

**Domestic urea consumption likely to remain sluggish in near term**

**NOV 7, 2014**

Fertilizer sector is one of the vital industries for Indian economy as it produces a very critical raw material for agriculture which accounts about 15 percent of Indian GDP, providing sustenance to two-third of country's population. Indian fertilizer industry consists of two key segments - urea fertilizer and non urea fertilizers. Within these two segments, the urea fertilizer segment accounts for around 50% of the total fertilizer consumption and is regulated by the government as the price and the subsidy is fixed by the government. While, non-urea segment which consists of the DAP, complex NPK and MOP fertilizers, functions under a fixed subsidy. India is world's largest consumer of fertilizer after China. Nitrogen, Phosphate and Potash, (N, P & K) are the three nutrients which are used by fertilizer manufacturer for the production of urea and non-urea fertilizers. As industry manufactures a very critical raw material for agriculture which is the major occupation of the country, the primary objective of sector is to ensure the supply of primary and secondary nutrients in the required quantities. Till now, India has achieved 75% self-sufficiency in production capacity of urea. Similarly, 50% indigenous capacity has been developed in respect of phosphatic fertilizers to meet domestic requirements. However, the raw materials and intermediates for phosphatic fertilizers are largely imported. While, the country does not have potash (K) resources and has to entirely depend upon import for meeting the requirement of Muriate of Potash (MOP).

**Govt increases natural gas price to \$5.61 per mmBtu**

The government has approved raising natural gas price to \$5.61 per million metric British thermal unit (mmBtu). The new gas price will be implemented from November 1 and will be revised every six months with the next revision being on April 1. Though the government modified the Rangarajan formula to bring down the increase in rates from \$8.4 to \$5.61 per mmBtu, the new gas prices is higher than \$4.2 per mmBtu at present and will directly impacts the margins of the industry players. Natural gas is the dominant fuel for the production of fertilizers and the increase in gas price would augment the production cost of industry players as it accounts for around 70 percent of production cost. It is estimated that one dollar increase in gas price per mmBtu will lead to Rs 1,370 per tonne rise in urea production cost. With the increase in gas prices, Indian fertilizer industry will become more dependent on Government's subsidy, while the government has been under-allocating fertilizer subsidies and high gas prices could become a concern for players if the government makes further inordinate delays in payments.

**New Urea Investment Policy notified**

With an aim to increase the domestic urea production, the Fertilizer Ministry has notified New Urea Investment Policy for setting up and expansion of urea plants in the country. As per the New Urea Investment Policy, the companies will get a subsidy on production only if the urea production starts in the next 5 years. The subsidy will continue till 8 years after the commencement of production. However, interested private companies are required to give a bank guarantee of Rs 300 crore for every project, while PSUs firms have been exempted from it.

In India, the shortfall between demand and production of urea is around 8 million tonnes which is met through imports. The move to amend the urea policy came after as many as 13 players including IFFCO, RCF and Tata Chemicals proposed setting up of urea plants entailing capacity addition of 16 million tonnes. As earlier policy was assuring the 'guaranteed buyback', the proposed capacity addition by the applicants was more than the actual requirement. Therefore, the ministry decided to replace guaranteed buyback clause with the Rs 300 crore bank guarantee so that only interested players approach for setting up of new urea projects. Furthermore, the flexible lower limit and ceiling limit of urea cost has been fixed after factoring the gas price.

