# cardinal UPDATE

SEPTEMBER 2013

## DIVIDEND INCREASES

| | |
|---|---|
| Bank of Nova Scotia | 3.3% |
| Royal Bank of Canada | 6.3% |
| Saputo Inc. | 9.5% |
| Toronto Dominion Bank | 4.9% |

(During the period: August 1 – 31, 2013)

## POTASH CORP. (POT) – ATTRACTIVE & SAFE DESPITE THE DRAMA

The potential break-up of the BPC (a potash marketing organization owned by Russia's Uralkali and Belarusian state-owned Belaruskali) has been well-covered in the media since Uralkali threatened to leave the partnership to pursue a volume-over-price strategy after accusing Belaruskali of making sales outside of their agreement. Since then, the business spat has turned political with the CEO of Uralkali being arrested in Belarus. Russia has retaliated by threatening to cut oil deliveries and dairy exports. The saga is likely to unfold further. BPC and Canpotex (a marketing organization for Potash, Mosaic, and Agrium) are two potash 'cartels' that comprise approximately 70% of global potash shipments and a similar share of total global exports. The potential breakup of BPC threatens the strong pricing power this industry has enjoyed for many years.

Amid all the drama Cardinal has been using this opportunity to invest further in Potash Corp. Potash is nearing the end of a multi-year capital spending program which will boost free cash flow and allow the firm to return more capital to investors. The company recently confirmed the dividend is safe while they also reaffirmed their commitment to the $2 billion share buyback program. Potash has more potash capacity than any other global producer and their cash cost of goods sold last quarter were $98 per metric tonne (mt), much lower than the marginal cost of producers in Europe at around $200-$275/mt and significantly favorable relative to current potash prices of approximately $400/mt. As a result, Potash is well-positioned should the spat within the BPC cartel result in lower pricing for any period of time. Did we mention the firm has an estimated $5 billion gain on equity investments that is not reflected on its balance sheet? This adds even more fire power should they need it.

Worldwide population growth, greater per-capita income in developing countries, and farmers aiming to improve their yield per acre, should all lead to higher demand for fertilizer (89% of potash use). Global demand for potash is expected to rise 3.5% annually, from 2012 to 2016.

In the short term, if prices continue to move lower, Potash can still fair well. Being a low cost producer ensures that Potash remains a key supplier in the industry. In the medium term, there is reason to believe the BPC cartel will reconcile their differences as it is in both parties' interest to cooperate with a pricing-over-volume strategy. Over the long term, we believe the downside in the stock is minimal while investors earn a 4.8% annual dividend yield waiting for the dust to clear.

## COMPANY FOCUS

### THE SYRIAN AFFECT

Syria continues to be embroiled in a civil war that has claimed over 100,000 casualties and has brought accusations of chemical weapons use that could potentially pull the United States into intervention. With respect to the oil markets, Syria has been under an embargo since 2011 and was not historically a large exporter of crude. Despite this, Brent crude rose to over $116/bbl. Prices have been bid higher with the risk of conflict spreading to surrounding larger exporters, high tensions between the U.S. and Israel and Syrian allies' Iran and Russia, and Libyan production is being impacted by one million barrels per day.

What happens next is anyone's guess, but Cardinal's oil stocks do not have material exposure to the Middle Eastern conflicts. The majority of production and reserves are located in Canada, which has the third highest oil reserves in the world. Companies such as Suncor, Cenovus, Canadian Natural Resources, and Imperial Oil have a massive base with which to grow production. Higher prices on supply concerns go straight to the bottom line to be reinvested in attractive projects and returned to shareholders in the form of growing dividends.



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