Will Agrium Inc. Outperform Potash Corporation of Saskatchewan Inc. Again in 2016?

Description

Like nearly every other major commodity producer, fertilizer producers **Agrium Inc.** (TSX:AGU)(NYSE:AGU) and **Potash Corporation of Saskatchewan Inc.** (TSX:POT)(NYSE:POT) both saw the prices of their key products plunge in 2015. As a result, fertilizer stocks as a whole greatly underperformed the market.

Agrium, however, was an exception. While Potash Corp. shares lost 41% in 2015, Agrium returned 13%, outperforming all of its fertilizer peers as well as the overall TSX. It did so despite U.S. farm incomes being at a 13-year low, crop prices being at a 10-year low, and potash and nitrogen prices falling to multi-year lows.

This outperformance is thanks to Agrium's retail segment, which generates steady cash flow and strong growth opportunities, making it less dependent on potash and nitrogen prices. Does this mean Agrium will once again outperform in 2016? Possibly, but a repeat of 2015's outperformance is unlikely. Here's why.

Potash Corp. is likely in for a better 2016

Potash Corp.'s CEO mentioned in a recent conference call that 2015 was one of the worst years for potash on record thanks to weak importer currencies and record crop harvests, which put pressure on crop prices and farmer incomes (and their ability to buy potash).

While Potash Corp. can take action to adapt to a weak market (by reducing production, cutting capital costs, and producing more at low-cost mines to reduce operating expenses), its top line is ultimately at the mercy of global potash markets. Strong global demand equals more volume that can be sold at higher prices.

There are signs now that potash prices are stabilizing, and Potash Corp. recently stated that it expects a stable environment for pricing in 2016 due to projected demand growth and because most newsupply for the world will come from Potash Corp.

This means that the worst may be over, but it also means that Potash Corp. is very unlikely to grow earnings in 2016. Potash Corp. itself sees its earnings dropping by as much as 40% in 2016 (which would happen if prices stay at levels seen towards the end of 2015 and if global demand is soft).

The best-case scenario according to Potash Corp.'s guidance would see its earnings drop by 20% (although many analysts see Potash Corp. outperforming this guidance). Fortunately, Potash Corp. is trading at such a low forward price-to-earnings ratio now (about 13 times its estimated 2016 earnings—the lowest levels since 2013) that it could return closer to its average of 15 times earnings if the market improves, giving it some upside.

Agrium is set to show greater growth

Unlike Potash Corp., Agrium is likely to grow earnings into 2016. Firstly, most of Agrium's operations are based in North America, which had a very rough 2015. In 2016, U.S. corn acreage is expected to grow, and cash margins for corn are expected to grow by 20% (due to stable pricing, land rents falling, and more acreage). This means farmer incomes should be stable or improve, which is good for Agrium's retail business.

At the same time, potash demand should improve, since potash-dealer inventories are low and farmers will need to replenish potash after years of large crops. These improving conditions will help Agrium. At the same time, Agrium's retail operations are set to grow from small acquisitions, and its fertilizer-production business should benefit from increasing volumes due to recent expansions.

The end result is that Agrium should grow earnings. Currently, Agrium is also trading at its lowest forward price-to-earnings ratio since 2013.

Which to choose?

These two stocks should be closer in 2016, but Agrium's better earnings-growth prospects should lead it to outperform Potash Corp. once again.

CATEGORY

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