### **New urea investment policy, clarity on gas price to attract investments in urea segment**

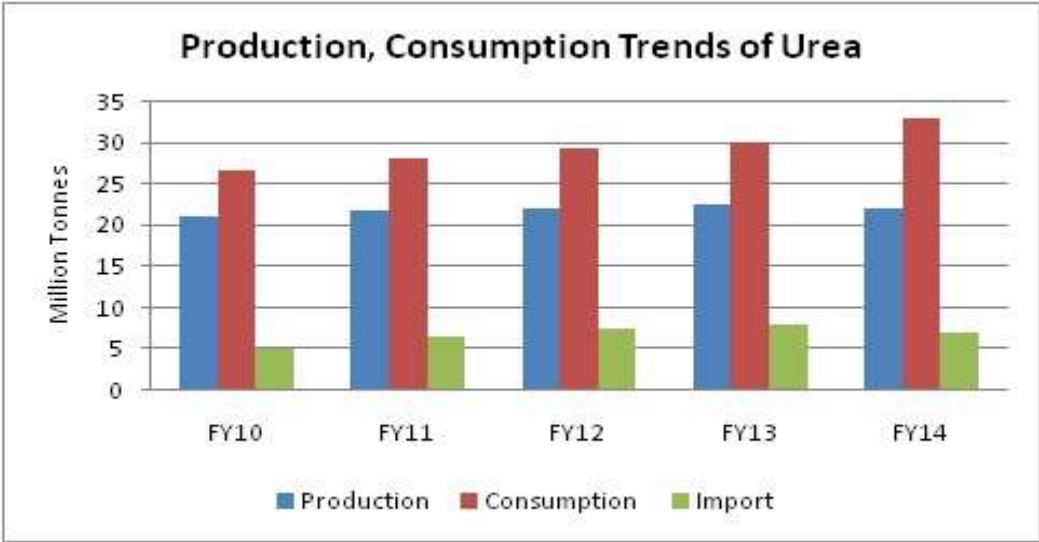
During the past few years, investment in urea sector has not been picking up as earlier policy lacked clarification on the guaranteed buyback scheme. Further, there was also some uncertainty over the natural gas price hike as the previous UPA government had approved the Rangarajan formula under which gas price was likely to get doubled at \$8.40 per mmbtu from the current price at \$ 4.20 per mmbtu. Giving some relief to industry, new government has modified the Rangarajan formula approved by previous UPA government to bring down the increase in rates from \$8.4 to \$5.61 per mmBtu. Though gas prices increased, it is far below than previous approved gas rate and could appear attractive for industry players to make fresh investment in urea segment. Furthermore, the uncertainty over the guaranteed buyback scheme has been cleared by the government through introducing new urea investment policy. Therefore, investment in urea segment is likely to increase in future.

### **Segmental Analysis**

#### **Urea**

Urea is the most important fertilizer in the country because of its high nitrogen content and is the only fertilizer, whose 80% demand is met through the domestic production. Urea becomes water soluble, making it a highly desired ingredient for lawn fertilizer. India was self sufficient in urea production till FY02, however with the constantly rising consumption and lack of major investments, domestic demand has outpaced the country's production. Urea consumption in the country has been witnessing rising trend over the past decade. During the FY14, urea consumption increased by 9.42% to 33 Million Tonnes (MT) from 30.16 MT in the previous fiscal. On the other hand, production declined by 2.57% to 22 MT in FY14 as compared to 22.58 in FY13. Over the past few years, domestic manufactures have been operating at over 100% capacity utilization as the country's installed capacity of urea stands at around 21 MT. Urea export also declined FY14 due to the availability of carry-over stocks. In value terms, urea imports decreased by 30% to Rs 15,353 crore in FY14 mainly driven by fall in global prices on account of increased supply. However, in the current fiscal, the urea demand is under pressure as urea consumption declined by around 6% during April-August FY15 due to delayed monsoon leading to delaying sowing and declined supply for urea plants on account of gas availability issue. Monsoon has remained subdued during Kharif 2014, which has led to delayed sowing and stunted crop growth in some regions of the country, mainly in northern and north-western crop

belts of Haryana, Punjab, UP and Bihar. Several districts in these states have been declared drought-hit. However, monsoons in other regions of India have remained close to normal levels. Lower Kharif crop output estimates and drought scenario in many parts of the country lead to concerns on urea demand in coming future.

