InvestorIntel decrypts the market trend of some key commodities: agbusiness, uranium and gold

Agbusiness:

It is not only the growing world population’s hunger that is driving the prices of wheat, corn, soybeans and other agricultural products and the OECD expects for years with rising agricultural prices. The main role affecting prices is played by soy, sugar, corn and wheat. Modern food production would not be sustainable without the use of mineral derived fertilizers from potash to phosphate, given the quantities that are needed. Potash helps the soil retain water, while making crops more flavorful and resistant to disease. It is estimated that more than a third of the world’s current food production would not be possible; as the world population expands, therefore, potash will become even more important in order to match food production with demand. Economic growth in China and India and a resulting change in the diet toward more meat (meaning more animal feed) and carbohydrates have led to a sharp increase in potash. The fertilizer producer K+S is recovering from the slump in the market in 2013 faster than expected.

Potash prices have recovered faster than the most optimistic expectations (and InvestorIntel was decidedly in the bullish camp). PotashCorp, (NYSE: POT) one of the world’s largest potash producers expects worldwide demand for the mineral to remain at least as high in 2015 as in the previous years, while K+S (DE: SDF) in Germany, which almost collapsed in the wake of shockwaves of Russia’s Uralkali’s pullout from the BPC consortium with Belarusian state concern Belaruskaly in July

2013, has announced a 16% increase in operating profit last week with shares rising over 6% in Frankfurt trading. Farmers' demand for potash is strong.

Agricultural commodities include a wide variety of inter-related products ranging from the food we eat to the products needed to facilitate their production from fertilizers such as potash, nitrogen and phosphate and even land. Indeed, the growing global contest between urban sprawl and agricultural land risks lowering rather than raising living standards for different populations, causing damage to habitats and entire ecosystems. Yet, the world's population continues to grow and land productivity has become a crucial issue, given the ever increasing demand for food. Changing dietary habits in developing countries, where people are consuming more meat, and the rising popularity of bio-fuels and distribution of biofuels require more land devoted to agriculture and far greater efficiency to maximize yields and the quality of harvests. Biofuel production has started to impinge on the production of food for the poor: 40% of the corn produced in the US, 50% of the sugar beet grown in Brazil and 80% of the sunflower produced in Europe are used by the biofuels sector.

Food security is the key to our future. In 2050, there will be nine billion people inhabiting the earth and the problem of how to ensure safe and healthy food to a growing world population is one of the greatest challenges for the coming years. While this problem has generated a worldwide debate over the search for solutions from how to deal with basic food needs, fighting hunger even as the public and private sectors must to work in harmony to ensure better economic, social and environmental agricultural development models, there are tremendous opportunities. Agricultural products have become ever more expensive and there are excellent opportunities for investors. Milk is more expensive – now everyone knows how much agricultural commodities are on the rise.

Uranium & Nuclear Energy

Japan’s decision to restart two nuclear reactors has woken up uranium prices from their slumber. On November 6, uranium enjoyed a 4.5% increase in spot prices, the largest daily increase since the Fukushima disaster of 2011, which had condemned all Japanese plants to be shut down, adding a setback to the global nuclear industry. Kagoshima Prefecture signaled a green light to restart two reactors at Sendai while Russia has agreed to build two new reactors in Bushehr, Iran. And Australia is preparing to sell nuclear fuel to India. For several days, sales of uranium concentrate have increased on the spot market and there has been a rush to buy, especially in the USA, fueled by an effort to avoid delays in resupply lest prices rise further. Fears of a global uranium surplus have proven premature and the price per pound of uranium concentrate is not likely to relapse. It is now worth USD$ 39, 50% more than before the summer on the spot market, USD$ 45 on the market long term. Uranium mining companies have benefited from the spot price increases from Canada to Australia and even in France where Areva stock has also improved after a reporting season of problems driven by bad results this year. Uranium producers decreased their production by 11% while there has been a lower availability of recycled uranium fuel supply.

Gold, Base & Precious Metals

Global consumption of gold has declined slightly in the third quarter 2014, with a decline of 2%, which nevertheless masks regional disparities, according to the recently issue of the World Gold Council (WGC) quarterly report. Notably, while demand has dropped in China – many believe that personal purchases of gold ingots and jewelry has sharply declined due to the zeal of fiscal authorities controlling illicit earnings and corruption – it has increased in India. Together, India and China are the major gold consumers in the world. India’s demand increase is the product of a strong appetite for jewelry (+ 60%) despite of the introduction of restrictive measures on the import of gold in the country. There is also an optimism in India that has been missing from the main economic outlook of the past few years; in India, people think that economic growth will improve, which has encouraged to spend a little more."

