



Potash Corporation of Saskatchewan Inc.: Does the Recovery Have Legs?

Description

Potash Corporation of Saskatchewan Inc. (TSX:POT)(NYSE:POT) is up 12% in the past month.

Let's take a look at the current situation to see if the beleaguered producer of crop nutrients deserves to be on your buy list.

Mega merger

The global fertilizer space has been under pressure in the past two years as battles for market share, oversupply, and volatile currencies have wreaked havoc on the industry.

This has made life difficult for producers and is driving consolidation in the sector.

Potash Corp. has been involved in three potential transactions in recent years. The company rejected a US\$38.6 billion bid by **BHP Billiton** back in 2010. BHP hoped its hostile attempt would succeed, despite the pushback from Potash Corp. executives, but the Canadian government blocked the deal on the grounds that it failed the "net benefit" test, meaning the takeover would not provide an overall benefit to Canadians.

In hindsight, Potash Corp. investors are probably wishing the deal had gone through.

In 2015 Potash Corp. became the aggressor, bidding US\$8.7 billion to buy German potash producer **K+S AG**. The company eventually abandoned its attempt amid strong resistance from K+S and a continued decline in the potash market.

Potash Corp. investors let out a sigh of relief on the failed attempt, as the acquisition would have loaded up the balance sheet with debt just as potash prices were falling off a cliff.

Now it looks like Potash Corp. has finally found a marriage that will work. In September 2016 the company announced plans to merge with **Agrium Inc.** (TSX:AGU)(NYSE:AGU), which would create a global fertilizer giant worth US\$36 billion.

Both companies are based in Canada, so there is less concern about a government rejection.

The deal brings the world's largest fertilizer producer Potash Corp. together with the globe's biggest agriculture retailer Agrium.

Shareholders of both companies have voted in favour of the merger, which would result in Potash Corp. shareholders retaining 52% of the new company and Agrium shareholders owning 48%.

The merger is expected to deliver annual cost savings of US\$500 million.

A look at earnings

Potash Corp. reported rough Q3 2016 results. The company earned US\$81 million, or US\$0.10 per share, compared to US\$282 million, or \$1.28 per share, in the same period last year.

Gross margins fell due to weaker year-over-year realized prices in potash, nitrogen, and phosphate.

On the bright side, potash demand improved in Q3 2016 in all major markets, and spot prices increased from the Q2 lows. Potash Corp. reported record potash sales of 2.5 million tonnes in the third quarter, but the company's average realized potash sale price was just US\$150 per tonne compared to US\$250 per tonne in Q3 2015.

Ouch!

Nitrogen prices remained at multi-year lows through Q3 due to lower production costs and rising output from new projects in North America. Phosphate also had a bleak three months.

Will Agrium save the day?

Agrium reported weak year-over-year results due to unfavourable market conditions and actually lowered its full-year 2016 guidance, so there isn't much to cheer about there either.

Overall, the fertilizer space remains challenged and the numbers hardly justify a large upward move in Potash Corp.'s stock.

Should you buy?

Buying Potash Corp. today requires a belief the fertilizer slump has bottomed and the merger with Agrium will work out well.

If you are in that camp, the stock attractive today as a long-term contrarian pick, but investors shouldn't expect to see the strong near-term rally that has occurred in the other commodity names.

CATEGORY

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