

DBRS Canada Newsletter

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AGRIUM'S ONGOING CAMPAIGN TO ACQUIRE CF INDUSTRIES – RATING IN UNCERTAIN TIMES

How does a rating agency react to a major corporate transaction in the light of turbulent financial markets and knowing that many corporate transactions can take unpredictable twists and turns?

An excellent example is the multi-billion dollar cross-border offer by Agrium Inc. (Agrium) to acquire CF Industries Holdings, Inc. (CF) for a combination of cash and Agrium shares, initiated on February 25, 2009. As we indicated on that day, “DBRS believes that there is a significant chance that Agrium’s offer for CF Industries will be modified, and has therefore placed the ratings for Agrium Under Review with Developing Implications pending further clarity as to the final nature of the proposed transaction, the financing package and the impact of regulatory matters,” which has certainly been the case.

Placing Agrium’s ratings Under Review with Developing Implications was not our only alternative. We could have just as easily placed emphasis on the potential positive or negative outcomes a successful deal might imply. Was our first impression correct?

Let’s step back and look at the context of the February 25, 2009 offer. Both CF and Agrium were major players in North American/world fertilizer markets with CF focused on nitrogen- and phosphate-based fertilizers and with Agrium strong in nitrogen- and potash-based fertilizers, with a smaller footprint in phosphate-based fertilizers. Agrium, a Canadian-based company, and CF, organized under the laws of the State of Delaware, had discussed a combination of the companies prior to CF’s initial public offering in 2005, but no agreement had been reached. At the time of the February offer, CF and Agrium had just reported record 2008 financial results and CF was a little over a month into its own proposal to acquire leading nitrogen-based fertilizer producer Terra Industries Inc. (Terra), launched on January 15, 2009.

How did we approach the Agrium offer given these circumstances and what were the complications?

Our first step was to look at the business aspects of a potential transaction. Did the deal make business sense and would the business profile of the combined companies be stronger than if they stood alone?

Agrium sees itself as playing an important role in helping farmers feed a hungry world and their chosen vehicle has been to be one of the world’s leading providers of inputs for plant growth. Agrium’s fertilizer assets are extensive and they operate in similar markets to CF. CF on the other hand is one of North America’s largest manufacturers and distributors of nitrogen and phosphate fertilizer products. The successful acquisition of CF would add nitrogen and phosphate production facilities and extensive crop nutrient distribution assets to Agrium’s broad wholesale and retail farm input capabilities as well as triple its phosphate and UAN capacity. To DBRS, the complementary nature of CF and Agrium’s businesses seemed to be evident and fully within Agrium’s vision of being “one of the world’s leading providers of inputs for plant growth.”

A more problematic aspect of the transaction was its size and the ability of Agrium to integrate CF into its operations. At the outset, Agrium’s offer for CF of approximately \$3.6 billion was clearly a material transaction representing about 37% of the book value of Agrium’s assets at December 31, 2008. Throughout Agrium’s history, acquisitions have formed an important part of its growth strategy. The successful integration of the Royster-Clark, Nu-Gro fertilizer, Pursell Technologies Inc., 22 retail crop input bought from Archer Daniels Midland and UAP, all since 2006, demonstrated the Company’s past success in managing both smaller- and large-scale purchases. That said, successful integration of the two companies remains a significant risk to Agrium’s financial health and rating.

The size and nature of the CF acquisition would provide an additional business risk, as governmental and

regulatory consents would be required to allow the transaction to be completed. Agrium and CF are both active in Canadian and American fertilizer markets with significant product overlap. Transactions of the size contemplated are subject to review on a number of fronts including by government agencies responsible for competitive markets. Government reviews can often add costs and change the very nature of what is being transacted or what is to be retained by the combined companies.

In this case, Agrium has entered into an agreement with Terra to sell a 50% interest in a portion of its Carseland nitrogen facility to Terra for approximately \$250 million and for a conditional purchase arrangement for Agrium to purchase approximately 175,000 tonnes of nitrogen products, both conditional upon Agrium's successful acquisition of CF and other matters. Agrium has indicated that the agreement was entered into at least in part because, "this agreement will address regulatory concerns under Canadian competition law in connection with its offer to acquire CF." Additionally, from a DBRS perspective, the prohibition of CF's acquisition of Terra as a condition of its offer made sense in that it kept Agrium's transaction to a reasonable scale and avoided some regulatory issues in terms of industry concentration in specific sub-sectors of the North American fertilizer market. The need for regulatory approval on both sides of the border of the proposed Agrium/CF deal remains outstanding and the nature of the ultimate shape of Agrium going forward may well change again.

