producers are not as motivated to push prices lower to gain market share because they have a much flatter cost curve (that is to say, they have similar costs) than other industries.

Should prices continue to fall into 2016, it will likely be met by a demand response (as farmers can afford more potash), which should further help to support prices.

Potash Corp. has been reducing costs

While potash prices have been falling, Potash Corp. has been taking action to reduce its overall cost structure to adapt to the current business environment, and this process has been (and will continue to be) helped by the weak Canadian dollar.

Since 2005, Potash Corp. has been undertaking massive expansions (\$8.5 billion worth). In 2016 these expansions are finally ramping down and, as a result, Potash Corp.'s capital expenses will be falling. In 2015 expenses were expected to be about \$1.2 billion. In 2016 they should fall to \$800 million and then down to \$700 million the year after.

In addition, Potash Corp. just shut down its Picadilly mine in New Brunswick, which will lead to a further \$50 million on capital cost reductions in 2016.

These reductions will help fund the dividend (which, according to Potash Corp., should be secure with potash prices down to \$200 per tonne). With Potash Corp. shares currently trading at their lowest forward price-to-earnings ratio in five years and the potash market showing signs of firming up, now is a low-risk opportunity to buy.

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Date

2025/08/25

Date Created

2016/01/28

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