POTASH CORP OF SASKATCHEWAN INC
Form 10-Q
May 05, 2006

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

þ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the Quarterly Period Ended March 31, 2006

OR

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

Commission File Number 1-10351
POTASH CORPORATION OF SASKATCHEWAN INC.
(Exact name of registrant as specified in its charter)

Canada	**N/A**
(State or other jurisdiction of incorporation or organization)	*(I.R.S. Employer Identification No.)*
122 1st Avenue South Saskatoon, Saskatchewan, Canada	**S7K 7G3**
(Address of principal executive offices)	*(Zip Code)*

306-933-8500
(Registrant s telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Sections 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

YES þ NO o

Indicate by check mark whether the registrant is an accelerated filer (as defined in Exchange Act Rule 12b-2).

YES þ NO o

Indicate by check mark whether the registrant is a shell company (as defined in Exchange Act Rule 12b-2).

YES o NO þ

As at April 30, 2006, Potash Corporation of Saskatchewan Inc. had 103,676,570 Common Shares outstanding.

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PART I. FINANCIAL INFORMATION

ITEM 1. *FINANCIAL STATEMENTS*

Potash Corporation of Saskatchewan Inc.
Condensed Consolidated Statements of Financial Position
(in millions of US dollars except share amounts)
(unaudited)

	March 31, 2006	December 31, 2005
Assets		
Current assets		
Cash and cash equivalents	**$ 172.7**	$ 93.9
Accounts receivable	**390.0**	453.3
Inventories (Note 2)	**513.4**	522.5
Prepaid expenses and other current assets	**68.1**	41.1
	1,144.2	1,110.8
Property, plant and equipment	**3,327.2**	3,262.8
Other assets (Note 3)	**989.8**	852.8
Intangible assets	**33.9**	34.5
Goodwill	**97.0**	97.0
	$5,592.1	$5,357.9
Liabilities		
Current liabilities		
Short-term debt	**$ 604.9**	$ 252.2
Accounts payable and accrued charges	**591.4**	842.7
Current portion of long-term debt	**1.2**	1.2
	1,197.5	1,096.1
Long-term debt	**1,257.3**	1,257.6
Future income tax liability	**561.5**	543.3
Accrued pension and other post-retirement benefits	**213.0**	213.9
Accrued environmental costs and asset retirement obligations	**100.1**	97.3
Other non-current liabilities and deferred credits	**15.3**	17.2
	3,344.7	3,225.4
Contingencies and Guarantees (Notes 10 and 11, respectively)		
Shareholders Equity		
Share capital	**1,383.0**	1,379.3
Unlimited authorization of common shares without par value; issued and outstanding 103,672,170 and 103,593,792 at		

March 31, 2006 and December 31, 2005, respectively		
Unlimited authorization of first preferred shares; none outstanding		
Contributed surplus	**37.3**	36.3
Retained earnings	**827.1**	716.9
	2,247.4	2,132.5
	$5,592.1	$5,357.9

(See Notes to the Condensed Consolidated Financial Statements)

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Potash Corporation of Saskatchewan Inc.
Condensed Consolidated Statements of Operations and Retained Earnings
(in millions of US dollars except per-share amounts)
(unaudited)

	Three Months Ended March 31	
	2006	**2005**
Sales (Note 6)	**$861.6**	$921.4
Less: Freight	**54.9**	67.2
Transportation and distribution	**31.2**	28.9
Cost of goods sold	**572.0**	566.8
Gross Margin	**203.5**	258.5
Selling and administrative	**30.8**	29.3
Provincial mining and other taxes	**14.2**	38.4
Foreign exchange gain	**(2.4)**	(5.9)
Other income (Note 8)	**(31.2)**	(20.0)
	11.4	41.8
Operating Income	**192.1**	216.7
Interest Expense	**23.2**	20.7
Income Before Income Taxes	**168.9**	196.0
Income Taxes (Note 4)	**43.4**	64.7
Net Income	**125.5**	131.3
Retained Earnings, Beginning of Period	**716.9**	701.5
Dividends	**(15.3)**	(16.8)
Retained Earnings, End of Period	**$827.1**	$816.0
Net Income Per Share (Note 5)		
Basic	**$ 1.21**	$ 1.18
Diluted	**$ 1.19**	$ 1.15
Dividends Per Share	**$ 0.15**	$ 0.15

(See Notes to the Condensed Consolidated Financial Statements)

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Potash Corporation of Saskatchewan Inc.
Condensed Consolidated Statements of Cash Flow
(in millions of US dollars)
(unaudited)

