Agrium Inc. Just Lost its Biggest Competitive Advantage

Description

Last week was a roller-coaster ride for **Potash Corporation of Saskatchewan Inc.** (TSX:POT)(NYSE:POT) and **Agrium Inc.** (TSX:AGU)(NYSE:AGU) investors as the stocks gave up most of the gains from previous week.

Investors are wary about what lies ahead now that the two companies have agreed to merge. While it's a big deal, I'm still trying to figure what Agrium stands to gain. The transaction still awaits regulatory approvals, but I believe Agrium has put its biggest competitive advantage at stake by agreeing to the merger. If you ask me, Agrium will be reduced to yet another company at the mercy of volatile and unpredictable fertilizer prices if the deal goes through.

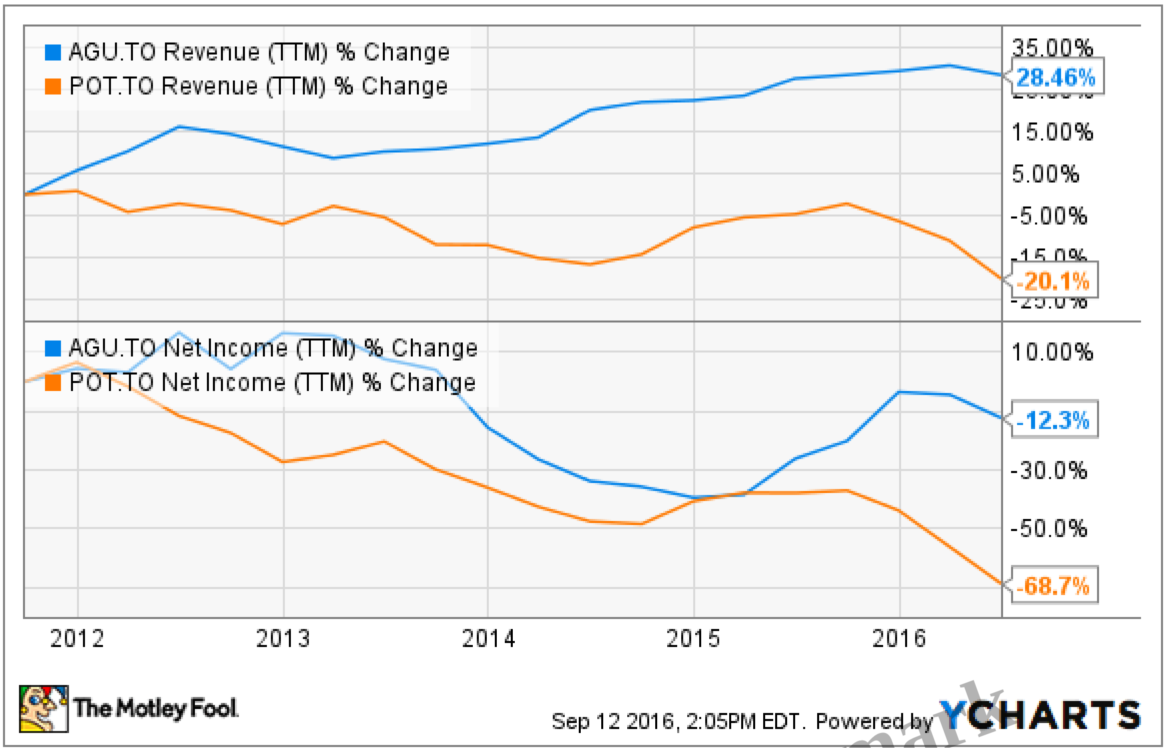
Before I tell you why, take a look at the striking chart below.

AGU Total Return Price data by YCharts

Why do you think Agrium has crushed Potash Corp. in terms of total returns (which includes stock appreciation and dividends) all these years, despite operating in similar fertilizer markets amid similar business conditions? The answer lies in Agrium's diversity.

Potash Corp. is a pure-play fertilizer company that sells potash, phosphate, and nitrogen. Agrium also sells all three nutrients, but it derives a major portion of its revenue from the retail side of its business, which constitutes seeds, crop nutrients, and crop protection products. Farmers may apply low amounts of fertilizers to crops on any given year, but they still need seeds to grow the crops.

The relatively resilient demand for seeds and other retail products combined with its solid distribution network explains why Agrium's bottom line withstood the tests of time way better than Potash Corp.'s.



AGU Revenue (TTM) data by YCharts

The merger: Agrium's loss, Potash Corp.'s gain

Going by the above charts, it's already quite evident why Potash Corp. is interested in combining with Agrium. The merger will not only give Potash Corp. access to Agrium's fertilizer assets, which includes the Vanscoy potash mine and the Borger urea plant, but also entry into the higher-margin retail side of agriculture. In other words, Potash Corp. may have just found a way to reduce the volatility in its earnings through the merger.

The situation is vice-versa for Agrium as its exposure to fertilizers could increase manifold once it combines with Potash Corp. History may not repeat itself, but it's been proven time and again that the fertilizer business is risky thanks to its commodity-centric nature. Agrium (on its own) held tremendous growth potential as it sought to expand its retail network further. That may not hold after the merger as this is what the merged company could look like:

Source: Merger website https://www.worldclasscropinputsupplier.com/

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As you can see, 80% of the merged entity will be fertilizers. Let's also not forget that Agrium's diversity has largely helped it boost its dividend at a time when Potash Corp. was slashing its dividend. Agrium's dividend growth will likely decelerate after the merger as volatility in earnings goes up. While the merger still has to pass regulatory hurdles, Agrium will clearly end up losing its mojo to a bigger rival if the deal materializes.

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