DeMatteo Research

IDEA NOTE

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NTR

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Nutrien Ltd.

Industrial/Transportation

03/05/2018

PRESENTED

DATE		03/01/2018
PRICE 49.49	MARKET CAP $31.80B	ENT VALUE $45.91B
P/E RATIO 128.19x	BOOK VALUE $N/A	DIV YIELD 3.23%
SHARES O/S 840.16M	AVE DAILY VOL 2,079,510	SHORT INT N/A

CURRENT

PRICE	$54.99	MARKET CAP	$31.80B

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Chart
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Nutrien Ltd. produces and distributes potash, nitrogen, and phosphate products for agricultural, industrial, and feed manufacturers worldwide. The company was founded on June 2, 2017 and is headquartered in Saskatoon, Canada.

Publicly traded companies mentioned herein: Arab Potash (APOT JR), Mosaic Co (MOS), Nutrien Ltd (NTR), Sociedad Quimica y Minera de Chile SA (SQM), Tesla Inc (TSLA)

Highlights

Nutrien (NTR) began trading on January 2, 2018, following the completion of the Potash/Agrium merger. The presenter is long at this time, seeing a favorable risk/ reward with the stock at ~$50 per share and the potential for a 50% to 100% gain over 12 - 24 months. Investors have “left most of the fertilizer companies for dead” following a five year period of dramatic underperformance relative to the market due to weak commodity prices (NTR is “incredibly sensitive” to phosphate, nitrogen, and potash prices). However, the company is deploying capital in the form of a healthy dividend and buyback program, must sell its substantial holdings of SQM and APC, and stands to benefit from $500MM+ in estimated cost synergies, as well as tight supply/ demand dynamics. If his thesis is correct, and NTR is at the bottom of the cycle with macro tailwinds, its EBITDA and FCF could potentially rise to $6.5B - $7B and $7.50 per share, respectively, over the next two years. This would be up from an expected $3.5B - $4B and $3 per share for 2018, and assumes a return to the average nutrient prices seen over the last eight years.

- The fertilizer space has performed extremely poorly over the past five years. Mosaic is down ~55%, while the S&P is up over 70%; and a custom index tracked by the presenter - of fertilizer stocks - is down 60% vs the market (SPY). While there has been inflation in hard commodities recently, it has not been seen in soft commodities yet, namely corn and soybeans, which are still at the lows. Regardless, fertilizer prices have been moving up, NTR’s guidance reflects substantially lower price levels, and investors have been “slow” to return to the space, thus the opportunity.
    - A combination of poor supply/ demand dynamics and Chinese export activity has weighed heavily on nitrogen, phosphate, and potash prices since 2013 - 2014. However, the presenter noted that prices (per metric ton, courtesy of Bloomberg) have started to rebound from 2017 lows:
        - Nitrogen is ~$250, with a high of $440 (2/26/14) and low of $163.50 (6/2/17). Five-year average price is $275.29.

        - Phosphate is ~$375, with a high of $500 (3/31/14) and low of $295 (12/2/16). Five-year average price is $383.
        - Potash is "coming off the bottom" at ~$225, with a high of $393.25 (8/31/13) and low of $214 (2/28/17). Five-year average price is $285.63).
    - The presenter sees supply/ demand dynamics improving. China's environmental controls (i.e., reducing water pollution) have resulted in [nitrogen] operating rates sitting at all-time lows. At the same time, Mosaic closed a big phosphate mine and NTR is likely to rationalize some of its high-cost capacity as part of its synergy plan. Overall, supply is tight and demand has been much stronger due to higher application rates.
    - When guidance was given, price levels were 10% - 15% lower than present levels. This could lead to a positive revision of the guidance range in early May when NTR is expected to report earnings.

- Incremental changes in nutrient prices result in large swings in NTR's financial performance. The presenter said, "The second derivative looks good, and there have been no new major capacity announcements, so there's nothing to boost supply". A +$25/ton move in nutrient prices (on average) would add $650MM to EBITDA. Based on his model, normalized numbers could be 2x - 3x today's level, and at cycle peak the number could be multiples of that; "The leverage is huge".
- In his opinion, NTR is the best way to play the trend, as it has the infrastructure to move commodities at low costs. In addition, Potash had made investments in a number of companies over the years, including a 32% stake in SQM and a 28% stake in APC, which are collectively worth just over $5B today (or, ~$16% of the present market cap). Due to the terms of merger agreement, the stakes must be sold.
    - The presenter assumes NTR will use the proceeds to reduce leverage, which would put the company at "a little over a half-turn of leverage".
    - SQM is a valuable asset, as it is one of the largest and lowest-cost producers of lithium in the world.
- When asked about the synergy target, the presenter said he believes the $500MM figure may be conservative. He believes there may be an incremental $100MM of cost synergies to be had by the end of 2019 (for ~$600MM total), but it is "hard to lock down" what the ultimate benefit of shutting down the relatively high cost capacity will be. Regardless, taking the capacity offline could result in an even tighter supply picture, for potash in particular.
- The presenter said it is relatively easy to model EBITDA and FCF above guidance given the current price trajectories (management set a low bar by using the average 2017 fertilizer prices). Looking out 12 - 24 months, he thinks the stock could see $70, and then possibly $100+ if prices revert to average levels. Excluding the equity stakes, and assuming the proceeds are used to reduce debt, he sees the stock at just ~4x EV/Expected EBITDA. On Street estimates for 2019, it presently trades at 9x.
    - At $6.5B - $7B of EBITDA, FCF would be $7.50, for a double digit FCF yield today.
    - Additionally, the $0.40 per share quarterly dividend gives NTR an attractive 3.2% yield, and the buyback program is meaningful (5% of the market cap in 2018).

Risks

The biggest risks to the thesis are a resurgence of Chinese exports and/or that prices roll over again (NTR does not have pricing power, everything is spot pricing). An additional risk could be lower realized prices for NTR's stakes in SQM and APC. However, the stock is cheap on both an EV/EBITDA and FCF basis, and downside may be further limited by the 3.2% yield, "great" balance sheet, and buyback. Worst case, he sees NTR reverting to "dead money".

- China has broadened its environmental focus to include water pollution, not just air. Nitrogen and phosphate exports are noticeably lower over the past six months, and the presenter thinks Beijing is unlikely to change its course
- SQM's stock has been volatile, and there had been speculation about Tesla's interest in the company, as well as a potential Chinese

- investor/ buyer. In the presenter's opinion, the lithium space is attractive and the fact that NTR's stake comes with board seats could mean it will fetch a premium, not a discount as feared.

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