Michael Gorlon

Buffett's Next Passive Investment: Potash Corp. (POT)

Potash Corporation is the world's largest fertilizer company by capacity. It produces three of the primary crop nutrients that are essential for plant growth: potash, nitrogen, and phosphate. The company was founded in 1953 and its vision is to "play a key role in the global food solution while building long-term value for all stakeholders".

Investment Thesis: World population is projected to grow to around 9 billion by 2040, technology will improve over time resulting in longer life spans, and poor countries will increasingly become middle class resulting in a higher consumption of grain and meat. All of these factors will require an increase in demand for fertilizer.

Economic Moat: Low cost producer with a 3 year average gross margin of 40%, operating margin of 36%, and profit margin of 24%. The next closest competitor in their industry is Mosaic with a 3 year average gross margin of 26%, operating margin of 20%, and profit margin of 16%. There are high barriers to entry in the potash industry due to: long lead times to build a mine, high costs of production, and scarce locations. According to the current CEO of BHP Billiton, there hasn't been any meaningful potash mine built since the 1970s. Average return on equity over the last 10 years is 28.6% and average return on invested capital is 19.6%. Free cash flow has been positive every year over the last 10 years except 1.

Financial strength: Retained earnings have grown from $717 million to $6,423 million over the last 10 years. Their average 5 year interest coverage ratio is 19, total debt to equity is currently 48.2% and total debt to assets is currently 24%.

Management: During 2014, management bought back 29 million shares at an average price of $35 and reduced the outstanding share count by 5%. Executive officers have an average service period of 19 years. They have also returned large amounts of capital to shareholders via dividends over the last 10 years. Potash's dividend in 2006 was 7 cents annually and $1.40 in 2014.

Valuation: Sells at 12 times pre-tax income; close to Buffett's preference of 10 times. Valued at $38.99 a share using TTM free cash flow, the 10 year US gov't bond yield, and a 4% growth rate. This is a 19% margin of safety from its current price.

Berkshire Hathaway's Acquisition Criteria:

1. Large purchases (at least $50 million of before-tax earnings) - **Potash has TTM pre-tax income of $2.64 billion.**
2. Demonstrated consistent earning power (future projections are of no interest to us, nor are "turnaround" situations) - **Net income has been positive during the past 2 recessions and for over 15 years. It has also been consistently above $1 billion over the last 5 years.**
3. Businesses earning good returns on equity while employing little or no debt - **ROE has been above 15% over the past 10 years, and the average 10 year debt to equity ratio is 57%.**
4. Management in place (we can't supply it) - **CEO with over 30 years of experience in the mining industry, and committed to building shareholder value. Average service for executive management is almost 19 years.**
5. Simple businesses (if there's lots of technology, we won't understand it) - **No technology. Sells crop nutrients for fertilizer that will be in demand as long as human beings need food to survive.**
6. An offering price (we don't want to waste our time or that of the seller by talking, even preliminarily, about a transaction when price is unknown) - **$27.2 billion at the close of the market on April 3rd.**

Source: beta.tutor2u.net

Potash Corp.

Michael Gorlon

Disclosure

- I have an ownership position in Potash (POT) at the time of writing
- Financial data and stock price are at the close of April 3, 2015
- Financial data was provided by Morningstar

Berkshire Hathaway's Acquisition Criteria

- We are eager to hear *from principals or their representatives* about businesses that meet all of the following criteria:

- 1. Large purchases (at least $50 million of before-tax earnings),

- 2. Demonstrated consistent earning power (future projections are of no interest to us, nor are "turnaround" situations),

- 3. Businesses earning good returns on equity while employing little or no debt,

- 4. Management in place (we can't supply it),

- 5. Simple businesses (if there's lots of technology, we won't understand it),

- 6. An offering price (we don't want to waste our time or that of the seller by talking, even preliminarily, about a transaction when price is unknown).

Passes Berkshire Hathaway's Acquisition Criteria

- 1. Pre tax income of $2.64 billion in 2014 and an average of $2.83 billion over the last 5 years,

- 2. Net income has been between $1.5 and $2 billion over the last 5 years, with the exception of a $3 billion profit in 2011. Net income has also been positive for more than 15 years

	2014	2013	2012	2011	2010	2009	2008	2007	2006	2005
Net Income (millions)	$1,536.00	$1,785.00	$2,079.00	$3,081.00	$1,806.00	$988.00	$3,495.00	$1,104.00	$632.00	$543.00

- 3A. ROE has been above 15% over the past 10 years,

	2014	2013	2012	2011	2010	2009	2008	2007	2006	2005
ROE	16.68%	18.27%	23.41%	42.06%	27.15%	17.81%	65.90%	25.08%	25.72%	24.03%

3B. Long term debt hasn't been above 60% of equity over the last 10 years,

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Long-term debt	$1,258.00	$1,357.00	$1,339.00	$1,740.00	$3,319.00	$3,707.00	$3,705.00	$3,466.00	$2,970.00	$3,213.00
Total stockholders' equity	$2,132.00	$2,780.00	$6,019.00	$4,589.00	$6,501.00	$6,804.00	$7,847.00	$9,912.00	$9,628.00	$8,792.00
L/T Debt as a % of Equity	59%	49%	22%	38%	51%	54%	47%	35%	31%	37%

- 4. President and CEO with 30-year career in the mining industry,
- 5. Very little technology. Potash Corp. sells agricultural products that are essential for crop growth. A growing population means more demand for fertilizer,
- 6. $27.2 billion at the close of April 3rd

With Only Two Exceptions

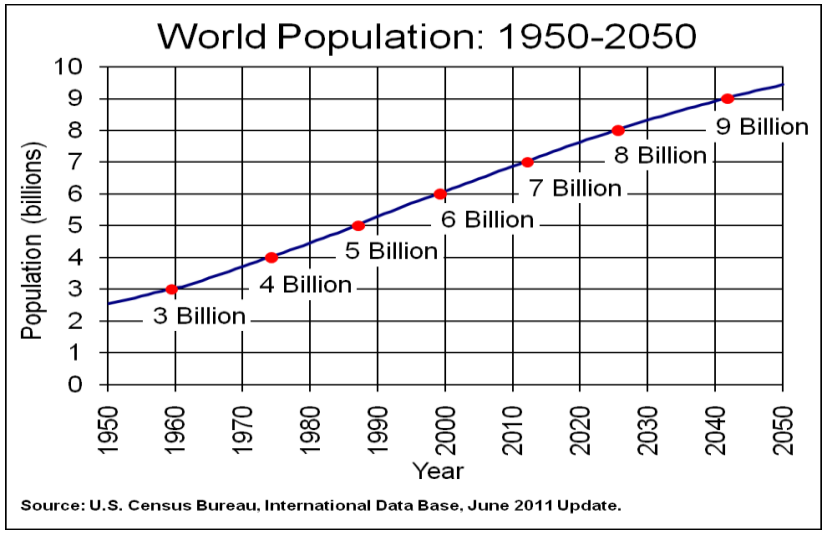
The larger the company, the greater will be our interest:

