Is it Time to Sell Agrium Inc. After Dismal Q1 Earnings and a Lower Outlook?

Description

Agrium Inc.'s (TSX:AGU)(NYSE:AGU) first-quarter numbers are in, and they're bad enough to send panic waves.

The company's net income slumped a staggering 83% year over year, compelling it to downgrade its 2016 earnings guidance range by 5-11% to USS$5.25-6.25 per share. Now even if Agrium hits the upper end of the range this year, it will still have earned 11% lower profits than 2015. So should you exit Agrium before slow growth hits the stock?

Why profits crashed

No points for guessing why Agrium's Q1 profits fell so much. A supply glut and lower crop prices have hurt farmers' income, driving nutrient prices down to multi-year lows. Every fertilizer company is bearing the brunt of a slowdown, like **Potash Corporation of Saskatchewan Inc.** (TSX:POT)(NYSE:POT), which saw its profits fall as much as Agrium's during the first quarter.

Agrium realized 18% lower prices for its key nutrient, nitrogen, which sent its wholesale (fertilizer) segment gross profit plunging almost 81%. That's largely why its net income tumbled despite the company deriving more than 80% of its sales from retail products like seeds and crop protection.

A silver lining

With both Agrium and Potash Corporation downgrading their outlook for the full year, it's clear that the fertilizer markets will take time to turn around. These are cyclical companies, which are bound to go through periods of ups and downs. During a downturn, how well the companies manage their costs and growth plans gains priority and should influence investors' actions on the stocks.

Fortunately, Agrium appears to be doing a good job when it comes to controlling costs. It lowered its selling, general, and administrative expenses by 6% year over year in Q1. Agrium is also free cashflow (FCF) positive, having generated FCF worth nearly US$169 million last quarter. That neatlycovered Agrium's quarterly dividend payments primarily because of lower capital expenditurescompared with the year-ago quarter when the company was ramping up its potash facility.

What should you do with Agrium stock now?

I'm only worried if Agrium's full-year FCF will cover its dividends now that the company is guiding for even lower profits. That's the only caveat, as Agrium is otherwise trading reasonably cheap at 12 times trailing earnings with a dividend yield of 4%. That may not be as high as Potash Corporation's 6% yield, but Agrium has been a lot more aggressive in increasing dividends in recent times.

At such levels, I believe much of the pessimism has already been baked into the stock price, especially after its 14% year-to-date drop. It's a cyclical downturn that's hurting every fertilizer company, and that doesn't make for a valid reason to exit Agrium. Investors may get a better entry point going ahead, but I see limited downside in Agrium at current prices and a lot of potential upside once nutrient markets recover.

CATEGORY

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