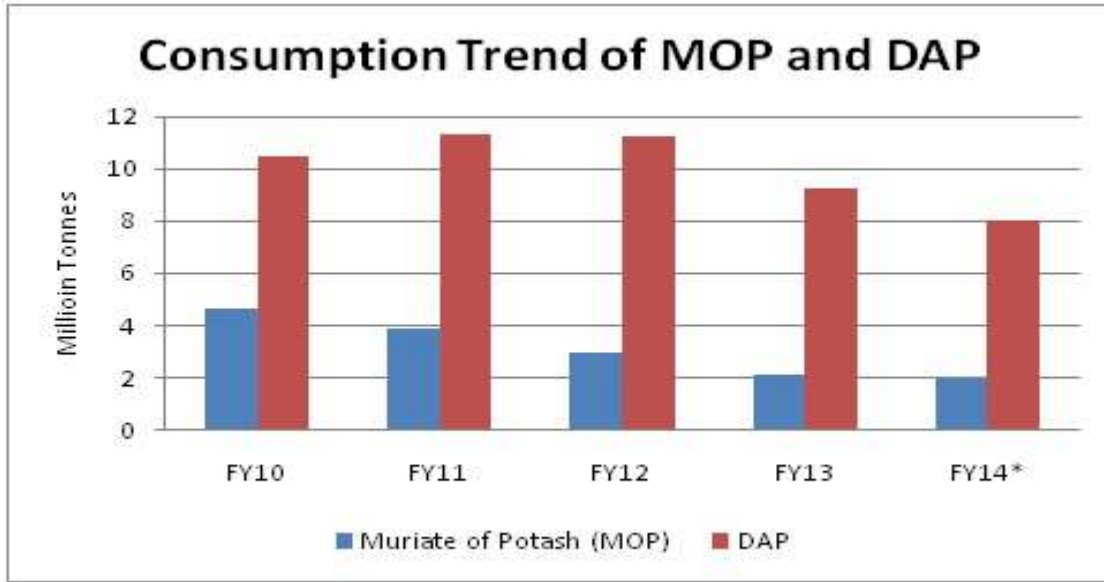


**DAP and MOP Fertilisers**

Di-ammonium phosphate (DAP), which is manufactured by reacting phosphoric acid and ammonia, is the world's most widely used phosphorus fertilizer. However, the consumption of DAP declined to around 8 MT in FY14 as against 9.2 MT in the previous fiscal. India does not have potassic (K) resources and has to entirely depend upon imports for requirement of potassic fertilisers. Domestic consumption of MOP during FY14 was recorded at around 2 MT as compared to 2.13 MT in FY13. India imports MOP mainly from countries such as Commonwealth of Independent States (CIS) region, Canada, Jordan, Israel and Germany. However, during the current fiscal, domestic consumption of P&K fertilizers such as DAP and MOP has been increasing at brisk pace at around 21%. The factors such as prevailing stable global prices of these fertilizers on account of increased supply and the base effect of low sales in previous fiscal can be attributed to increase in demand of P&K fertilizers.

Domestic consumption of DAP and MOP is much lower as compared to urea, indicating imbalanced application of nutrients in India. Farmers are using excessive urea as it is cheaper than decontrolled Phosphatic (P) and Potassic (K) fertilisers such as DAP and MOP. The ideal ratio of NPK for soil health is 4:2:1, while in India it is hovering around 8.3:2.7:1 and adversely impacts the soil health. Government policy can also be attributed to large difference between the price of urea and non-urea fertilisers. Urea is highly subsidised and is sold at Rs 5,360 per tonne as against the average production cost of over Rs 20,000 per tonne in 2013-14. Government pays 70-75 percent of total cost of production per tonne as subsidy, while in P and K fertilizers the

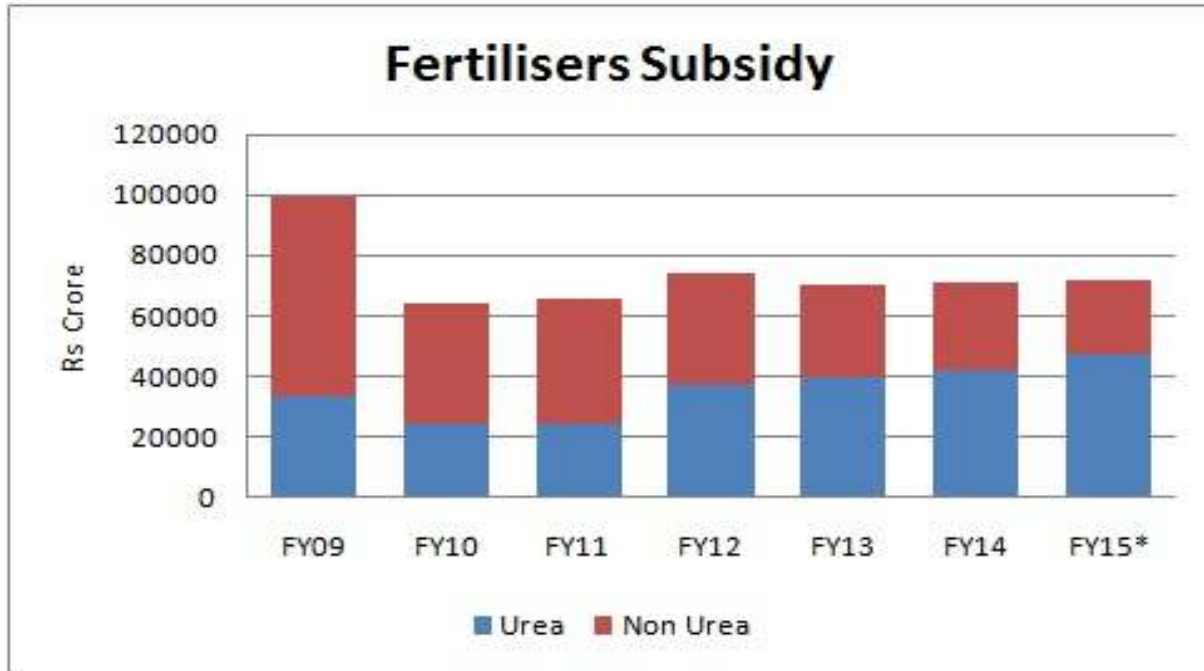
central government pays 25-40 percent of total cost of production as subsidy. Hence, increasing imbalanced use of nutrients has made it imperative for the Government to take measures to promote balanced use of fertilisers by bringing down urea consumption that has resulted in a huge subsidy bill and affected soil health.