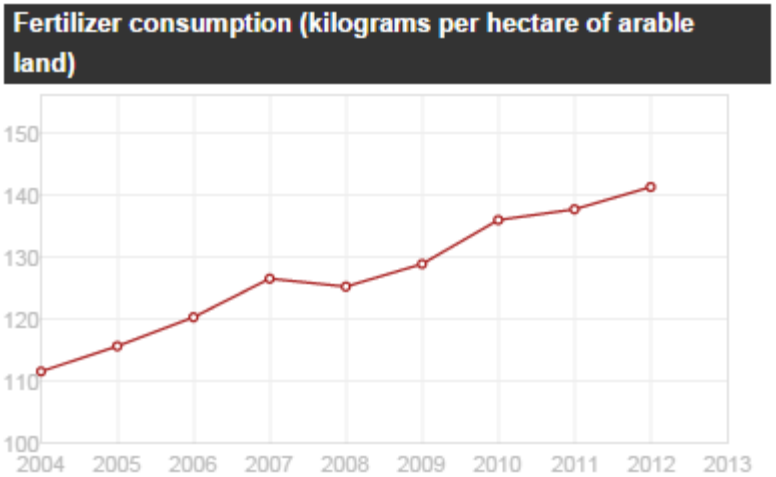
- **We would like to make an acquisition in the $5-20 billion range.**

- ***We are not interested, however, in receiving suggestions about purchases we might make in the general stock market.***

Long Term Thesis: Growing population

- World population was 3 billion in 1960 and was 7 billion in 2013
- It's projected to grow to around 9 billion by 2040
- A growing population will result in an increased demand for fertilizer in order to feed more people

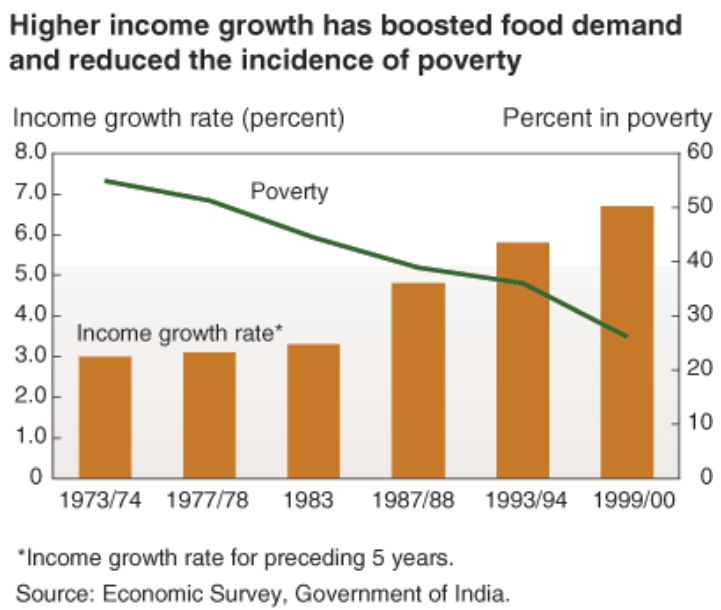


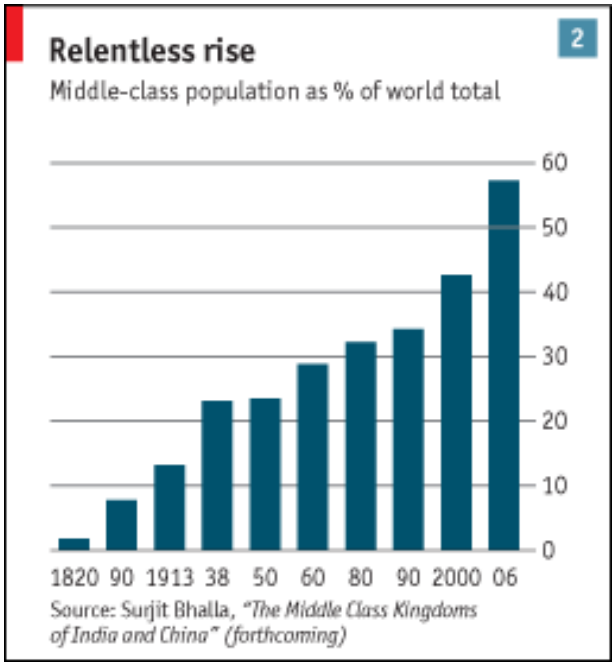


Source: World Bank

Long Term Thesis: Growing Middle Class

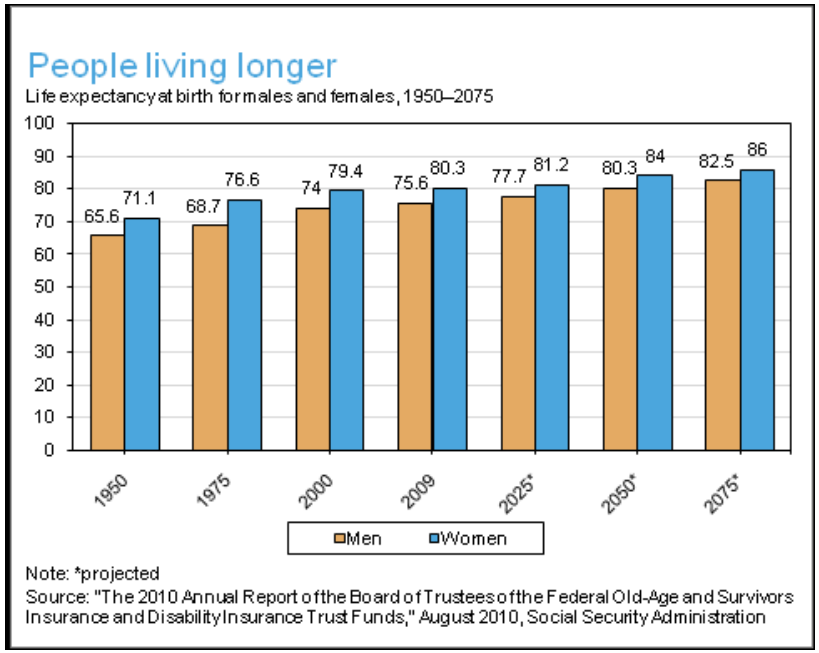
- World Bank estimates that more than 500 million people in China were lifted out of poverty, as their poverty rate fell from 84% in 1981 to 13% in 2008
- Higher incomes lead to more demand for higher calorie foods such as meat