	Three Months Ended March 31	
	2006	**2005**
Operating Activities		
Net income	**$ 125.5**	$131.3
Adjustments to reconcile net income to cash (used in) provided by operating activities		
Depreciation and amortization	**58.8**	59.6
Stock-based compensation	**1.5**	1.0
Loss on disposal of long-term assets	**0.3**	2.0
Foreign exchange on future income tax	**(0.2)**	(1.2)
Provision for future income tax	**13.9**	6.5
Undistributed earnings of equity investees	**(12.4)**	(13.1)
Other long-term liabilities	**2.0**	5.2
Subtotal of adjustments	**63.9**	60.0
Changes in non-cash operating working capital		
Accounts receivable	**63.3**	(63.5)
Inventories	**8.9**	(1.7)
Prepaid expenses and other current assets	**(27.0)**	(6.2)
Accounts payable and accrued charges	**(247.1)**	1.8
Subtotal of changes in non-cash operating working capital	**(201.9)**	(69.6)
Cash (used in) provided by operating activities	**(12.5)**	121.7
Investing Activities		
Additions to property, plant and equipment	**(120.0)**	(63.0)
Purchase of long-term investments	**(126.3)**	
Proceeds from disposal of property, plant and equipment	**2.0**	4.4
Proceeds from sale of long-term investments		5.2
Other assets and intangible assets	**(4.5)**	3.0
Cash used in investing activities	**(248.8)**	(50.4)
Cash before financing activities	**(261.3)**	71.3
Financing Activities		
Repayment of long-term debt obligations	**(0.3)**	(0.2)
Proceeds from short-term debt obligations	**352.7**	0.8
Dividends	**(15.3)**	(16.5)

Repurchase of common shares		(82.3)
Issuance of common shares	**3.0**	47.0
Cash provided by (used in) financing activities	**340.1**	(51.2)
Increase in Cash and Cash Equivalents	**78.8**	20.1
Cash and Cash Equivalents, Beginning of Period	**93.9**	458.9
Cash and Cash Equivalents, End of Period	**$ 172.7**	$479.0
Supplemental cash flow disclosure		
Interest paid	**$ 16.3**	$ 11.2
Income taxes paid	**$ 142.0**	$ 75.5

(See Notes to the Condensed Consolidated Financial Statements)

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Potash Corporation of Saskatchewan Inc.
Notes to the Condensed Consolidated Financial Statements
For the Three Months Ended March 31, 2006
(in millions of US dollars except share and per-share amounts)
(unaudited)

1. Significant Accounting Policies

Basis of Presentation

With its subsidiaries, Potash Corporation of Saskatchewan Inc. (PCS) together known as PotashCorp or the company except to the extent the context otherwise requires forms an integrated fertilizer and related industrial and feed products company. The company s accounting policies are in accordance with accounting principles generally accepted in Canada (Canadian GAAP). These policies are consistent with accounting principles generally accepted in the United States (US GAAP) in all material respects except as outlined in Note 12. The accounting policies used in preparing these interim condensed consolidated financial statements are consistent with those used in the preparation of the 2005 annual consolidated financial statements, except as described below.

These interim condensed consolidated financial statements include the accounts of PCS and its subsidiaries; however, they do not include all disclosures normally provided in annual consolidated financial statements and should be read in conjunction with the 2005 annual consolidated financial statements. In management s opinion, the unaudited financial statements include all adjustments (consisting solely of normal recurring adjustments) necessary to present fairly such information. Interim results are not necessarily indicative of the results expected for the fiscal year.

Significant Accounting Policies

Implicit Variable Interests

In January 2006, the company adopted Emerging Issues Committee Abstract No. 157, Implicit Variable Interests Under AcG-15 (EIC-157). This EIC addresses whether a company has an implicit variable interest in a variable interest entity (VIE) or potential VIE when specific conditions exist. An implicit variable interest acts the same as an explicit variable interest except that it involves the absorbing and/or receiving of variability indirectly from the entity (rather than directly). The identification of an implicit variable interest is a matter of judgment that depends on the relevant facts and circumstances. The implementation of EIC-157 did not have a material impact on the company s consolidated financial statements.

