



What an Agrium Inc. Merger Means for Potash Corporation of Saskatchewan Inc. Shareholders

Description

On August 30, **Agrium Inc.** (TSX:AGU)(NYSE:AGU) and **Potash Corporation of Saskatchewan** (TSX:POT)(NYSE:POT) rattled the entire fertilizer market by stating they were in talks about a potential merger. While details are scarce, the implications of a transaction would be massive; the combined company would be worth close to US\$30 billion, making it by far the largest fertilizer producer in the world.

The general consensus (although this could be completely incorrect) is that Potash Corp. is looking to acquire Agrium in this transaction, since Potash Corp., at first glance, seems to have much more to gain from such a transaction. The combined entity would be much larger and more diversified with more control over global supply and more leverage to rising potash prices.

The combined entity would be number one globally for potash capacity, controlling an estimated 23% in 2017, compared to the 19% Potash Corp. would control without the merger. In addition to this, the combined entity would control a staggering 60% of North American production according to analysts at **TD Bank**.

With early signs that the potash market is potentially bottoming (the market should post a two-million-tonne deficit in 2016, according to **Bank of Nova Scotia**, and Potash Corp. sees 2017 global capacity climbing by only one million tonnes, but demand growing by three million tonnes), do Potash Corp. shareholders benefit more with or without a merger?

The pros

The pros to a Potash Corp. initiated merger of Agrium are fairly clear.

The first benefit is increased earnings stability. For 2017, about 60% of Agrium's EBITDA is expected to come from its retail segment, and the segment currently has a 17% (and growing) share of the North American market, making it the largest player. Agrium's retail segment is notoriously stable, even through highly cyclical crop nutrient and fertilizer markets, and it's a strong source of free cash flow

through the cycle.

Potash Corp.—entirely a wholesale producer of fertilizers—has no insulation from volatile commodity prices, and the result has been a 75% dividend decrease this year alone. Agrium, on the other hand, has been increasing its dividend, and stability is of great value to investors. The combined company would have 31% retail EBITDA contribution according to TD Bank, which would provide much-needed stability to Potash Corp.’s earnings.

In addition to this, Potash Corp. would gain control over Agrium’s potash production, particularly its Vanscoy mine. This could technically give Potash Corp. the option to shut down the Vanscoy mine temporarily (which would improve potash prices), and it would also give Potash Corp. the option to drive cost reductions by maximizing capacity at its lower-cost mines, like its Rocanville operation, and reducing production at higher-cost mines, like Vanscoy.

There would also almost certainly be synergies from such a merger, and analysts have generally said there could be up to US\$300 million in cost-saving synergies by combining administration, focusing on lower-cost operations, as well as using Agrium’s retail network to distribute potash tonnes.

Overall, Potash Corp. would definitely see some earnings accretion from such a transaction (the exact amount would depend on what Potash Corp. pays for Agrium), but the end result would be that Potash Corp. would be a larger, more diversified play on potash price increases.

The cons

The main con of Potash Corp. pursuing Agrium is that Potash Corp. would almost certainly need to pay up for Agrium, especially since the deal is considered a “merger of equals.” Agrium currently trades at a large discount to Potash Corp., and Potash Corp. would likely need to pay a large premium to acquire Agrium, since the deal presents much less benefit for Agrium than Potash Corp.

In addition, Agrium would need to depart from its retail-focused strategy and add exposure to more volatile commodity prices.

Once more details come out, the full benefits and costs to Potash Corp. will become clearer.

CATEGORY

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