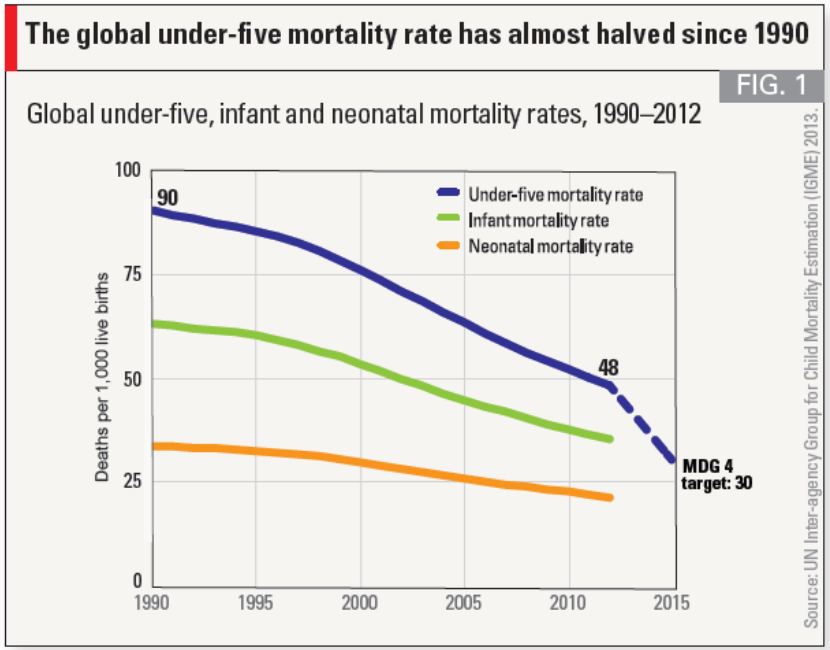




Why is world population likely to grow over the long term?

- People are living longer
- Deaths for children under the ages of 5 are decreasing
- Medical technology is getting better





- “The lives of people in poor countries will improve faster in the next 15 years than at any other time in history. And their lives will improve more than anyone else’s.”

  - Bill Gates, 2015 annual letter

- “By 2035, there will be almost no poor countries left in the world.”

  - Bill Gates, 2014 annual letter

Four Keys to Agricultural Productivity

- **Proper use of fertilizer** – Using the right fertilizer makes the soil healthier and can help double or triple yields
- Crop rotation
- Timing
- Planting techniques

Source: Alliance for a Green Revolution in Africa (AGRA)

Background

- **PotashCorp is the world's largest fertilizer company by capacity, producing three primary crop nutrients: potash (K), nitrogen (N), and phosphate (P)**
- 5 Potash mines located in Saskatchewan and 1 mine in New Brunswick
- 3 Nitrogen facilities located in the U.S. and 1 in Trinidad
- 2 Phosphate Mining/Processing facilities located in the US

Company Profile

- Founded: 1953
- Headquarters: Saskatoon, Canada
- Employees: 5,136
- Sector: Basic Materials
- Industry: Agricultural Inputs
- Stock Style: Large Value

WHO we are

Our place in the industry – and in the world

PotashCorp is the world's largest fertilizer company by capacity, producing the three primary crop nutrients – potash (K), phosphate (P) and nitrogen (N). As the world's leading potash producer, we are responsible for approximately 20 percent of global capacity.

With operations and business interests in seven countries, we are an international enterprise and a key player in meeting the growing challenge to feed the world.

POTASH

1 Allan SK
2 Cory SK
3 Lanigan SK
4 Patience Lake SK
5 Rocanville SK
6 Sussex NB

PHOSPHATE

1 Aurora NC[1]
2 Cincinnati OH
3 Geismar LA
4 Joplin MO
5 Marseilles IL
6 Weeping Water NE
7 White Springs FL[1]

NITROGEN

1 Augusta GA
2 Geismar LA
3 Lima OH
4 Trinidad

INVESTMENTS

1 Israel Chemicals Ltd. (ICL), Israel
2 Arab Potash Company Ltd. (APC), Jordan
3 Sinofert Holdings Limited (Sinofert), China
4 Sociedad Quimica y Minera de Chile S.A. (SQM), Chile

[1] Phosphate mining and processing facility.

Source: Potash 2014 Annual Report

Key Nutrients that Potash Sells:

- Potash (K) - Increases crop yields by helping plants retain water. Also, aids plants in fighting disease.

- Phosphate (P) – Plants require this for energy

- Nitrogen (N) – Key element for protein, which plants need to grow

	K	N	P
Used for			
Fertilizer	Improves root strength and disease resistance; assists water retention; enhances taste, color and texture of food	Builds proteins and enzymes; speeds plant growth	Aids in photosynthesis; speeds crop maturity
Feed	Aids in animal growth and milk production	Plays a key role in animal growth and development	Assists in muscle repair and skeletal development
Industrial	Used in soaps, water softeners, de-icers, drilling muds and food products	Used in plastics, resins, adhesives and emission controls	Used in soft drinks, food additives and metal treatments
How Produced	Mined from evaporated sea deposits	Synthesized from air using steam and natural gas or coal	Mined from sea deposits
Barriers to Entry	High	Low-Moderate	Moderate
Timeline for Greenfield (including ramp-up)	Minimum 7 years [1]	Minimum 3 years [2]	Minimum 3-4 years [3, 4]
Cost of Greenfield (excluding infrastructure)	CDN $4.6 billion [1]	$1.7 billion [2]	$4.1 billion [4]
Cost of Greenfield (including infrastructure) [5]	CDN $5.1-$6.7 billion [1]	$1.8-$2.0 billion [2]	$5.1 billion [4]
Number of Major Producing Countries	12	~60	~40
Global Production Traded	76% (KCl)	11% (NH_3)	10% (P_2O_5)

[1] Estimate for a conventional 2 million tonne mine in Saskatchewan
[2] Estimate for a 1 million tonne NH_3 ammonia/urea complex
[3] Does not include time for permitting, research and engineering
[4] Estimate for a 1 million tonne P_2O_5 operation including phosphate rock mine and beneficiation, sulfuric acid, phosphate acid and DAP/MAP granulation plants
[5] Includes rail, utility systems, port facilities and, if applicable, cost of deposit

Source: 2014 Potash Annual Report

Marketing

We sell to a diverse group of customers both by geography and by end product and, apart from sales of potash to Canpotex Limited ("Canpotex"), no one customer accounted for more than 10% of our total sales in 2014. Market conditions will vary on a period-over-period basis, and sales can be expected to shift from one period to another.