Another consideration for DBRS in evaluating the proposed transaction is its inherent value. Agrium expects to realize approximately \$150 million in annual synergies for the combined organizations, to be fully realized over a three-year period. In addition, the company expected the transaction to be accretive to both earnings and cash flow in 2010 and significantly accretive on both measures in subsequent years. It is also notable that at September 30, 2009, CF had \$498 million in cash and \$205 million in short-term investments with only \$4.6 million in notes payable on its balance sheets indicating Agrium would not be acquiring a significant amount of debt from CF.

The economic context of the initial offer was that fertilizer markets had been on a roller coaster ride. Following record prices in 2008, the economic collapse of the fourth quarter of that year and strong farmer resistance to the potent combination of financial uncertainty and extremely high prices, led to a fertilizer application "strike" in the fall of 2008. This led to a collapse in prices, particularly for nitrogen and phosphate fertilizers, providing a highly uncertain environment for any acquisition in the first few months of 2009.

We examined the financial history of CF and Agrium as well as the outlook for the combined companies. We looked past the immediate events of the economic crisis to the long-term basics of the fertilizer business. From a valuation perspective, the original offer did not seem to be outside acceptable valuation ranges.

Subsequently, we have seen earnings and cash flow generation throughout the fertilizer sector continue to be hard hit by the economic downturn, low product prices, weather-related application issues and, in some product areas, soft demand. As Agrium's bid price for CF increases, we continue to reassess the inherent value of the transaction. Our view as to a quick near-term recovery of fertilizer markets has been shaken by continuing weak results, but the long-term fundamentals remain in place.

A key consideration in assessing Agrium's February 25, 2009 offer was how it was to be financed. A significant part of the deal was to be financed using Agrium's available equity and cash resources. In addition, the transaction was supported by \$1.4 billion in committed financing underwritten by two Canadian banks. DBRS's expectation was that the deal, if completed as then contemplated, would maintain Agrium's financial metrics within a range acceptable for its rating. The increasing cash component of the current offer will increase the financial risk from the perspective of Agrium's debt holders barring sources of funds other than debt.

Important to our assessment of the financing of the proposed acquisition of CF was Agrium's attitude towards its financial profile. In 2006, following the Royster-Clark, Nu-Gro and Pursell transactions, gross leverage (excluding operating leases and accounts receivable securitization) for the company at year-end 2006 was high at 42%, but this was reduced to 37% at September 30, 2007 prior to the launch of the UAP bid in December 2007. The \$2.7 billion UAP transaction was partially pre-financed by a \$1.4 billion equity

offering in December 2007 and closed in May 2008. At the end of 2008, Agrium's gross leverage was 35% and 29% at the end of September 2009, showing the company's desire and ability to maintain its leverage in check following a major transaction. It is notable that on October 30, 2009, the Toronto Stock Exchange granted conditional listing approval of the 50.2 million Agrium common shares to be issued in connection with the proposed acquisition of CF, subject to customary listing conditions.

Since Agrium's original offer for CF, a number of significant events have occurred including: (1) Agrium increasing the cash component of its offer three times or by a total of \$13.30 per CF share (an aggregate of approximately \$665 million) to \$45.00 per CF share currently (\$2.4 billion aggregate cash component); (2) the rejection of each offer by CF; (3) the continued pursuit of Terra by CF and the rejection of each of those offers by Terra; (4) the agreement for Terra to acquire a 50% interest in a portion of Agrium's Carseland nitrogen facility for approximately \$250 million and for Agrium to conditionally purchase approximately 175,000 tonnes of nitrogen products from Terra, both conditional upon Agrium's successful acquisition of CF and other matters; and (5) the extension of Agrium's offer for CF until 12:00 midnight, New York City time, on November 18, 2009.

CF is a Delaware incorporated corporation and the company has continued to date to reject Agrium's overtures. Delaware corporate law, CF's articles of incorporation and its stockholder's rights plan make it difficult, time consuming and expensive to pursue a takeover without the co-operation of CF's board. As Agrium's proposed acquisition of CF remains conditional on a number of items including the termination of the CF bid for Terra, the receipt of necessary regulatory approvals and the opportunity to conduct limited confirmatory due diligence, there remains the distinct possibility that the terms of the offer may continue to change or that the offer may ultimately be unsuccessful.

Our resolution of Agrium's Under Review with Developing Implications status will depend on the final terms of any potential transactions, including the related financing and the sale of an interest in the Carseland facility, in combination with the outlook for agricultural markets. While we expect that additional complications will arise, we will continue to assess the impact of any final deal on the business profile of Agrium, the valuation metrics of what is acquired, the ongoing financial metrics of the company including its liquidity and the expected course of agricultural markets.

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