Chinese demand is a still acceptable and it remains key pillar of global demand for gold, and it seems that India and China switch their position as world's largest gold consumers from time to time. It was in 2014 that China became the world's largest consumer of gold from, overtaking India only to relinquish the rank now. Central banks, for their part remained net buyers of gold for the 15th consecutive quarter. Russia has continued to boost its reserves during the last quarter by 55 tons, reaching a total of close to 1,150 tons at the end of September. Moreover, there are signs of a bullish – or at least a least bearish one – inversion of the recent down trend for gold and even silver. Last Friday both precious metals proved to be resilient in the face of another increase in the US Dollar, suggesting a longer term rebound, which could see gold quickly resuming a price in the order of USD$ 1,200/oz. or higher as early as this week.

Potash is the new safe haven sector to hedge against market volatility

Panic descended on the markets last week. The selloff on Wall Street and other major exchanges was not especially dramatic, but it was sustained as investors reacted – with just a little panic – to signs of a global economic slowdown, possible policy changes at the Fed (i.e. higher interest rates) and a high US Dollar. The lower growth expectations and lackluster US employment statistics suggest that the Fed will not be especially eager to raise interest rates just yet. Nevertheless, the markets will be marked by more turbulence this fall and mining companies and commodity prices will be among those most subjected to its whims. While investors will be struggling to predict and make sense of the markets, there are opportunities in precious metals, which have fallen to yearly lows; uranium had also started to attract some interest in August. Then, there are fertilizers, agricultural sector stocks and potash in particular. These are looking rather good – especially in the mid and long terms.

There is the sensation that fertilizer – potash, phosphate, nitrogen – stocks are 'overweight' and that there is a potash glut. Grain prices have dropped, suggesting that investors will react in a bearish manner, as if guided by 'Pavlovian' conditioning. Nevertheless, fertilizer prices, and potash ones in particular, should hold, since consumption is high and the industry has had plenty of time to absorb and expect the lower grain prices – a trend that may last into the next year. Indeed, the sustained low crop prices may be close to reaching the bottom and any increase will meet a corresponding increase in fertilizer prices. The price of corn is especially low (USD$ 3.50 a bushel – it has been as high as USD$ 8 according to RBC). Any lower and it will cost more to produce than to sell. The 'natural' forces of supply and demand will unleash their magic and restore a modicum of balance, pushing crop prices higher. There is also the issue of global fertilizer demand continuing to increase. For the past decade the big drivers of potash prices have been China and India. The annual contract negotiations between the potash majors through CANPOTEX and the Russian giant Uralkali over the price for a ton of potash (now at about USD$ 310/ton) set the tone for the rest of the year.

This year, the crops were said to be abundant but low quality, which may determine higher demand for potash, which helps to improve soil and crop quality. PotashCorp advised that it predicts record high potash shipments and suggests this trend will continue into 2015. PotashCorp said that China continue to be a strong buyer as its farmers have set new consumption records, encouraged by the lower prices, setting the best market conditions in a decade. Farmers in North America are no different; they too appreciate a bargain and the lower prices have made potash more popular. The switch to 'volume' sales model adopted by Uralkali may have some sense now. The lower prices have made it easier for potash to be used by a far wider number of farmers, many of whom, will have become convinced of its necessity in the future, boosting demand. The fact that agricultural scientists have observed "an increasing nutrient deficiency and declining soil test levels in North America" can only be good news for potash miners.

Predictions of a sustained volume based potash market were strengthened by the fact that Uralkali no interest in restoring the price-cartel. Demand has simply defied and exceeded expectations. In 2013, Uralkali's decision to break the Belarusian Potash Co sales organization (BPC), de facto ended an informal, global price fixing cartel through which it and CANPOTEX, in North America, controlled two-thirds of the world's potash market. At the time of the BPC collapse, there were dire predictions about the potash market, yet potash prices have not dropped nearly as dramatically, as some analysts had predicted at the time (InvestorIntel was far more optimistic). The analysts failed to predict improved demand from Brazil and China as expected. They also failed to consider the global hunger for higher crop yields, which has kept the potash price above USD$ 300 per ton. In fact, Brazil, which requires potash for its sugar cane fields agreed recently to a price of USD$ 380/ton with Uralkali. Uralkali has also gained market share in the BRICS (Brazil, Russia, India, China and South Africa) thanks to their response against sanctions adopted by the NATO bloc against Russia in the wake of the crisis in Ukraine.