The following table summarizes our sales, by geographical distribution, from potash, nitrogen and phosphate products in the past three fiscal years (in millions of US dollars).

	2014	2013	2012
Potash			
Canada	$ 153	$ 165	$ 200
United States	1,295	1,285	1,287
Canpotex[1]	1,233	1,253	1,492
Other	147	260	306
Total	$ 2,828	$ 2,963	$ 3,285
Nitrogen			
Canada	$ 14	$ 16	$ 17
United States	1,896	1,842	1,871
Other	515	417	462
Total	$ 2,425	$ 2,275	$ 2,350
Phosphates			
Canada	$ 165	$ 184	$ 171
United States	1,330	1,349	1,487
PhosChem[1]	—	97	248
Other	367	437	386
Total	$ 1,862	$ 2,067	$ 2,292

Source: 2014 Potash 10k

Sales Breakdown by Percentage

- Potash Corp. isn't over-reliant on just one crop nutrient

- Potash makes up an average of 41% of sales, Nitrogen makes up 32% and Phosphate makes up 27% over the last 3 years

	2014	2013	2012
Potash			
Canada	5%	6%	6%
US	46%	43%	39%
Canpotex	44%	42%	45%
Other	5%	9%	9%
Potash/Total Sales	**40%**	**41%**	**41%**
Nitrogen			
Canada	1%	1%	1%
US	78%	81%	80%
Other	21%	18%	20%
Nitrogen/Total Sales	**34%**	**31%**	**30%**
Phosphates			
Canada	9%	9%	7%
US	71%	65%	65%
PosChem	0%	5%	11%
Other	20%	21%	17%
Phosphates/Total Sales	**26%**	**28%**	**29%**
Total Sales	**$ 7,115.00**	**$ 7,305.00**	**$ 7,927.00**

Who does Potash sell to?

- Retailers
- Dealers
- Cooperatives
- Distributors
- Other fertilizer producers

No one customer accounted for more than 10% of total sales during 2014

Vision

- To play a key role in the global food solution while building long-term value for all stakeholders

Stock Price Information

- Price: $32.70
- Shares: 831.30 million
- Market Cap: $27.2 billion
- Average volume: 3.9 million

BPC Cartel Breakup

- Russia's Uralkali left the Belarusian Potash Company
- Belarusian Potash Company was one of two potash cartels. The other is North America's Canpotex, which Potash is a part of
- Uralkali will embark on a strategy of increased volume, which will lead to lower prices for potash
- Potash Corp's stock decreased around 23% in response to the news

BPC Cartel Breakup

- Potash prices look to be settling in the low $300s after Belarusian Potash signed a contract with China to sell potash for $315 per ton
- Leaving the cartel doesn’t make sense for Uralkali since lower prices hurt them just as much as other potash producers

Why will this company be around over the long term?

- Phosphorous and potassium are necessary for the growth of all living things
- They can’t be made and there is no substitute
- They are essential for farming
- People have to eat in order to live
- Strong economic moat due to: scarce location of agricultural inputs, low cost producer, and barriers to entry
- Strong balance sheet to survive recessions
- Positive net income during the last two recessions

Management - CEO

Source: Potash Website

51 years old

Jochen Tilk has been the president and chief executive officer since July 1, 2014

Former CEO, Bill Doyle, will remain with Potash for 15 months after Jochen took over to provide guidance with the transition

Holds a Master's degree in engineering from the University of Aachen in Germany

He was previously the president, chief executive officer and member of the board of directors of Inmet Mining Corporation

Has 30 years of experience in the mining industry

Is currently Chairman of Canpotex Ltd.

Shareholder Oriented Management

- "We took steps to further enhance shareholder value by completing the share repurchase program initiated in 2013. In 2014, we bought back 29 million shares at an average price of $35 per share with the entire program reducing our outstanding share count by approximately 5 percent. We also returned approximately $1.1 billion to investors through quarterly dividends, an important element of our capital allocation strategy."

- - Jochen Tilk, 2014 letter to shareholders, committed to increasing shareholder value as new CEO.

Experienced Executive Officers

Our Executive Officers

The name, age, period of service with the Company and position held for each of our executive officers as at February 20, 2015 is as follows:

Name	Age	Served Since	Current Position Held
Jochen E. Tilk	51	2014	President and Chief Executive Officer
Wayne R. Brownlee	62	1988	Executive Vice President, Treasurer and Chief Financial Officer
G. David Delaney	54	1983	Executive Vice President and Chief Operating Officer
Stephen F. Dowdle	64	1999	President, PCS Sales
Joseph A. Podwika	52	1997	Senior Vice President, General Counsel and Secretary
Darryl S. Stann	47	2003	Senior Vice President, Finance & Chief Risk Officer
Mark F. Fracchia	60	1984	President, PCS Potash
Raef M. Sully	48	2012	President, PCS Nitrogen
Paul E. Dekok	57	1992	President, PCS Phosphate
Denis A. Sirois	59	1978	Vice President and Corporate Controller
Denita C. Stann	46	2006	Vice President, Investor and Public Relations
Lee M. Knafelc	47	1998	Vice President, Human Resources and Administration
William L. Flahr	58	1995	Vice President, Internal Audit
Rob D. Bubnick	54	1998	Vice President, Safety, Health & Environment

