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FEATURE

Fertilizer Stocks' Gains Have Just Begun

By Bill Alpert August 18, 2018

PHOTO: CATE ANDREWS

With the planet's population surging past 7.5 billion, you might expect steady demand for crops and al fertilizer that's essential for crop yield. Farming isn't that easy. The mid-decade crash in grain prices th agriculture stocks off the bull market's back. And even as farm icons like Deere have regained favor in years, investors kept a wary distance from fertilizer sellers CF Industries Holdings, the Mosaic Co., anc concerned that new producers would weigh down pricing.

A plant-food glut hasn't happened, and now looks unlikely. And Wall Street has started warming to the three fertilizer leaders got a lift in early August, after good second-quarter earnings. Yet the stocks stil go, says Charlie Neivert, the Cowen & Co. chemicals analyst who was ahead of the crowd when he tur fertilizer in early March. "The new supply, which was coming on fairly rapidly, is slowing its advance," sa demand, which constantly increases, is catching up." He sees 25% upside for the shares of Nutrien—t Saskatchewan-based Canadian giant formed in the recent merger of PotashCorp and Agrium—and al headroom for CF and Mosaic.

As shown in the chart toward the end of this story, prices of crops such as corn have been fairly stable Trump administration's trade war, while prices have been rising for fertilizers containing the three mai nitrogen, phosphorus, and potassium. "The fundamentals of the industry are improving," says Nutrien Magro, whose company (ticker: NTR) is the industry's largest. "By the 2020-21 year, the supply-demar could even be tight."

Fertilizer companies will do quite well, even if their products' prices don't reach the crazy levels seen i some fertilizers spiked above $1,000 a metric ton. Those prices were a culmination of the 20th centur revolution, which taught farmers to ditch manure and drive their crop yields by applying chemical ferti

In the first half of this decade, business boomed for farmers in North and South America. Corn passec 2012, up fourfold from the level just a few years earlier. Corn is the hungriest crop for fertilizer, especia London-based economist Pedro Vergel Eleuterio studied the fertilizer industry in 2015 for his Ph.D. th that the strongest drivers of fertilizer shares are crop prices.

Farmers tend to budget their spending in proportion to their anticipated revenue per acre, says Cowe

Refreshed Fertilizer

Stock prices revive for key nutrients

Source: Bloomberg

Neivert, and through the 2014-15 season, farms in North America and high prices on record corn acreage. The resulting profits were reinves machinery from Deere (DE), CNH Industrial (CNHI), and Agco (AGCO), were happy to buy fancy seeds and fertilizers. Then, crop prices tanke

As corn fell back toward $3 a bushel in 2015, plantings retreated and of the leading nitrogen producer, CF Industries (CF). Soybeans, anoth from $15 a bushel to $9. By 2016, the stock of the Deerfield, Ill.-based slid from near $70 to $22. Last year, farmers found profit in corn and allowing CF's revenue to grow for the first time in several years. Sales 12%, to $4.1 billion. The recovery continued this year. Farmers ordere amount of nitrogen-based fertilizer from CF, lifting its second-quarter over the prior-year period's, to $1.3 billion. June quarter earnings jump million from $3 million, and to 63 cents a share from a penny.

CF stock moved up 12% on these Aug. 1 results, to $49, as analysts lif estimates for 2018 earnings to $1.25 a share, according to the FactSe and $1.90 for 2019. What got pulses racing was CEO Tony Will's forec nitrogen supplies. While North American producers are enjoying low r prices from the shale boom, rivals in Europe have idled nitrogen plant 50% rise in their gas costs. Exports from China fell 74%, meanwhile, encountered higher coal prices and tougher environmental rules.

