How to Apply the Buffett Model With This 1 Stock

Description

Warren Buffett has made amazing investment decisions using a long time horizon and periodic short-term dips in prices to make market-beating returns for years.

Some companies go through cycles, and unless the risk of bankruptcy in the long term outweighs the future return from a given stock or an industry, the economics of the current low-price commodity environment suggest that now is likely the best time to get in on securities that are relatively safe long term with economic "moats" and advantages that will continue to provide a margin of safety into the medium to long term.

We need to look for stocks with the following characteristics:

- Solid underlying long-term fundamentals (value, not "glamour")
- Long-term competitive advantage (moat)
- Long history of dividend payments with a reasonable yield and significant principal upside

I'll be looking at one stock that encompasses all of these traits: **Potash Corporation of Saskatchewan Inc.** (TSX:POT)(NYSE:POT).

Solid underlying long-term fundamentals

Potash Corp. has an impressive balance sheet as compared to its largest North American competitors.

Potash Corp. is currently in the middle of a merger with **Agrium Inc.** (TSX:AGU)(NYSE:AGU) which will further enhance its market-leading performance should the merger receive regulatory approval. As such, I will assess Potash Corp.'s balance sheet against that of **Mosaic Co.** (NYSE:MOS), its largest competitor.

Looking at the fundamentals, we can see important points of divergence which will be expanded upon more next (Potash Corp. numbers listed first):

- Profit margin: 8.57% vs. 4.16%
- Operating margin: 14.54% vs. 4.45%
- Return on Equity (ROE): 4.05% vs. 3.14%

While Potash Corp. has a higher debt load and a higher price-to-book valuation than Mosaic, it is clear the company's operating performance is superior, leading to a smaller free cash flow loss and higher ROE than its major competitor. Potash Corp.'s debt load will increase should the merger with Agrium go through.

I'll now take a look at why this merger may pay off big in the long term.

Long-term competitive advantage

In looking for a company with a competitive advantage over its peers in a low-margin business that is sensitive to market share and volume movements. Potash Corp. has a unique advantage over its peers. The company's potash reserves are located much closer to the surface than other deposits around the world (largely on a horizontal plane), and the production technology used by Potash Corp. allows it to benefit from a cost advantage over its peers.

This cost advantage is important in maintaining higher long-term margins than its competitors. In theory, as the company continues to gobble up market share, as it anticipates it will do with its Agrium merger, it will continue to widen the gap between it and its competition, demanding a higher market price and returning more value to shareholders than other firms in the industry.

Dividend history

Potash Corp. has had a very consistent history of dividends; in fact, the company has issued quarterly dividends consistently for 18 years, only recently cutting the dividend due to the rapid drop in commodity prices. The recent dividend cut doesn't ensure the sustainability of the current yield as the payout ratio is currently abnormally high, but it does indicate management prudence, which is important in this current economic environment.

Conclusion

Long-term investors: take a deeper look at the numbers relative to other players in the industry.

Stay Foolish, my friends.

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