Source: 2014 10K

Service for Executive Officers is an average of almost 19 years

6 out of 14 Executive Officers have more than 20 years of service

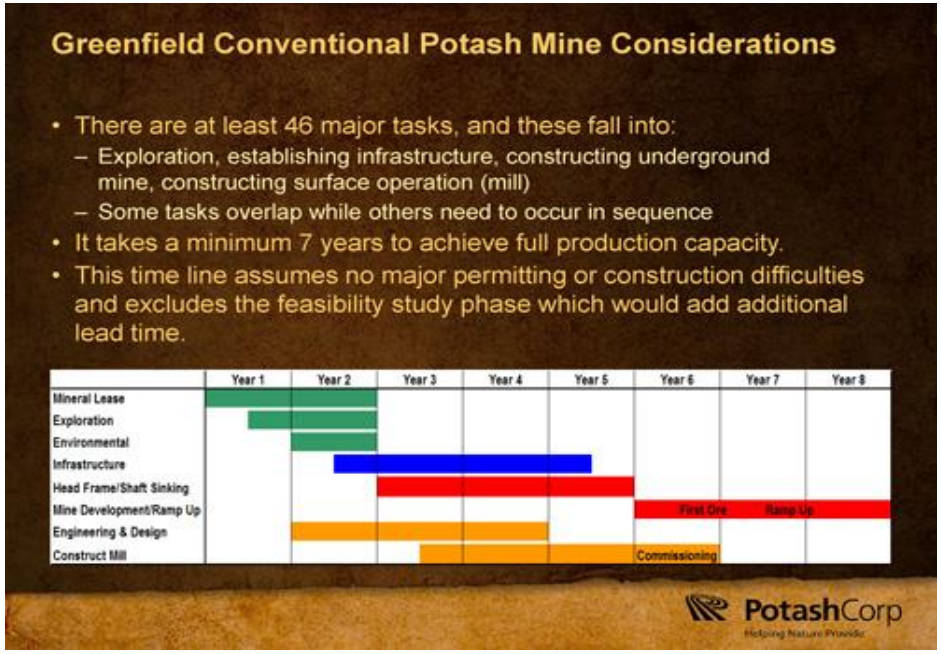
Economic Moat – Low cost producer

- Potash has the highest gross, operating, and net income margin compared to its peers

3 year averages in millions	Potash	Mosaic	Agrium	Intrepid Potash
Sales	$ 7,449.00	$10,046.00	$16,151.67	$ 399.00
COGS	$ 4,500.00	$ 7,455.33	$12,212.00	$ 302.33
Gross Margin	40%	26%	24%	24%
Operating Expenses	$ 288.00	$ 546.67	$ 2,307.67	$ 32.67
Operating Margin	36%	20%	10%	16%
Income Before Taxes	$ 2,513.67	$ 2,020.33	$ 1,531.67	$ 62.00
Income Before Taxes Margin	34%	20%	9%	16%
Net Income	$ 1,800.00	$ 1,617.67	$ 1,090.00	$ 39.67
NI Margin	24%	16%	7%	10%

Economic Moat – High entry barriers

- Can cost over CN $4 billion for a greenfield potash mine, excluding infrastructure
- Lead time of 7+ years for new potash mine
- Permits are required
- According to the CEO of BHP Billiton, Andrew Mackenzie, no major new mines have begun production since the 1970s



Source: June 22, 2010 Potash Capacity Development Presentation

Economic Moat – Scarce locations

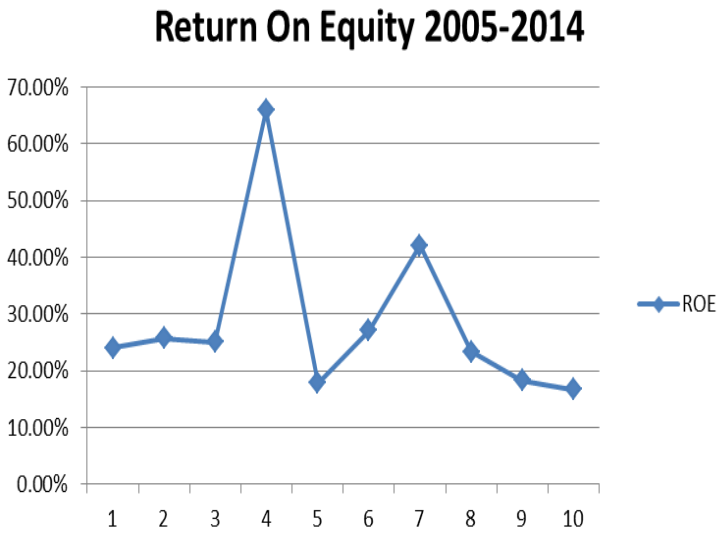
- 80%+ of potash reserves are in Russia, Canada, and Belarus
- Canada is a more politically stabilized country than Russia and Belarus
- 90% of phosphate reserve are located in: Morocco, China, South Africa, Jordan, and the U.S.
- Morocco controls up to around 85% of the total

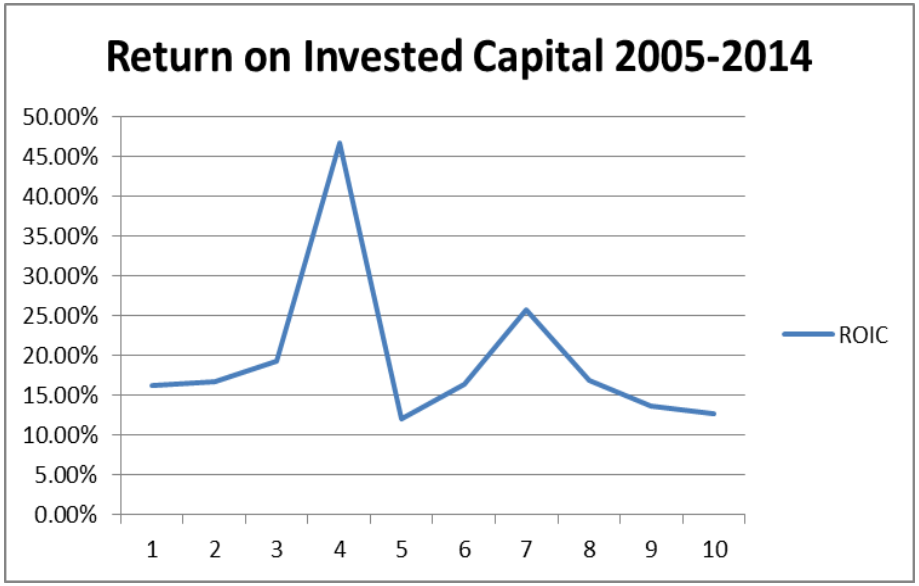
High ROE and ROIC

- Potash's economic advantage shows up in its high returns on equity and invested capital

Year	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
ROE	24.03%	25.72%	25.08%	65.90%	17.81%	27.15%	42.06%	23.41%	18.27%	16.68%

Year	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
ROIC	16.18%	16.79%	19.35%	46.77%	12.11%	16.44%	25.83%	16.89%	13.71%	12.67%





