



## Economics & Financial Markets

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#### **With Consolidation in the Industry will Mosaic (MOS) Benefit?**

Will Mosaic benefit from the Consolidation within the Fertilizer industry? Probably not directly but indirectly it indicates that the assets of Mosaic are likely to be highly undervalued in the intermediate period.

Today February 25, 2009 Agrium (AGU) offered to buy CF Industries (CF) for \$3.6 Billion to expand its fertilizer business. The offer was for \$76 per share in a stock and a cash deal which was 37% over the \$55.58 closing price on Tuesday. A month prior CF had made a hostile offer of \$2.1 Billion to purchase Terra Industries (TRA).

The entire fertilizer sector is down significantly from their mid year highs with many of the companies down over 75%, and trading with a PE of 5 down from a historical average of 12. We currently have a strong buy on The Mosaic Company (MOS) on a valuation basis and their ability to maintain pricing during this recession. In addition we expect that world demand will only increase in coming years as the recession abates, and there are limited suppliers of agricultural fertilizers.

Given this M&A activity during a period of time when there is limited M&A in other sectors, indicates not only that the companies have stored cash balances, but there is a clear set of indicators that these companies are currently undervalued. This report is not intended to be a discussion of the value of the assets in any of the companies involved in the M&A discussion, it is a report on Mosaic indicating that this M&A activity is simply a further indication of how undervalued Mosaic may actually be.

After the Analyst meeting in New York on January 15<sup>th</sup> 2009 we argued that we are maintaining our \$60 price target for the following reasons:

1. The Ability to Maintain Existing Prices for Potash and Phosphates

- A. We have discussed the issue of China's pricing practices at great length in other reports. We have argued that while China thinks they are gaining an advantage in reality they may well

be enabling restricted competition within the industry. Every year there has been protracted negotiations around the China contract for an annual countrywide sales price, and this sales price is used worldwide as a base price for the fertilizer companies to keep prices artificially high.

- B. This practice is followed in all the other major importing countries at point of sale including India, Japan, and Brazil.
- C. The China contract in essence puts an artificial floor on all prices and enables the potash producers to use that floor in their negotiations of price. It may be more psychological than economic, but nevertheless to the extent that the respective companies are disciplined, which they have been, and there is currently no sign of breaking this pattern. There is however heightened stress with growing complaints from farmers.
- D. The fertilizer companies have been willing to reduce output in order to keep current prices high, as opposed to lowering prices and selling additional product. They appear to be taking a longer term view of their business.

## Expectations

The expectations of SISR are no different than they were prior to attending the meetings:

- A. We were one of the first on the street to argue that in a down turn they will attempt to keep prices levels constant and sacrifice output. In fact in our October report we correctly projected output levels which were well below the companies projections at the time.
- B. Currently we are on record for believing that the price will decline by 20 to 30% percent in the next 3 to 6 months, but not much more. Given that prices are up 400%, this would not be a major decline in price in our view.
- C. Given that these were our expectations prior to the meetings we are hard pressed to believe that there is anything really different than what we believed last week.
- D. We are maintaining our price target of \$60 a share by end of summer 2009.

In the past couple of weeks there has been some price deterioration much in line with what we had discussed in the above paragraph. We continue to maintain our price target and look at the level of M&A activity as a further indication of the contention that Mosaic is undervalued.

We do not expect that there will be an attempted takeover of Mosaic because they are too large and there would likely be serious Anti-trust considerations if such a move gained any traction. We would make identical arguments for the Potash Corporation (POT) as we have for Mosaic.

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- 1 – Recommended List – The stock has our highest recommendation and is expected to outperform the average equal weighted expected total return of the overall Market irrespective of sector. Our investment horizon is 12 – 18 months except as specified by the reporting analyst.
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A price chart, with changes of ratings and price targets in prior periods, is included above, for all securities covered in this report.

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