Cartel ‘games’ keep Potash Prices undervalued while Demand grows

Potash and Phosphate Month-in-Review: The ProEdgeWire potash index dropped an average 15.44% over the month of April 2013.

Allana Potash (TSXV: AAA | OTCQX: ALLRF) dropped 9.57% in Toronto and 10.70% at the OTCQX for the month; however, it was starting to rise last week thanks to a boost from a better than expected Potash Corp Q1 results. Allana Potash has been proceeding toward production having filed the final mining application and feasibility with the Ministry of Mines for its Dallol potash project. Allana expects to complete all regulatory requirements before the end of 2013 and is estimates that it will be able to start producing by 2015 at below USD$ 100/ton.

IC Potash (TSX: ICP | OTCQX: ICPTF), which is developing the Ochoa Project in New Mexico also saw its shares rise on the Potash Corp tide, but closed the month at -21.74% in Toronto and 20.95% at the OTCQX confirming the trend – which has little to do with actual demand. IC Potash is competing in a different space, as it is focusing on premium quality sulphate of potash (SOP) at its Ochoa facility, which is usually priced anywhere between 30-50% higher than lesser varieties of SOP. The total proven and estimated capacity at Ochoa is 400 million tons with production expected to start in 2015.

Potash Minerals (‘Potmin’, ASX: POK) is the big winner and the only gainer, rising 1.79%. That is rather a small rise, considering that in April – albeit at the very end – Potmin announced that the Federal Bureau of Land Management (BLM) approved its potash project in Utah at Hatch Point in what is a milestone, perhaps the most important since launching the K2O project. The permit is especially significant considering that it is the first one to be awarded in Utah in the past 25 years, receiving the designation of “Non-Known Potash Leasing Area” (Non-KPLA). Potmin will now be able to continue exploration in some of the areas considered to hold the best resource. Potmin also expects to be able to produce at very low cost. Potmin has already identified the crucial water source, which is at the heart of the solution mining technique; the fact that it is non-potable water, from an on-site source, should also ease environmental and community concerns. Potmin has a unique combination of a massive potash resource coupled with onsite water, gas, electric and transportation to nearby U.S. markets.

The BLM action from Potmin will surely transfer to Magna Resources (CNSX: MNA), which closed April flat at 0.0% difference. Magna Resources, operating the 51,000 acre Green River Potash Project in Paradox Basin, Utah said that it expects to obtain a decision from the BLM by next summer, concerning its request to drill eight holes, having already secured State approval.

Aguia Resources (ASX: AGR) is more engaged in the phosphate space and it announced having received approval to develop two additional phosphate tenements in Rio Grande do Sul, enabling it to expand its resource at the Tres Estradas Project. Brazil is the world’s third largest market for mineral fertilizer and demand is slated to increase. Brazil imports about half of its phosphate needs and the Aguia is strategically placed to take advantage of Brazil’s plans to reduce its reliance on phosphate imports. While Aguia closed the month at -36.67%, it should be noted that phosphate demand is increasing. Israel Chemicals, one of the world’s main phosphate players, recently announced that it has launched a major campaign to identify new phosphate sources worldwide.

Where is the pressure on potash valuations coming from?

While the drop in valuations is based only on the performance of ProEdgeWire sponsors, it reflects the wider and rather counter-intuitive trend in the potash sector. Simply stated potash prices are undervalued. At the end of last March, none other than Goldman Sachs (GS) itself, set buy ratings for Potash Corp (NYSE: POT) and Mosaic Inc (NYSE: MOS). The famous investment bank that has been extremely bearish on gold, frantically calling on gold holders to sell, has also given its blessing to BHP Billiton's plan to build the Jansen mine, which would end up being the world's largest potash project, in Saskatchewan. GS has gone further identifying potash as "the commodity for the next decade" for the same reasons that just about all common sense endowed observers have been reiterating, which is that pressure from growing food demand in the fast growing and developing countries in Asia, South America and Africa, where agriculture has suffered from nutrient deficient soils, will boost potash demand over the next decades.

GS is not even concerned that BHP's proposed potash mine (still being evaluated by the BHP Board) might saturate the market depressing prices, because it sees potash as the new 'iron ore' – which rose 912% in the span of ten years from March 2003 to March 2013. While there is more than adequate potash supply now, more demand is expected later this spring as farmers in North America will start what is a late planting season due to an especially cool start to the spring. Moreover, for all the new mega-projects being planned, there has been an all but deliberate effort by the two potash cartels, CANPOTEX in North America and BPC in Russia and Belarus, to corner the market, raising the barriers to entry for any would be competitor. Rather than slowing down their production, the cartels were willing to accept lower pricing, giving into demands from Chinese and Indian buyers.

The new ceiling price is USD$ 400/ton – still much higher than the average potash price before the 2008 leap – but potash investors had become accustomed to averages of well over USD 500/ton in the past four years, creating a psychological barrier-psychological, because even at USD 400/ton, the margins are very much in favor of the producers. BPC was the first to accept a lower 'bottom' price and CANPOTEX followed suit. Now both consortia will be focusing on capacity utilization rates, even at the cost of lower prices (no pun intended). Indeed, they can afford it, because they produce at very low cost. So, what is their strategy? By keeping overall prices lower, the two potash cartels expect to discourage large new players from coming on stream. They are sending a not so kind message to BHP Billiton and Vale SA on one hand and to the medium players such as K+S Group on the other (which incidentally also plans to build a new mine in Saskatchewan).

This has the effect of forcing the big mining giants into a Hamlet-like spiral of second guessing their big potash plans. Vale SA already confirmed they will abandon their big Rio Horizonte potash project in Argentina last week, while BHP's board is still pondering whether or not to approve the Jansen mine. The effect on juniors has been to make financing very difficult, delaying projects and complicating feasibility studies and the various stages needed to bring potash to production; and potash is well known for having one of the highest entry costs. The effect of all this 'scheming' is that greenfield projects will be kept to a minimum, putting pressure on juniors. Against this backdrop then, the few juniors still developing their projects have to been given credit for continuing to survive in spite of the difficulties. Those that make it to production will gain access to all the advantages currently held by the cartels, if they can get there by keeping their operational and CAPEX costs low. The market has not caught up with this reasoning but should start rewarding the juniors as well this year. Import demand is expected to rise in India and the ceiling price of USD $400/ton should rise accordingly.