Growing Net Income

- Net income has grown from $543 million to $1,536 million over the last 10 years.
- Annual growth rate of 11%
- Net income was positive during the great recession

In millions	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Net income	$543.00	$632.00	$1,104.00	$3,495.00	$988.00	$1,806.00	$3,081.00	$2,079.00	$1,785.00	$1,536.00

Growing Free Cash Flow

- Free Cash flow has grown from $482 million in 2005 to $1,454 million in 2014
- An annual growth rate of 11.6%
- 9 out of 10 years of positive free cash flow

	2014	2013	2012	2011	2010	2009	2008	2007	2006	2005
Net cash provided by operating activities	$2,614.00	$3,212.00	$3,225.00	$3,485.00	$2,999.00	$924.00	$3,013.00	$1,689.00	$697.00	$865.00
Capital expenditure	$(1,160.00)	$(1,624.00)	$(2,204.00)	$(2,248.00)	$(2,019.00)	$(1,818.00)	$(1,245.00)	$(607.00)	$(509.00)	$(383.00)
Free cash flow	$1,454.00	$1,588.00	$1,021.00	$1,237.00	$980.00	$(894.00)	$1,768.00	$1,082.00	$188.00	$482.00

Strong Balance Sheet

- Total debt to equity ratio of 48% in 2014
- Retained earnings have increased from $717 million to $6,423 million over the last 10 years
- Average 5 year interest coverage ratio of 19
- Despite a downward trend, Potash Corp. still covers interest payment over 10 times
- Average 10 year debt to equity ratio is 57%

	2014	2013	2012	2011	2010	2009	2008
Interest Coverage Ratio	11.26	18.17	14.97	27.08	23.93	9.15	57.8

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Short-term debt	$ 253.00	$ 558.00	$ 90.00	$ 1,432.00	$ 729.00	$ 1,871.00	$ 832.00	$ 615.00	$ 967.00	$ 1,032.00
Long-term debt	$ 1,258.00	$ 1,357.00	$ 1,339.00	$ 1,740.00	$ 3,319.00	$ 3,707.00	$ 3,705.00	$ 3,466.00	$ 2,970.00	$ 3,213.00
Total debt	$ 1,511.00	$ 1,915.00	$ 1,429.00	$ 3,172.00	$ 4,048.00	$ 5,578.00	$ 4,537.00	$ 4,081.00	$ 3,937.00	$ 4,245.00
Total stockholders' equity	$ 2,132.00	$ 2,780.00	$ 6,019.00	$ 4,589.00	$ 6,501.00	$ 6,804.00	$ 7,847.00	$ 9,912.00	$ 9,628.00	$ 8,792.00
Total debt to equity	71%	69%	24%	69%	62%	82%	58%	41%	41%	48%
								10 year average: 57%		

Valuation

- “Many people will be surprised to learn that the discount rate that Buffet uses is simply the rate of the long term U.S. government bond, nothing else…he does not add a risk premium to his formula for the simple reason that he avoids risk.”

- “Instead of cash flows, Buffett prefers to use what he calls ‘owner earnings’ – a company’s net income plus depreciation, depletion, and amortization, less the amount of capital expenditures and any additional working capital that might be needed.”

- - Robert G. Hagstrom, The Warren Buffett Way

Valuation – FCF Model

- 10 year U.S. government bond: 1.84%
- TTM Free Cash Flow: $1.454 billion
- Growth rate: 4% (2015 IMF estimate for global growth)
- Terminal Value Multiple: 15 (Assumed multiple for a company with growing and consistently positive FCF)

Valuation – FCF Model

TTM FCF	$1,454.00
10 yr bond rate	1.84%
Growth rate	4.00%

Year	0	1	2	3	4	5	TV
Free Cash Flow	$1,454.00	$1,512.16	$1,572.65	$1,635.55	$1,700.97	$1,769.01	$1,801.56
Discount Rate		0.98	0.96	0.95	0.93	0.91	
Discounted FCF		**$1,484.84**	**$1,516.33**	**$1,548.49**	**$1,581.34**	**$1,614.88**	

Sum of Discounted FCF	**$7,745.88**	
FCF in TV year	$1,801.56	Growth decreases to 10 yr bond rate
Multiple	15.00	
Terminal value	$27,023.45	
Discount	0.91	
Discounted Terminal Value	**$24,668.84**	
Discounted TV plus Sum of Discounted FCFs	**$32,414.72**	
Shares Outstanding (million)	831.3	
Price per share	**$38.99**	

- Free cash flow and terminal values are in millions
- Price per share is $32.70
- Margin of safety is 19%

Valuation - Multiples

- TTM pre tax income multiple:
  $27.2B/$2.164B = 12.6 times **close to Buffett's preference of 10x TTM pre tax income**

- 5 year average pre tax income multiple:
  $27.2B/$1.256B = 21.65 times

- TTM free cash flow:
  $27.2B/$1.454B = 18.7 times

- 5 year average free cash flow multiple:
  $27.2/$2,827B = 9.62 times

Valuation – Dividend Discount Model

Source: Seeking Alpha

- TTM dividend: $1.40
- Constant growth rate: 5%
- Required return: 10%
- Price support: **$29.40 = $1.40 x (1.05)**
  .10-.05
- TTM dividend yield: 4.28%
- High dividend yield has created a strong support level for this company at $28 a share
- If the dividend holds, and earnings don't contract too steeply, the $28 support level over the last 5 years should hold also

	2015 (est.)	2014	2013	2012	2011	2010
EPS	$2.06	$1.83	$2.06	$2.42	$3.60	$2.04
Dividend	$1.52	$1.40	$1.19	$0.56	$0.24	$0.13
Payout Ratio	74%	77%	58%	23%	7%	7%

Dividend Coverage

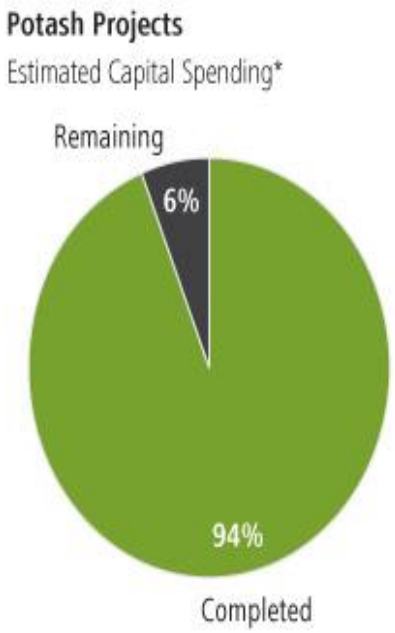
- Dividend has remained steady despite rumors of Potash cutting it
- Just announced an increase to 38 cents a quarter from 35 cents
- Free cash flow has covered the dividend every year except 2009

