Potash Corporation of Saskatchewan Inc. and Agrium Inc. Create an Ag Giant

Description

Two of agriculture's largest companies have moved fast in recent weeks, attempting to create one of the industry's largest mergers.

Late this August, *CNBC's* Marc Faber reported that a mega merger between **Potash Corporation of Saskatchewan Inc.** (TSX:POT)(NYSE:POT) and **Agrium Inc.** (TSX:AGU)(NYSE:AGU) could be just "weeks" away. The following day, Potash Corporation confirmed that it was in preliminary discussions with Agrium regarding a "potential merger of equals." On September 12, they agreed to a $36 billion tie-up.

The proposed terms call for existing Potash Corporation shareholders to get 0.4 shares in the new company for every Potash Corporation share they own. Agrium shareholders would see their shares converted into 2.23 shares in the new company. In total, Potash Corporation shareholders would own 52% of the new entity, and Agrium shareholders would own the other 48%.

What can investors expect from the move?

The name of the game is diversification. Potash Corporation, which controls the largest amount of fertilizer capacity in the world, could use some offsetting revenues that are not tied to the volatile commodities market. Agrium, meanwhile, has an extensive global direct-to-farmer retail network and could benefit from vertical integration, gaining direct access to many nutrients it currently has a smaller presence in.

Potash Corporation could have used the diversification in recent years. For example, potash prices (its main nutrient) have fallen more than 80% since 2008. Average realized prices last quarter were roughly US$15o per tonne versus $275 per tonne a year ago. In 2008 the company logged prices of over $900 a tonne. Potash Corporation has seen three straight years of declining sales and income, which forced the company to slash its dividend twice this year.

The incentives for a merger are clearly high for Potash Corporation. No wonder it tried (unsuccessfully) to launch a hostile bid for **K&S AG** last year.

Agrium shareholders should be a bit more skeptical. There's no doubt that, by combining forces, each company would diversify its revenue streams and play to each other's strengths. It's just that Agrium already has strong, secular tailwinds buoying its business.

Agrium is the largest global retail distributor of crop inputs in an industry where scale matters. The company has over 1,500 retail and wholesale locations spread across Canada and the United States. It also has a sprawling network through some of South America and most of Australia. These locations are able to offer crop inputs and services for over 50 different crops.

In the U.S. retail market, Agrium has a leading market share of 17%; its nearest competitor comes in at only 7%. The company's international operations have even greater market shares closer to about 30%. Agrium can rely on its industry-dominating connection of existing infrastructure to serve customers faster and more fully.

Additionally, there are still significant opportunities for the company to grow. For example, 30% of the U.S. market is serviced through small, independent providers. Another 25% is serviced by farmer co-ops. This means that over half of the market could benefit by connecting to Agrium's sprawling, full-service retail locations. Agrium has also been able to buy a significant number of smaller competitors, unlocking value by connecting them to its existing distribution network.

Reevaluate your investment?

The combined company will have a very different investment thesis than before. Agrium shareholders should incorporate the added risk of Potash Corporation's commodity exposure. Potash Corporation shareholders should rejoice as they diversified away much of their volatility while gaining a secular, long-term growth driver.

Which side were you on?

CATEGORY

1. Investing
2. Metals and Mining Stocks

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