Demographic development in the long term speaks for the potash sector. Demographic development (according to United Nations estimates, the world's population will grow from 7 billion to almost 10 billion in 2050) coupled with efforts to operate more and more successful land management, mean that the long-term prospects for potash remains excellent.

The African continent presents tremendous market potential for mineral fertilizers and potash in particular. Africa is surely one the most important markets for mineral fertilizers, having the potential to increase the value of its annual agricultural output of $ 280 billion in 2010 to $ 500 billion by 2020 according to the African Development Bank (ADB). Moreover, Africa has the potential to attract 880 billion dollars of investment in agriculture by 2030, which will drive demand for products such as fertilizers, seeds, pesticides and machinery as Africa develops its own production of biofuel, grain refinement and food. Africa still has considerable untapped value in its agricultural industry and it needs regulatory improvements to facilitate more investment, encouraging market-oriented rural employment, technology transfers (of which potash use is a part) and provide the sound basis for sustainability and long-term transformation. The prospects for agricultural growth in Africa are excellent, especially if small farmers are helped to specialize and add value.

Higher Uralkali sales and

global trend suggest higher potash prices for 2015

Russian fertilizer giant Uralkali, a year after shaking the potash market by terminating its strategic pricing alliance (BPC) with the Belarusian potash concern Belaruskali announced that it expects better results for the final quarter of 2014. Global potash sales have reached record levels. This an important indicator for the potash market in general because Uralkali is the world's largest producer of potash. Its profits were down year to year, but they beat analysts' expectations. Significantly, Uralkali has seen a reversal of last year's trend, as revenue grew 7% to $ 1.7 billion, supported by a 42% surge in sales of potash volumes to 6.1 million tons; profits were lower because of a 30% export price drop. This suggests that the potash market is seeing signs of recovery both in terms of volumes and prices. The lower prices, meanwhile, are helping to spread potash use, widening the market and the basis of future demand. In July 2013, Uralkali adopted a new strategy of pushing production levels higher to bring down prices of potash and conquer new markets, sacrificing margins in the process. That decision led to a stock market collapse of major industry players, who were accustomed to controlling and adjusting production to support prices. Potash prices have since fallen sharply, but Uralkali suggests that its shift of strategy made it possible for demand to resume after hitting a 'dull' period in 2013. Uralkali noted that global potash consumption increased, potentially exceeding the record set in 2011 of 57 million tons.

This is good news for farmers. The potash cartel has weighed on agriculture. Potash is an important raw material for fertilizer, and thus determines the cost of crops. Competition in this market is highly regulated. Uralkali worked with

Belaruskali within a cartel like organization (BPC) representing 43% of the global market. While in Canada, CANPOTEX (Potash Corp, Mosaic and Agrium) controlled over 20% of potash demand. Together, BPC and CANPOTEX accounted for two thirds of the world potash market, helping to maintain high potash prices, which rose to USD$ 900/ton in 2009 – today they are hovering around USD$ 400. Uralkali preferred to leave the PCB agreed to sell larger quantities and take advantage of its favorable cost structure. Nevertheless, grain prices have declined significantly since the spring, and many producers prefer to wait rather than gamble as to whether or not sales will cover the costs of production.

Traditionally, the farming community works along the assumption that higher grain prices lead to higher fertilizer demand while the more they recede, the more fertilizer prices drop. However, the fertilizer market is more complex than it seems, and if grain prices have undoubtedly some influence on the fertilizer in fact fertilizer supply itself is controlled by many other factors that disrupt that linear relationship. Rebounds in the price of wheat have generally prompted a rebound in fertilizer prices but global factors have been weighing considerably. One of these is Chinese demand. This year, there is good news. Chinese demand is growing and that is having a decisive effect on fertilizer prices globally.