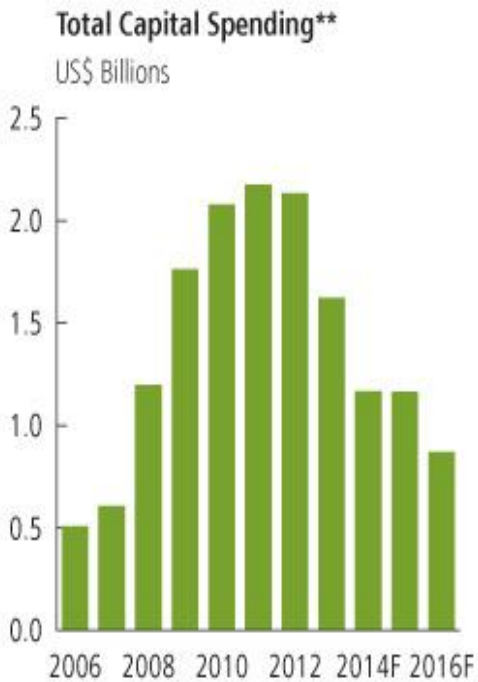
	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Operating cash flow	$865.00	$697.00	$1,689.00	$3,013.00	$924.00	$2,999.00	$3,485.00	$3,225.00	$3,212.00	$2,614.00
Capital expenditure	$(383.00)	$(509.00)	$(607.00)	$(1,245.00)	$(1,818.00)	$(2,019.00)	$(2,248.00)	$(2,204.00)	$(1,624.00)	$(1,160.00)
Free cash flow	$482.00	$188.00	$1,082.00	$1,768.00	$(894.00)	$980.00	$1,237.00	$1,021.00	$1,588.00	$1,454.00
Dividend paid	$(65.00)	$(61.00)	$(94.00)	$(123.00)	$(117.00)	$(119.00)	$(208.00)	$(467.00)	$(997.00)	$(1,141.00)
Difference of FCF & Dividend paid	$417.00	$127.00	$988.00	$1,645.00	$(1,011.00)	$861.00	$1,029.00	$554.00	$591.00	$313.00

Dividend Coverage

- Capital expenditures are estimated to decrease, which will likely result in higher free cash flow

Source: Potash Corp





*As at June 30, 2014. Includes both debottleneck and expansion spending.

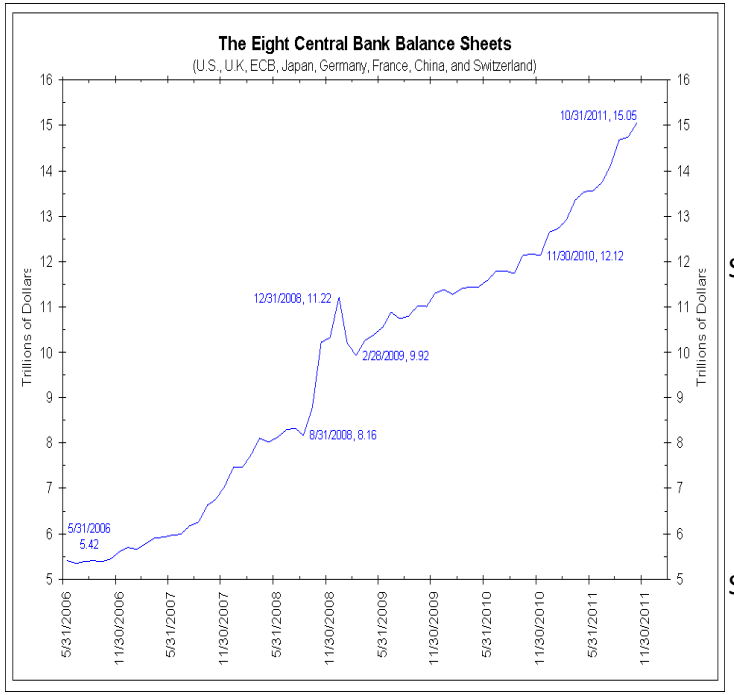
**Cash additions to plant and equipment per cash flow statement (2006-2013)

Possible Catalysts

- Increase in the money supply leads to inflation for fertilizer
- Uralkali rejoins BPC
- Price of potash revert towards the 10 year high

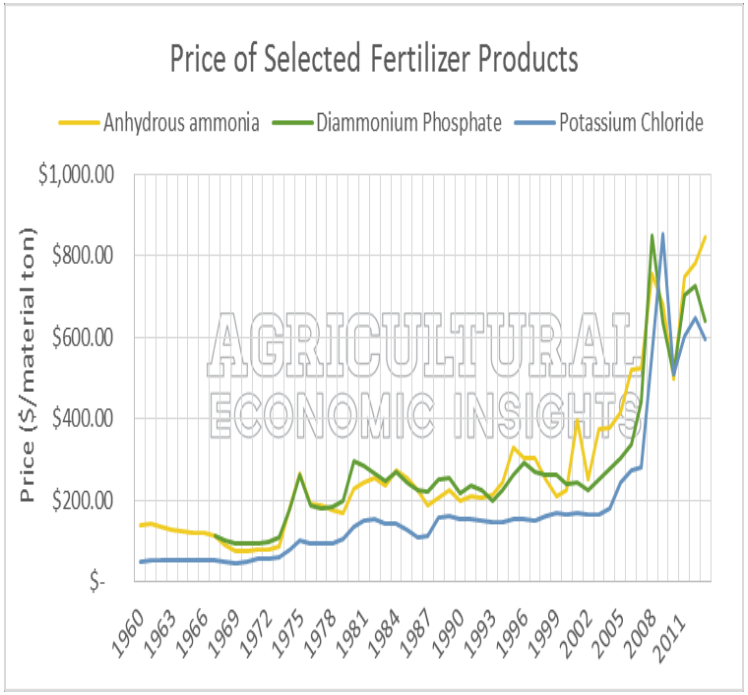
Catalysts – Increase in the money supply leads to inflation for fertilizer

- Balance sheets of U.S, U.K, ECB, Japan, Germany, France, China and Switzerland expanded from a total of $5.42 trillion in 2006 to $15.05 trillion in October 2011
- A large increase in the supply of money and low interest rates can lead to rises in fertilizer prices, similar to the periods of the 2000s and early 1970s



