Go With the Grain by Investing in Potash Corporation of Saskatchewan Inc. and Agrium Inc.

Description

Recent deals in the global potash market should instill confidence in investors of **Agrium Inc.** (TSE:AGU)(NYSE:AGU) and **Potash Corporation of Saskatchewan Inc.** (TSX:POT)(NYSE:POT) that demand is improving and the industry is positioning itself for a rebound.

Their stocks jumped on rumours that the two companies were in talks to merge. Both companies have seen their share prices decline about 10% from their most recent highs in mid-July, but the announcement erased almost all those losses, propelling the stocks higher by 7% and 11%, respectively.

Potash prices fell to their lowest level in a decade this year after China and India postponed new contracts because of high stockpiles. Analysts have indicated that these low prices are in line with expectations, but the recent supply contracts with China and India should provide some upside potential.

Uralkali PJSC, the world's largest potash producer by volume, announced this week that it signed deals to supply fertilizer to China and India. The Russian company will supply 600,000 metric tonnes of potash to Sinochem Group, China National Agriculture Means of Production Group Corp.

The price that China reaches with Belarusian, Russian, and North American suppliers has traditionally been the benchmark for sellers and buyers around the world. Belarusian Potash Co. first agreed on the deal with China in July, setting the price at $219 per tonne. This is well below the Chinese contract price, which was $315 a tonne last year.

In June Belarusian Potash Co. agreed to supply potash to India at the cheapest price in almost a decade. Indian Potash Ltd. agreed to buy 700,000 metric tonnes at $227 a tonne compared to a benchmark price of $334 per tonne in the same period last year. This is the first time since 2009 that India reached an agreement before China.

Conpotex Ltd., the Canadian joint venture that represents potash-export sales from Potash Corp., **Mosaic Co**

. and Agrium, said in July that it will only sign contracts to supply China and India for the remainder of 2016 as it expects prices to rise next year. This pricing strategy may lose them market share in the near term, but it will forego any risk associated with rising prices over the next year.

If you factor in this current low-price environment, both Agrium and Potash Corp. have still performed relatively well this year. Agrium posted second-quarter adjusted net earnings of $578 million, or $4.18 per share. Retail earnings results were the second-highest in history. Potash Corp. reported second-quarter earnings of $0.14 per share. The gross margin for the first six months was below 2015 levels primarily due to weaker prices for all three nutrients and lower potash sales volumes to offshore markets.

Agrium continues to outshine Potash Corp. primarily due to its vertical integration in the agricultural products and services market. As of Q2 2016, only 20% of its revenues where generated from wholesale mineral sales. The majority of its revenue comes from its retail division, which markets and distributes seed, crop protection products, and nutrients. On the other hand, Potash Corp. derives almost all of its revenues its mineral wholesale division.

If this merger is approved by their respective boards, shareholders, and the Competition Bureau of Canada, the synergies would be massive. Potash Corp. could leverage Agrium’s distribution and retail network, while Agrium would significantly expand its breadth of products. In the near term, both companies may lose some market share if their strategy to delay signing any long-term contracts remains, but both companies should realize some favourable upside potential as the price of potash appreciates.

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1. Editor's Choice

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