It is expected that China will pay the 2015 contract up to 10% more than last year to secure its supply of potash. Ukraine, a major player in the production of nitrogen fertilizer, will have difficulties producing, given the expected cuts in Russian gas supplies. Increasing tensions between Russia and the West will also raise potash prices. After Canada, Russia is the world’s largest producer of potash. The country also provides 7% and 8% of the supply of fertilizer phosphorus and nitrogen. There is even talk of a return of the BPC cartel between Uralkali and Belaruskali; talks are under way and it remains to be seen what will emerge in the coming months.

Brazil has been gradually increasing potash imports used especially to grow soybeans, used for food and fuel. Demand has increased steadily from 2012 to 2014 while areas used to plant soybeans are expected to grow 4%. Already, fertilizer orders for the first half of 2014 gained 7% over 2013, and a corresponding increase is expected in the second half of 2014. Finally, difficulties in transporting fertilizer in some areas due to the overload of rail and waterway networks have also exerted upward pressure on fertilizer prices.

New PotashCorp CEO shows confidence in 'price over volume' strategy

On July 1, Jochen Tilk formally replaced outgoing Bill Doyle as the CEO of PotashCorp. Doyle headed the Saskatchewan based PotashCorp for 15 years, adopting a rather bombastic style, which made potash a household word in North America. Doyle was also a proponent of the 'price over volume' market strategy that helped raise potash prices to unprecedented heights in 2008-2009, which have remained on the high side despite a notable drop from their USD 900/ton peak. This decision may soon prove its validity because there have been several indications that a re-establishment of the Russian/Belarusian potash pricing cartel BPC (Uralkali and Belaruskali) has turned from possible to probable.

It was just about a year ago that the BPC cartel burst, threatening the price-over-volume strategy it had pursued along with its North American equivalent, CANPOTEX (including PotashCorp, Agrium, Mosaic) changing the potash price mechanism. Not surprisingly, Uralkali, the World’s largest potash company, produced 3.1 million tons of potassium chloride in the second quarter of this year. This was a significant increase over the same period of 2013 with 2.4 million tons, potentially unsettling the market. However, while the BPC breakup was a dramatic development that forced the share prices of most potash companies down in 2013, the situation has calmed down since then. After an uncertain phase in the months leading up to the Chinese and Indian contracts being settled at above USD$ 305/ton, which showed that the potash markets had regained traction, given initial fears that potash would drop below USD$ 200/ton.

There are two main reasons that suggest a revival of BPC. The first is that PotashCorp’s new CEO, Tilk, has decided to uphold the strategy of adapting production to demand, which proved to be successful. This suggests that in the medium term – if not even the short term – Tilk expects Belaruskali and Uralkali to revive the BPC. Since last August, Uralkali as much volume as possible, sending prices into a tailspin. Until last July, BPC and the North American counterpart CANPOTEX controlled about 70 percent of the market and ensured that prices always remained at a high level. Nevertheless, last June, the Warburg Research moved the German K+S Potash, one of the companies that suffered the biggest market losses because of the BPC collapse, from ‘hold’ to ‘buy’. Apart from the fact that general agricultural conditions have favored higher potash prices in the past few months, there is more optimism that Uralkali and Belaruskali will resume their pricing mechanism.

This would certainly help potash prices move above USD$ 400 per ton, as they were in the weeks preceding BPC’s breakup. Moreover, reports that the Russian state-owned energy giant Rosneftegaz intended to take over Uralkali’s shares from the previous major shareholder, Suleiman Kerimov. The would-be offer would price Uralkali, the world’s largest potash producer, at USD$ 20 billion. The fact that Rosneftgaz, as Russian government controlled company, wanted to take over Kerimov's shares hints to the influence of Russian President Vladimir Putin, who has been seeking a fast solution in potash dispute between Russians and Belarusians. The replacement of Uralkali's main shareholder had raised hopes and expectations that Uralkali and Belkaruskali will resume talks to revive the BPC cartel. Uralkali's CEO, Vladislav Baumgartner, was arrested in Belarus last August 26, accused of embezzling funds from the BPC cartel. The Belarusian government stated, "Uralkali and Belaruskali could resume their alliance if Uralkali had new ownership". Last November, Uralkali's biggest shareholder, billionaire Suleiman Kerimov, sold a 21% stake in Uralkali to billionaire Mikhail Prokhorov as a first attempt to ease tensions with Belarus.