Recent Accounting Pronouncements

Comprehensive Income, Equity, Financial Instruments and Hedges

In January 2005, the CICA issued Section 1530, Comprehensive Income , Section 3251, Equity , Section 3855, Financial Instruments Recognition and Measurement and Section 3865, Hedges . The new standards increase harmonization with US GAAP and will require the following:

Financial assets will be classified as either held-to-maturity, held-for-trading or available-for-sale. Held-to-maturity classification will be restricted to fixed maturity instruments that the company intends and is able to hold to maturity and will be accounted for at amortized cost. Held-for-trading instruments will be recorded at fair value with realized and unrealized gains and losses reported in net income. The remaining financial assets will be classified as available-for-sale. These will be recorded at fair value with unrealized gains and losses reported in a new category of the Consolidated Statements of Financial Position under shareholders equity called other comprehensive income (OCI); and

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Derivatives will be classified as held-for-trading unless designated as hedging instruments. All derivatives, including embedded derivatives that must be separately accounted for, will be recorded at fair value on the Consolidated Statements of Financial Position. For derivatives that hedge the changes in fair value of an asset or liability, changes in the derivatives fair value will be reported in net income and be substantially offset by changes in the fair value of the hedged asset or liability attributable to the risk being hedged. For derivatives that hedge variability in cash flows, the effective portion of the changes in the derivatives fair value will be initially recognized in OCI and the ineffective portion will be recorded in net income. The amounts temporarily recorded in OCI will subsequently be reclassified to net income in the periods when net income is affected by the variability in the cash flows of the hedged item.

The guidance will apply for interim and annual financial statements relating to fiscal years beginning on or after October 1, 2006. Earlier adoption will be permitted only as of the beginning of a fiscal year. The impact of implementing these new standards is not yet determinable as it is highly dependent on fair values, outstanding positions and hedging strategies at the time of adoption.

Conditional Asset Retirement Obligations

In November 2005, the Emerging Issues Committee issued Abstract No. 159, Conditional Asset Retirement Obligations , to clarify the accounting treatment for a legal obligation to perform an asset retirement activity in which the timing and/or method of settlement are conditional on a future event that may or may not be within the control of the entity. Under this EIC, an entity is required to recognize a liability for the fair value of a conditional asset retirement obligation if the fair value of the liability can be reasonably estimated. The guidance is effective for the second quarter of 2006 and is to be applied retroactively, with restatement of prior periods. The implementation of this EIC is not expected to have a material impact on the company s consolidated financial statements.

Stripping Costs Incurred in the Production Phase of a Mining Operation

In March 2006, the Emerging Issues Committee issued Abstract No. 160, Stripping Costs Incurred in the Production Phase of a Mining Operation . This EIC discusses the treatment of costs associated with the activity of removing overburden and other mine waste minerals in the production phase of a mining operation. The EIC concludes that such stripping costs should be accounted for according to the benefit received by the entity and recorded as either a component of inventory or a betterment to the mineral property, depending on the benefit received. The implementation of this EIC is not expected to have a material impact on the company s consolidated financial statements.

2. Inventories

	March 31, 2006	**December 31, 2005**
Finished product	**$261.2**	$268.5
Intermediate products	**96.0**	94.9
Raw materials	**57.8**	59.9
Materials and supplies	**98.4**	99.2
	$513.4	$522.5

3. Other Assets

In February 2006, the company acquired an additional 10.01-percent interest in the ordinary shares of Sinochem Hong Kong Holdings Limited (Sinofert) for cash consideration of $126.3. The purchase price was financed by short-term debt. The additional investment increased the company s interest in Sinofert to 20 percent.

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In April 2006, the company purchased an additional 220,100 shares of Arab Potash Company Inc. (APC) for cash consideration of $3.7. The company s ownership interest in APC remains at approximately 28 percent.

4. Income Taxes

The company s consolidated effective income tax rate for the three month period ended March 31, 2006 is approximately 26 percent (2005 33 percent). The reduction in the effective rate for the quarter was due to the receipt of income tax refunds relating to a recent Canadian appeals court decision (pertaining to a uranium producer) which affirmed the deductibility of the Saskatchewan Capital Tax Resource Surcharge. The refunds related to the 2002-2004 taxation years. The company also expects income tax refunds in connection with the 1999-2001 taxation years. These refunds are currently under review and have not been reflected in these interim condensed consolidated financial statements.

In April 2006, the Province of Saskatchewan announced changes to the corporation income tax and the capital tax resource surcharge. The corporate income tax rate will be reduced from 17 percent to 12 percent over the next three years, with a 3 percentage point reduction (to 14 percent) effective July 1, 2006 and further 1 percentage point reductions on July 1, 2007 and July 1, 2008. The capital tax resource surcharge will be reduced from 3.6 percent to 3.0 percent over this same period, with a reduction to 3.3 percent on July 1, 2006, 3.1 percent on July 1, 2007 and 3.0 percent on July 1, 2008. The condensed consolidated financial statements for the three months ended March 31, 2006 do not reflect the benefit of these announced changes.

