



Another Big Blow to Potash Corporation of Saskatchewan Inc.'s Growth: Investors Beware

Description

It looks like **Potash Corporation of Saskatchewan Inc.** (TSX:POT)(NYSE:POT) is digging itself a deeper hole. In a huge setback, one of the top potash-consuming nations, India, has halted potash imports and is postponing contract negotiations for the year as it battles drought conditions. That could push Potash Corporation's turnaround even further away, especially as the potash markets are already battling severe headwinds, including a supply glut.

Potash Corporation's estimates could fall short

Potash companies are largely banking on India for higher sales this year as shipments to the largest market, China, are expected to decline in the wake of higher inventories. Expected monsoons in India encouraged Potash Corporation to project 2016 global potash shipments to be in the range of 59-62 million tonnes, in line with last year's total of about 60 million tonnes.

In management's words: "Demand in India is expected to strengthen in 2016. We forecast deliveries of 4.2-4.7 million tonnes to this market, a slight increase from 2015 when a weak monsoon and currency issues reduced demand late in the year."

What's worrisome is that declining demand from India threatens potash prices, which are already at multi-year lows, having slumped more than 50% from 2012 levels.

It's important to note that the contracts signed by China and India each year generally set the benchmark for global potash prices. With concerns of oversupply and dwindling margins for potash producers looming large, key customers such as India will have a stronger negotiation power in terms of the prices at which they contract to import potash later in the year.

Here, investors should note two key projections that Potash Corporation has for 2016:

1. A 21-41% drop in its earnings per share.
2. Potash gross margin of US\$0.8-1.1 billion, which translates into a staggering 39% drop from 2015 at the lower end.

Remember, the dismal forecast assumes higher shipments to India and the bottoming of potash prices. With both factors looking uncertain now, Potash Corporation's margins could take a big dip this year.

A double whammy for investors

While Potash Corporation shares could bear the brunt of muted expectations and erode shareholders' capital, lower profits could put dividends at risk. A prolonged slump in potash markets compelled the company to slash its quarterly dividend by 34% last month.

With the current annual dividend of US\$1 per share, Potash Corporation intends to pay out nearly 100% of its earnings this year. If end markets weaken further as the year progresses, investors may have to put up with further dividend cuts.

At less than 11 times trailing earnings, Potash Corporation may appear attractive, but it could still be a high price to pay as challenges are aplenty and analysts project the company's earnings to tank at least 30% this year.

CATEGORY

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Author

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