The outlook for potash prices has taken a 'cautiously' optimistic turn

Rio Tinto ('Rio', NYS: RIO) has decided to proceed with its plans to build a potash mine. The Australian Rio will work with its Canadian joint venture partner North Atlantic Potash company (an Acron Group subsidiary) to develop the Albany Project using solution mining. The Albany deposit is said to hold inferred resources of 1.4 billion tons at an average grade of 31% KCl with about 30% recoverability. Rio Tinto's entry into the North American potash industry has added more pressure on what seems to be an already oversupplied sector. In 2013, BHP Billiton (NYSE: BHP) decided to build what will be the world's largest potash mine; that project alone threatens to break the model preferred by CANPOTEX (the pricing consortium that includes PotashCorp, Agrium and Mosaic), which relies on regulating supply to sustain price rather than compete on the basis of lower prices.

The CANPOTEX companies may become victims of their own pricing mechanism, having shown the world just what kind of high margins are possible in the potash market. It should be no surprise that the world's mining giants have wanted to claim their own stake in the potash industry. Nevertheless, the added pressure and the dissolution of BPC, the Russian/Belarusian equivalent of CANPOTEX, have not done much harm to PotashCorp's stock price. Indeed, shares of PotashCorp (NYSE: POT) have rebounded to the high USD$ 30's and low 40's in June, which is exactly what they were on the day before Belaruskali and Uralkali ended the BPC pricing mechanism on July 30, 2013. Therefore, many potash investors might be, rightly, wondering how Rio Tinto's entry into the potash market will affect the potash sector.

Rio Tinto has entered the potash market but its total capacity is in the order of five or four times lower than BHP Billiton or PotashCorp itself. However, BHP (ASX, NYSE: BHP | LON: BLT) has shown signs that it is not yet fully committed to the massive CAD$ 12 billion Jansen potash mine because, even while this would make BHP one of the world's main potash producers, on June 25, it reportedly relinquished an exclusivity agreement with the Port of Vancouver claiming it is "evaluating alternative rail and port options in Canada and the US". In fact, BHP, as noted by CEO Andrew Mackenzie himself, is large enough a company that it can afford to keep potash as an 'option'. BHP's strategy is to make sure it has a foothold in the sector, having already invested about a billion dollars, even as it focuses on what it calls its four 'pillars': iron ore, copper, coal and petroleum.

Potash is a 'would-be' fifth pillar, a welcome option but not a priority. Mackenzie reiterated that BHP's motivations for entering the potash sector in the first place has not changed: “growth will be driven by a rising population in and greater economic prosperity, which will change the patterns of food consumption, requiring higher yields from increasingly constrained arable land”. In other words, BHP’s potash entry is a hedge strategy. However, BHP and Rio Tinto can afford to play this ‘game’ because they can still bank on potash’s large margins while compensating for any loss or lower prices while earning significant profits from their other commodities, which are also in high demand. Where PotashCorp and the other current big producers have some margin is not that BHP nor would Rio Tinto, even if they decided to commit fully to their potash properties, need a few years before reaching production stage, allowing the market to ignore the extra supply for some time.

The threat to prices, if any, is still emanating from Russia and Belarus, which maintain close ties to Chinese companies and which could be used as tools in the commodity wars – oil & gas – related to the standoff between the West and Russia. For the time being, the Russian Uralkali has decided to support higher prices by applying an 8% cut in production, which means that for the time being prices should not fall and may even rise. PotashCorp, for its part, has decided to continue production at its mine in New Brunswick, which had been slated to shut down. In this optimistic scenario, PotashCorp also noted that it made record shipments of potash – by tonnage – in the first half of 2014. Evidently, the lower prices for the natural fertilizer have helped to widen the customer base. More and more farmers around the world are demanding potash; therefore the increased capacity should easily find a market when it comes online. This is good news for all of the junior potash projects heading toward production stage such as Allana Potash with its Danakhil Project in Ethiopia (TSX: AAA | OTCQX: ALLRF) or IC Potash’s Ochoa Project (‘ICP’, TSX: ICP | OTCQX: ICPTF) in New Mexico. Yet, the various uncertainties about the new large projects will keep the longer term pricing focus on the timing and possible revisions of the giant mining firms and legacy potash plays.