



Why the Bad News From Potash Corporation of Saskatchewan Inc. Is 2016's Best Buying Opportunity

Description

This year started off on a bad note for **Potash Corporation of Saskatchewan Inc.** (TSX:POT)(NYSE:POT). Potash Corp. started the year by announcing the closure of its brand new, \$2 billion Picadilly mine in New Brunswick. This will take 1.8 million tonnes of capacity offline.

While this certainly gave investors a negative view on future potash demand (Potash Corp. sees less of it), they followed up two weeks later by slashing their dividend by 34%—the first cut in their corporate history. Potash Corp.'s previous 10% yield was a major draw for investors, especially considering the poor share-price performance.

With all of the bad news, one would expect Potash Corp. shares to plunge. In fact, they did the opposite—they rose. This is even after Potash Corp. missed their guidance for 2015 for both earnings and production and reported massive year-over-year earnings declines.

Here's why the bad news may not be so bad.

The mine closure helps Potash Corp. adapt to weak conditions

The Picadilly mine was one of two mines in New Brunswick. The first mine—Penobsquis—was shut down in the fall (earlier than planned) with the goal being to transfer production to the brand new and lower-cost Picadilly mine.

The issue is that Picadilly was commissioned in 2007; at the time, Potash Corp. was anticipating global potash demand of 70 million tonnes by this point. Currently, demand is about 60 million tonnes (although steadily growing).

As a result, the market did not need Picadilly, so Potash Corp. is keeping to its long-term strategy of price over volume by slashing production. This strategy refers to matching supply and demand and reducing production if necessary to support prices.

Since Potash Corp. is the world's largest producer by capacity, Potash Corp. reducing production

matters for global supply, and it is possible other producers will see Potash Corp.'s move and follow suit. There are signs this has been happening.

Falling volumes will also have less impact on Potash Corp.'s cash flow than falling prices and will help prices to recover quicker as demand grows.

While the recent closure may be healthy for the market, it will also be good for Potash Corp.'s bottom line. Picadilly was Potash Corp.'s highest-cost mine, and by closing it Potash Corp. will be able to shift its production over to its lower-cost Rocanville mine in Saskatchewan.

Rocanville has some of the lowest operating costs in the world (around US\$40 per tonne), and not only that, it is also the world's largest mine by capacity. Rocanville is expected to add three million tonnes of capacity when it is fully completed, and Potash Corp. will be able to move the Picadilly production over to Rocanville at a much lower cost.

This will bring down Potash Corp.'s operating costs and save around \$200 million a year in capital costs.

The new dividend is much more sustainable

While Potash Corp.'s dividend cut was bad news, the new dividend (which still yields an impressive 6.4%), is much more in line with current market conditions. While there is no guarantee it is perfectly safe, the new dividend will cost about \$840 million annually.

If Potash Corp. attains the mid-point of its guidance for gross profit in 2016, and assuming they spend on the high end of their capital expenditures guidance, the company should have enough cash flow to just cover their dividend in 2016. Analysts at **RBC** agree, and they forecast Potash Corp.'s new dividend being safe if potash prices remain where they are or even if they decline slightly more.

This makes an excellent opportunity to buy Potash Corp.

While nobody is expecting Potash Corp. to double in 2016, there is an opportunity to collect a solid 6% yield, while benefiting from some share-price growth. Potash Corp. is currently trading at its lowest forward earnings multiple since 2011, and potash prices are very unlikely to repeat the poor performance of 2011 since demand is expected to grow and supply is remaining disciplined.

CATEGORY

1. Investing

Category

1. Investing

Date

2025/08/25

Date Created

2016/02/03

Author

amancini

default watermark