



## Why the Outlook for Potash Corporation of Saskatchewan Inc. Remains Bearish

### Description

It has been a tough year for investors in one-time dividend darling **Potash Corporation of Saskatchewan Inc.** (TSX:POT)(NYSE:POT). Not only has its stock plunged 40% over the last year, but it has cut its dividend for the second time since the start of 2016. Then there's management's credibility problem; they fumbled badly on the outlook for fertilizers and the 2016 guidance.

The confluence of these factors has created considerable consternation among investors and left many asking if the bottom is now in sight.

### Now what?

The key issue that Potash Corp. is facing is the difficult market conditions surrounding fertilizers, which are experiencing a steep decline in demand. The price of potash is at its lowest level in almost a decade. This sharp decline in demand is attributable to the marked slowdown in economic growth in China along with Brazil now being mired in its worst economic crisis in over 100 years. Both countries, along with India and North America, are responsible for 60% of global potash consumption.

There are signs that it will be some time before there is any uptick in demand from China or Brazil.

China's 2015 GDP growth rate was its lowest in over two decades, and because of declining industrial activity and reduced employment opportunities, the rate of rural to urban migration has slowed significantly. This is weighing heavily on demand for fertilizers such as potash, phosphate, and nitrogen.

You see, growing urban populations are an important driver of demand for fertilizers because these dense populations require considerable volumes of food stuffs that can only be produced through intensive agriculture. Given the rate at which intensive farming depletes soils, the use of fertilizers is the only way this can be achieved on a consistent basis.

Diminishing demand isn't the only issue; supplies of potash, phosphate, and nitrogen have grown at a tremendous rate.

Many miners invested heavily in expanding their productive capacity at the height of the commodities

boom, and even with potash prices at less than a third of their 2008 peak, this investment is continuing. **BHP Billiton** is pushing ahead with its Jansen mine, despite slashing its budget because of the slump in potash prices. **The Mosaic Company's** Esterhazy mine expansion, which will increase that mine's annual output to six million tonnes on completion.

It is estimated by the International Fertilizer Industry Association that these and other mine developments will see potash's global productive capacity grow by 8% in 2016. This doesn't bode well for Potash Corp. because it obtains about 40% of its revenue from potash.

The same phenomenon is occurring with phosphate and nitrogen; the International Industry Fertilizer Association has forecast that global output will increase by 3% and 5%, respectively, by the end of 2016. When coupled with the slump in demand, this doesn't bode well for Potash Corp.'s revenues because they are responsible for earning 28% and 31%, respectively, of Potash Corp.'s revenue.

### So what?

The overall outlook for fertilizers remains pessimistic as declining demand and growing supplies are set to keep pressure on prices for some time. This certainly doesn't bode well for Potash Corp., particularly with it having taken an overly optimistic view of the market and management having completely missed the boat on their original guidance.

Nonetheless, the revised 2016 guidance appears realistic, and with Potash Corp.'s dividend payment now less than its forecast full-year earnings per share, it should be sustainable. However, this does not necessarily mean that now is the time to buy. Potash Corp. will remain under pressure because of ongoing weakness in the global fertilizer market.

### CATEGORY

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