What Potash Corporation of Saskatchewan Inc.'s $2.2 Billion Mine Closure Means for Shareholders

Description

The bad news for **Potash Corporation of Saskatchewan Inc.** (TSX:POT)(NYSE:POT) shareholders keeps coming. The company recently slashed its dividend for the first time in its history, and last week the company closed its brand new Picadilly mine in New Brunswick.

In the fall, Potash Corp. announced the early and permanent closure of its other New Brunswick mine—Penobsquis—which had production capacity of about 800,000 tonnes. The original plan was to transition to the lower-cost Picadilly mine, which had a capacity of 1.8 million tonnes.

While Picadilly was set to ramp up over the next two to three years, the recent move by Potash Corp. will put Picadilly into care and maintenance mode indefinitely. With Picadilly expected to produce 400-500,000 tonnes in 2016, investors may see the recent closure as a negative. Although there are definitely negative elements to the decision, the move will help Potash Corp. survive current market conditions.

The Picadilly closure will reduce costs

Currently, Potash Corp. has five mines in Saskatchewan, and before Picadilly and Penobsquis closed the company had two in New Brunswick. The key difference between the New Brunswick mines and the Saskatchewan mines is costs.

Due to geology, drilling costs in Saskatchewan are significantly lower than the drilling costs in New Brunswick. Penobsquis was by far Potash Corp.'s most expensive mine—which is why they closed it first—and although Picadilly is lower cost, it is still much more expensive than Potash Corp.'s Saskatchewan operations.

Potash Corp. didn’t release specific numbers on the cost difference, but operating costs at their new Rocanville mine are expected to be about US$40 per tonne (potentially the lowest operating costs in the world), and Potash Corp.’s CEO described Picadilly’s costs as being an “order of magnitude”higher.

This means that closing Picadilly will give Potash Corp. an opportunity. Firstly, the closure will save Potash Corp. about $200 million in capital expenditures over the next two years. This is very important—potash prices have declined, and Potash Corp. will need its capital expenditures to drop, so it can continue to see positive free cash flow. Potash Corp. had $1.2 billion of capital expenses in 2015, and 2016 should see around $800 million thanks partially to the completion of other expansions and the closure of Picadilly.

Closing Picadilly will also reduce Potash Corp.’s operating costs because it will now be able to consolidate its production at its lowest-cost operations in Saskatchewan. Potash Corp.’s new Rocanville mine will be the largest mine capacity and will have a massive 5.7 million tonnes of capacity (up from 2.7 million tonnes now).

Rocanville will begin ramping up in 2016, and this means that Potash Corp. will have the ability to, over time, run its Rocanville mine at the highest possible rates and essentially replace the production that came out of Picadilly.

This move will reduce operating costs by $40-50 million in 2016, which will work out to a reduction of about $4-5 per tonne. Overall, this move will not result in much lost production for Potash Corp.; the company will simply be moving its production to a lower-cost mine, while maintaining the option of restarting Picadilly should global potash demand grow.

The move is also helping to reduce global potash supply

Potash Corp. has always had a “price-over-volume” strategy. That is to say, the company aims to make sure production is in line with demand to maintain prices, rather than producing at full capacity to gain market share at the expense of price.

The recent move is further evidence of this strategy and is positive for potash prices since Potash Corp. is the world’s largest producer and most the new production capacity coming online in 2016 is coming from Potash Corp.

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