

Materials sector shifts focus to fertilizer

By Jackson Strombeck and Riley Gill

The CUSP managers voted to add Nutrien (NTR) to the Materials sector in March 2023. The sales allowed the CUSP to free up funds to purchase shares of Nutrien (NTR). Nutrien is a large player in the fertilizer space and joins Albemarle (ALB) and Bery Global (BERY) in the sector. In order to make room for Nutrien, we voted to divest our holdings of LyondellBasell Industries N.V. (LYB) and Freeport-McMorrان Companies (FCX) in March 2023. In the paragraphs that follow, we describe each of the three companies and explain the rationale for the change in portfolio makeup within the Materials sector.

Nutrien (NTR):

Nutrien produces and distributes potash, nitrogen and phosphate products for agriculture, industrial and feed customers. Its retail segment distributes crop nutrients, crop protection products, seed and merchandise. The firm also provides agronomic services to growers. Potash, Nutriens' main segment at about 40% of revenues, is used to make all kinds of fertilizers. As technologies advance and manufacturing efficiencies evolve, we expect the price of fertilizer will likely drop over time. In contrast, we expect to see volumes rise with the ever-increasing demand for food products worldwide. The result should be an expansion of profitability for Nutrien.

The war in Ukraine has had a significant impact on the industry in which Nutrien operates. One of the results of the conflict has been a subsequent price increase in crops, followed by a price increase in fertilizers, which benefited Nutrien in 2021 and 2022. At present, there is no evidence to suggest the conflict will slow down or be resolved. The conflict has caused dislocations up and down the food chain. Near term, Nutrien has benefitted from some of this change. Longer term, we believe Nutrien is well positioned to continue to benefit from the growth in demand for agricultural products.

Nutrien has a strong balance sheet with limited debt. The firm initiated a \$4 billion stock repurchase program that will culminate in 2023. In addition, the firm's dividend yield is 3.12%. The firm is projected to generate \$5 billion in free cash flow, which they plan to use for operational improvements, share repurchases and debt repayments. The company prefers to grow internally with the goal of maintaining relatively high margins. In this industry, volume is more important than price as most fertilizers produce similar results, meaning margins are particularly important for producers.

The CUSP managers view Nutrien as a leading competitor in an ever-growing industry. Given the firm's competitive position, expanding market share, financial strength and economies of scale coupled with a reasonable valuation, CUSP managers voted to add the firm to the materials sector of the CUSP in March 2023.

Freeport McMoRan (FCX):

Freeport McMoRan (FCX) is best known for its production and sale of copper (80% of revenue) and gold (10% of revenues). Freeport is currently the biggest public copper producer in the world, with about 1.93 million tons produced in 2022. Due to its heavy reliance on copper as a product, the value of FCX common stock has a high degree of correlation with the price of copper. Given the current and projected need for copper, we expect Freeport will continue to play a prominent role in the production and sale of the commodity. The CUSP managers' decision to sell was motivated by the belief that price appreciation related to increasing demand for copper has already been fully recognized in the stock price.

At the time of sale, Freeport-McMoRan was valued at twice that of a set of comparable firms generated by Bloomberg on a price-to-earnings basis. Part of the premium over the comparable set can be attributed to Freeport's higher relative profitability. Still, on an intrinsic value basis, our analysis suggested Freeport-McMoRan was trading for a not-insignificant premium. The high earnings multiple and perceived premium over its intrinsic value offered a compelling reason to divest from Freeport-McMoRan. Moreover, a recent run up in copper prices has pulled FCX up along with the rest of the industry. Bottom line, the CUSP managers voted to divest Freeport in order to seek more favorably priced securities in the materials sector.

LyondellBasell Industries N.V. (LYB):

CUSP managers voted to divest LyondellBasell Industries (LYB) in March 2023. LYB is a globally diversified chemicals company that generates roughly half of its revenue in the United States, which represents its largest single market exposure. LyondellBasell primarily offers products within the categories of olefins and polyolefin, intermediates and derivatives, and advanced polymer solutions. The firm offers chemical materials that are sourced to companies in the automobile parts, plastic packaging, cosmetic and paint industries to be formed into their final state before being purchased by an end consumer.

The decision to sell LyondellBasell was not because of the company's financials but rather because of macroeconomic prospects for the chemical materials industry. Our analysis suggests that over the next 10 years growth in supply within the firm's sector is likely to outpace demand. More near term, over the next year, prospects for a global recession are weighing on demand prospects. The CUSP managers ultimately decided that the future prospects for Nutrien presented a better investment opportunity.