5. Net Income Per Share

Basic net income per share for the quarter is calculated on the weighted average shares issued and outstanding for the three months ended March 31, 2006 of 103,641,000 (2005 111,110,000).

Diluted net income per share is calculated based on the weighted average number of shares issued and outstanding during the period. The denominator is: (i) increased by the total of the additional common shares that would have been issued assuming exercise of all stock options with exercise prices at or below the average market price for the period; and (ii) decreased by the number of shares that the company could have repurchased if it had used the assumed proceeds from the exercise of stock options to repurchase them on the open market at the average share price for the period. The weighted average number of shares outstanding for the diluted net income per share calculation for the three months ended March 31, 2006 was 105,825,000 (2005 114,265,000).

6. Segment Information

The company has three reportable business segments: potash, nitrogen and phosphate. These business segments are differentiated by the chemical nutrient contained in the product that each produces. Inter-segment sales are made under terms that approximate market value. The accounting policies of the segments are the same as those described in Note 1.

	Three Months Ended March 31, 2006				
	Potash	**Nitrogen**	**Phosphate**	**All Others**	**Consolidated**
Sales	**$225.8**	**$331.9**	**$303.9**	**$**	**$861.6**
Freight	**25.0**	**9.6**	**20.3**		**54.9**
Transportation and distribution	**7.4**	**13.3**	**10.5**		**31.2**
Net sales third party	**193.4**	**309.0**	**273.1**		
Cost of goods sold	**102.6**	**229.6**	**239.8**		**572.0**
Gross margin	**90.8**	**79.4**	**33.3**		**203.5**
Depreciation and amortization	**11.8**	**19.3**	**24.3**	**3.4**	**58.8**
Inter-segment sales	**4.0**	**31.9**	**2.2**		

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	Three Months Ended March 31, 2005				
	Potash	Nitrogen	Phosphate	All Others	Consolidated
Sales	$352.1	$304.8	$264.5	$	$921.4
Freight	37.2	10.2	19.8		67.2
Transportation and distribution	9.1	11.7	8.1		28.9
Net sales third party	305.8	282.9	236.6		
Cost of goods sold	129.6	217.6	219.6		566.8
Gross margin	176.2	65.3	17.0		258.5
Depreciation and amortization	18.1	16.9	22.3	2.3	59.6
Inter-segment sales	2.0	19.8	4.2		

7. Pension and Other Post-Retirement Expenses

	Three Months Ended March 31	
Defined Benefit Pension Plans	**2006**	**2005**
Service cost	**$ 3.6**	$ 3.6
Interest cost	**8.4**	7.8
Expected return on plan assets	**(9.6)**	(8.9)
Net amortization	**2.9**	1.7
Net expense	**$ 5.3**	$ 4.2

	Three Months Ended March 31	
Other Post-Retirement Plans	**2006**	**2005**
Service cost	**$ 1.2**	$1.4
Interest cost	**3.0**	3.3
Net amortization	**(0.1)**	0.4
Net expense	**$ 4.1**	$5.1

For the three months ended March 31, 2006, the company contributed $6.8 to its defined benefit pension plans, $6.0 to its defined contribution pension plans and $2.1 to its other post-retirement plans. Total 2006 contributions to these plans are not expected to differ significantly from the amounts previously disclosed in the consolidated financial statements for the year ended December 31, 2005.

8. Other Income

	Three Months Ended March 31	
	2006	**2005**

Share of earnings of equity investees	**$12.4**	$13.1
Dividend income	**9.1**	3.1
Other	**9.7**	3.8
	$31.2	$20.0

9. Seasonality

The company s sales of fertilizer can be seasonal. Typically, the second quarter of the year is when fertilizer sales will be highest, due to the North American spring planting season. However, planting conditions and the timing of customer purchases will vary each year and sales can be expected to shift from one quarter to another.

10. Contingencies

Canpotex

PotashCorp is a shareholder in Canpotex Limited (Canpotex), which markets potash offshore. Should any operating losses or other liabilities be incurred by Canpotex, the shareholders have contractually agreed to reimburse Canpotex for such losses or liabilities in proportion to their productive capacity. There were no such operating losses or other liabilities during the first three months of 2006 or 2005.

