Potash Corporation of Saskatchewan Inc.: Can it Ever Rebound?

Description

Even after falling 50% in the past 12 months, Wall Street analysts have given a rash of downgrades to **Potash Corporation of Saskatchewan Inc.** (TSX:POT)(NYSE:POT). **CIBC** downgraded shares, believing that “potash markets could remain soft for the foreseeable future due to price competition among the producers.”

Paradigm Capital also downgraded shares, saying that “potash prices remain depressed in an oversupplied market with no rebound in sight.”

Even **Morgan Stanley** expects “potash to be oversupplied in the near to medium term.”

When and how can Potash Corporation turn things around?

A deteriorating market

Potash Corporation originally believed that company volumes would be 8.3-9.1 million tonnes in 2016. This guidance was based on projected total global demand of 59-62 million tonnes of potash. Through the first quarter of the year, however, it’s becoming likely that global shipments will fall below these initial estimates. Weak volumes have pushed already depressed potash prices even lower.

According to CIBC analyst Jacob Bout, the company’s 2016 earnings guidance (which was announced just two months ago) is already looking shaky. Management has attempted to control costs by cutting capital expenditures and the dividend, but the macro backdrop may simply be too challenging.

“While we were hopeful that producer discipline would help to stop the slide in potash prices, we are still seeing evidence in the U.S. and Asia markets of a continued fight for market share that trumps producer discipline,” said Jacob Bout in a note to investors.

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Most buyers are holding off on boosting demand

The United States, Brazil, China, and India comprise nearly 70% of global potash demand. Many of these countries are seeing structural issues that could dent demand this year.

China specifically seems to be purposefully gaming the market; it has repeatedly delayed signing potash deals with miners, instead relying on stockpiles to benefit from prices that are slumping to near-decade lows. It will likely wait until prices sink even further to strike new deals.

India, another major buyer, has halted its potash imports and delayed negotiations for next year's purchases until at least June due to severe droughts.

Record-low soybean and corn prices, along with the falling purchasing power of the real, is also pushing demand forecasts for Brazil lower.

The U.S. is the lone bright spot, where farmers will likely capitalize on the strong dollar and historically low prices.

Is the dividend safe?

Many investors have bought shares not for near-term gains, but for long-term income opportunities. Today, Potash Corporation has a dividend yield of nearly 6.8%. But there's reason to believe another cut may be around the corner.

First, potash prices will likely remain weak. The company's average realized price for potash collapsed to $238 per tonne in 2015, down from $284 per tonne in 2014. With over 95% of the industry having production costs of under $180 a tonne, there's no reason to believe prices can't continue to fall.

Management originally projected 2016 earnings to be $0.90-1.20 per share, potentially making it the smallest profit in over a decade. The recently reduced dividend still totals $1.00 a share. With the first quarter of the year looking weak, don't be surprised to see the payout ratio exceed 100% this year. At that rate, management will likely lower the dividend again to gain some financial breathing room.

Patient investors may still profit, but 2016 isn't looking like a rebound year for Potash Corporation.

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