With demand rising by 2% a year, those capacity constraints point to the nitrogen fertilizers ammonia and urea. "Over the next several year growth should outpace net global capacity additions," CF's Will told analysts on the earn

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Global supplies of potassium-rich potash are also growing at a slower pace than deman news for Nutrien, the world's largest producer. It's also the third-largest nitrogen producer. June-quar $8.1 billion, 11% over last year's pre-merger numbers at Agrium and PotashCorp combined. Merger sy widen profits on continuing operations to $740 million, or $1.17 a share. Those results sent the Canadi shares up 6%, to near $57; now, they've eased to $56. On raised guidance from Nutrien, analysts have earnings forecasts to some $2.60 a share for 2018 and $3.20 for 2019.

Industry watchers had worried about a new potash mine planned by Russia's Eurochem, but that proj more challenging than expected. Nutrien chief Magro says the new capacity will be absorbed by grow "Fundamentals have improved for farmers," Magro tells *Barron's*. "Right now, we see a strong, healthy good for the farmer and good for our business."

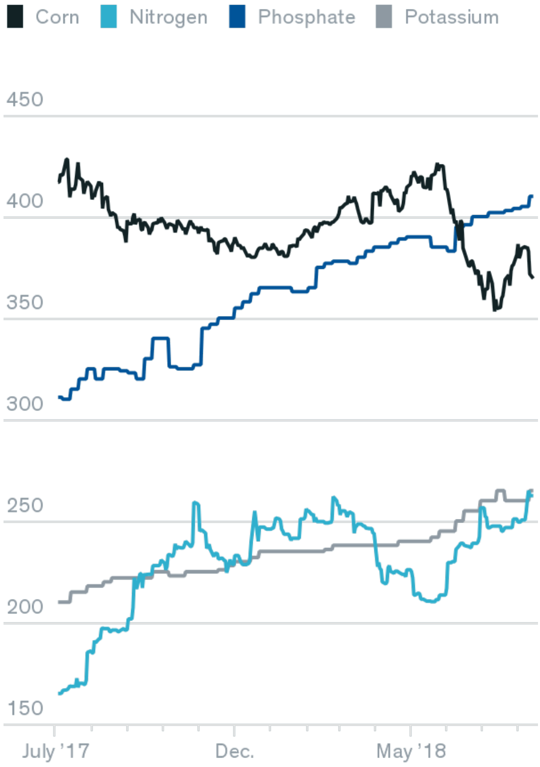
Incumbents such as Nutrien can enjoy increasing returns on rising fertilizer prices, notes Cowen analy they run their plants at higher utilization rates and reduce their marginal costs.

Potash is also a key product for Mosaic (MOS), the Plymouth, Minn., company that is a dominant produ phosphates. Prices for the phosphate fertilizers known as DAP and MAP have climbed, as China has c mom-and-pop producers for environmental reasons and Mosaic has idled a large plant in Florida. "Th advantage of being the largest in the market," CEO Joc O'Rourke says. "You have the ability to move th play a role in balancing supply."

Mosaic's June-quarter sales of $2.2 billion were 25% higher than the prior-year period's. Although ope doubled, the latest period's net income came in below last year's, because of tax differences and curr the company's large operations in Brazil. In 2017, Mosaic bought the fertilizer business of that country

More Food for More Plants

Demand for corn has stabilized, and it's riding for key plant nutrients.



Note: All units are U.S.$ per short ton, except for corn, which is based on per 5,000 bushels. Corn and urea futures from Chicago Board of Trade. U.S. Gulf spot price for DAP (phosphate) and for potash

Source: Bloomberg

Vale, hitching onto Brazil's booming agriculture sector.

Much of the world's demand growth for food is in the BRIC countries– India, and China—says O'Rourke. Of those, Brazil is the most attractive business. In the coming year, it's expected to pass the U.S. in soybean soybean farmers are big customers for Mosaic's potash and phosphat all of his ag industry peers, O'Rourke says he isn't happy about the imp China trade war on American farmers. But Mosaic is hedged against t because U.S. farmers' losses are Brazilian farmers' gains.

Mosaic shares moved up on the company's June-quarter results, to a r as analysts raised their earnings estimates to $1.65 a share for 2018 a

Analyst Neivert notes that he'd been negative on the fertilizer compan because of falling grain prices or unbalanced supply and demand. All negatives have now turned positive, and he expects the good times to

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