Mining Risk

In common with other companies in the industry, the company is unable to acquire insurance on its underground assets.

Investment in APC

The company is party to a shareholders agreement with Jordan Investment Company (JIC) with respect to its investment in APC. The terms of the shareholders agreement provide that, from October 17, 2006 to October 16, 2009, JIC may seek to exercise a put option (the Put) to require the company to purchase JIC s remaining common shares in APC. If the Put were exercised, the company s purchase price would be calculated in accordance with a specified formula based, in part, on future earnings of APC. The amount, if any, which the company may have to pay for JIC s remaining common shares if there were to be a valid exercise of the Put is not presently determinable.

Legal and Other Matters

In 1994, PCS Joint Venture responded to information requests from the US Environmental Protection Agency (USEPA) and the Georgia Department of Natural Resources, Environmental Protection Division (GEPD) regarding conditions at its Moultrie, Georgia location. PCS Joint Venture believes that the lead-contaminated soil and groundwater found at the site are attributable to former operations at the site prior to PCS Joint Venture s ownership. In 2005, the GEPD approved a Corrective Action Plan to address environmental conditions at this location. As anticipated, the approved remedy requires some excavation and off-site disposal of impacted soil and installation of a groundwater recovery and treatment system. PCS Joint Venture began the remediation in November 2005 and completed soil excavation activities in March 2006. No significant change to management s estimate of accrued costs was required as of March 31, 2006 as a result of approval of the remedial action plan.

In 1998, the company, along with other parties, was notified by the USEPA of potential liability under the US Comprehensive Environmental Response, Compensation and Liability Act of 1980 (CERCLA) with respect to certain soil and groundwater conditions at a PCS Joint Venture blending facility in Lakeland, Florida and certain adjoining property. In 1999, PCS Joint Venture signed an Administrative Order and Consent with the USEPA pursuant to which PCS Joint Venture agreed to conduct a Remedial Investigation and Feasibility Study (RI/FS) of these conditions. PCS Joint Venture and another party are sharing the costs of the RI/FS. The draft feasibility study has been submitted for review and approval. In January 2006, the parties responded to comments of the USEPA and Florida Department of Environment on the draft feasibility study. No final determination has yet been made of the nature, timing or cost of remedial action that may be needed, nor to what extent costs incurred may be recoverable from third parties.

In 2003, the USEPA notified PCS Nitrogen that it considers PCS Nitrogen to be a potentially responsible party with respect to a former fertilizer blending operation in Charleston, South Carolina, known as the Planters Property or Columbia Nitrogen site, formerly owned by a company from whom PCS Nitrogen acquired certain other assets. In March 2005, the USEPA released for public comment a range of remedial alternatives and a proposed remedy for this site. In September 2005, Ashley II of Charleston, L.L.C. (Ashley II), the current owner of the site, filed a petition in the United States District Court for the District of South Carolina seeking a declaratory judgment that PCS Nitrogen is liable to pay environmental response costs at the site and reimbursement of environmental response and other costs incurred and to be incurred by

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Ashley II. In December 2005, PCS Nitrogen filed a motion to dismiss the petition filed by Ashley II, which was denied in March 2006. In February 2006, PCS Nitrogen and other potentially responsible parties received a notice from the USEPA requesting reimbursement of previously incurred response costs of approximately $3.0 plus interest, and the performance or financing of future site investigation and response. PCS Nitrogen will continue to monitor these and other developments with respect to the site. PCS Nitrogen intends to vigorously defend its interests in these actions. It will also continue to assert its position that it is not a responsible party and to work to identify former site owners and operators that would be responsible parties with respect to the site.

The USEPA announced an initiative to evaluate implementation within the phosphate industry of a particular exemption for mineral processing wastes under the hazardous waste program. In connection with this industry-wide initiative, the USEPA conducted hazardous waste compliance evaluation inspections at numerous phosphate operations, including the company s plants in Aurora, North Carolina, Geismar, Louisiana and White Springs, Florida. In September 2005 and December 2005, respectively, the USEPA notified the company of various alleged violations of the US Resource Conservation and Recovery Act at its Aurora and White Springs plants. The company is currently reviewing and responding to these notices. At this early stage, it is unable to evaluate the extent of any exposure that it may have in these matters.

The company is also engaged in ongoing site assessment and/or remediation activities at a number of other facilities and sites. Based on current information, it believes that its future obligations with respect to these facilities and sites are not reasonably likely to have a material adverse effect on the company s consolidated financial position or results of operations.