Source: Agricultural Economic Insights →

Source: Ritholz ←



Catalysts –Uralkali rejoins BPC

- Uralkali rejoins BPC and prices revert back to the pre break-up level of $400 per tonne
- The CEO of Uralkali, Vladislav Baumgertner, was arrested less than a month after leaving the company's partnership with BPC
- The arrest resulted in new management
- Although this was over a year ago, new management has a higher likelihood of rejoining BPC than the previous one

Catalysts – Mean reversion

- Potash prices are selling at the low end over the last 10 years
- Despite being volatile, a 10 year chart does imply that potash prices have upside

Risks

- Jensen project by BHP Billiton
- Recession
- Russia’s Uralkali doesn’t rejoin BPC cartel
- Lower potash prices
- Dividend is cut which lowers the support level

Risks - BHP Billiton's Jansen Project

- BHP Billiton announced they will develop a potash mine after their $38.6 billion bid for Potash Corp. was turned down by the Canadian government
- The Jansen project is projected by BHP Billiton to be the largest potash mine in Saskatchewan, Canada
- BHP already allocated over $3 billion to bring the project to the feasibility stage
- The project can bring an additional 8 million tonnes per year of potash
- The Jansen project would be a negative sign for Potash, but BHP will still need at least another 3-4 years before the mine starts operating
- They will also need to spend billions of dollars more in capital expenditures

Risks - Recession

- Recession within the next 3-5 years is likely
- This will likely lead to lower prices for fertilizer and a lower stock price
- Fertilizer is likely to remain in high demand over a 10 year period, despite short term fluctuations

- **"People have this misconception that—when we buy a stock—we want it to go up. That's the last thing we want it to do."**

- Warren Buffett on CNBC, March 2, 2015

Risks – Uralkali doesn't rejoin BPC

- Uralkali predicted that the price of potash would fall 25% after they left BPC
- Potash prices have followed this prediction after falling from $400 to $300 per tonne
- Uralkali's "volume over price" strategy will likely keep potash prices from increasing back to $400 per tonne
- This can also have a positive impact on Potash Corp. since it will deter new entrants from trying to enter the industry

Risks – Lower potash prices

- Despite negative outlook for potash prices, they look to be stabilizing in the low $300's

Canpotex
Growing Relationships. Since 1972.

Fertilizer Press Announcement March 30, 2015

Canpotex Reaches Agreement with Chinese Customers

Canpotex has finalized potash supply contracts for 2015 with all of its major customers in China, including Sinofert (Sinochem Fertilizer Macao Commercial Offshore Ltd.). Pricing was confirmed with its customers at current competitive levels.

Canpotex expects its 2015 shipments to China will reach a minimum of approximately 1.8 million tonnes, surpassing the 1.6 million tonnes shipped in 2014. Under the parameters of its existing Memorandums of Understanding (MOUs), shipment volumes could increase to a maximum of approximately 2.5 million tonnes, depending on market demand, supply availability and logistics.

"We are encouraged by the strength we are seeing in Chinese potash demand," said Steve Dechka, Canpotex's President and Chief Executive Officer. "We believe these settlements help position our key customers in this region for continued growth and highlight Canpotex's increasingly important role in supporting China's rising potash needs."

- Belarusian Potash said in early March that it signed contracts with China for $315/ton including shipping costs
- Canpotex released a statement that said prices for potash supply contracts were at "current competitive levels" and supply would improve from last year
- Lower potash prices can shake out high cost producers allowing Potash Corp. to survive and take market share as the low cost producer

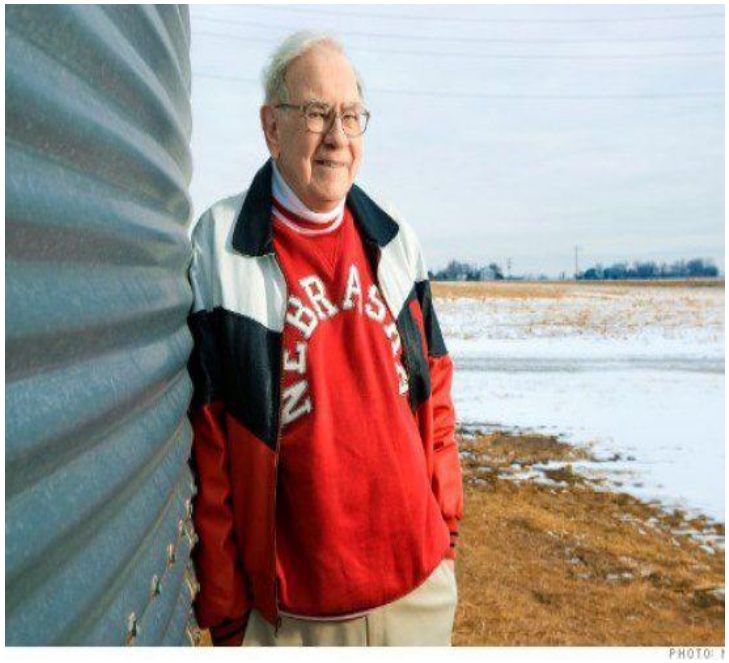
Source: Mosaic Company Investors Website

Risks - Dividend is cut

- Dividend has increased from 7 cents a share in 2006 to $1.40 in 2014
- Payout ratio has increased from 7% in 2010 to 74% in 2014
- A cut to the dividend will likely result in a drop in share price
- Despite the high payout ratio, management remains confident after recently increasing the dividend to 38 cents a quarter, or an estimated $1.52 per year

Conclusion – Buffett's next passive investment

- Population growth and a growing middle class will lead to more demand for fertilizer
- Buffett currently owns farm land, and despite admitting he knows nothing about operating a farm, he's made investments based on the long term fundamentals of crop demand in the past
- Potash has the biggest moat in the industry
- Shareholder friendly management
- A 19% margin of safety and close to Buffett's preferred 10x pre tax income multiple



"In 1986, I purchased a 400-acre farm, located 50 miles north of Omaha, from the FDIC. It cost me $280,000, considerably less than what a failed bank had lent against the farm a few years earlier. I knew nothing about operating a farm. But I have a son who loves farming, and I learned from him both how many bushels of corn and soybeans the farm would produce and what the operating expenses would be. From these estimates, I calculated the normalized return from the farm to then be about 10 %. I also thought it was likely that productivity would improve over time and that crop prices would move higher as well. Both expectation proved out."

- Warren Buffett, 2014 annual letter

Source: Fortune