\*- estimated

**Fertilisers Subsidy**

Urea, which is the main source of nitrogen (N), is regulated by the government and is highly subsidized fertiliser. In case of P and K fertilizers, the government pays only 25-40 percent of total cost of production as subsidy. In the previous fiscal, the government has given Rs 71,250 crore as fertilizer subsidy out of which around 58% or Rs 41,824 was allotted to urea segment, while the remaining was for the non-urea segment. For current fiscal, the government has pegged fertilisers subsidy at Rs 72,000 crore including Rs 47,400 crore as urea subsidy. As estimated fertilisers subsidy requirements are likely to be around Rs 1,10,000 crore, the budget subsidy amount is much lower than industry demand. Likely increase in industry subsidy requirement was due to higher gas cost, rollover of subsidy from FY14 and increase in fixed cost for urea. For every \$1 per mmBtu increase in gas price, the subsidy bill will rise by over Rs 2,395 crore. Therefore, subsidy gap is likely to rise from around Rs 37,000 crore at the end of FY14 to about Rs 40,000 crore by the end of FY15. Low subsidy allocation will impact industry players mainly urea manufacturers and compel them to seek more working capital loans which in turn will increase their interest cost burden.



\*- estimated

### Outlook

Increasing population and shrinking land resources in the country have increased the number of crop cycles that inadvertently reduce the productivity of the soil. Fertilizers play an important role in increasing the fertility and productivity of soil, which make it possible to churn-out more crops. Over the past few years, India's urea consumption has been growing at secular trend, increasing import dependence as there has been no significant investment in the fertilizer sector in the last several years. However, domestic fertilisers consumption is expected to remain under pressure as sluggish monsoon this year is likely to hit crop production. Further, increase in natural gas price is a new concern for the industry players.

On the positive side, industry performance in near term is expected to be aided by base effect of low sales during FY14, relatively stable, muted raw material and finished fertiliser prices in the international market and expected decline in subsidy delays during FY15. Moreover, investment in sector is also expected to increase as the government has clarified the doubts over urea investment policy and natural gas price hike.

**Companies Financial Data In Industry**

Company Name	CMP	MCAP	BOOK VALUE	DIV. YEILD %	TTM EPS	TTM PE
Bharat Agri Fert & Realty Ltd.	168.20	88.90	132.44	1.49	38.51	4.37
Zuari Agro Chemicals Ltd.	298.55	1255.64	186.69	1.00	35.28	8.46
Deepak Fertilisers & Petrochemicals Corporation Ltd.	143.50	1265.74	174.27	4.53	23.31	6.16
Tata Chemicals Ltd.	413.95	10545.64	229.81	2.42	19.83	20.88
Coromandel International Ltd.	338.00	9659.74	84.75	1.33	13.33	25.36
Gujarat State Fertilizers & Chemicals Ltd.	117.30	4674.14	110.46	1.71	11.74	9.99
Aries Agro Ltd.	94.65	123.09	103.64	2.11	8.36	11.32
Southern Petrochemical Industries Corporation Ltd.	27.10	450.61	10.51	0.00	8.14	3.33
Gujarat Narmada Valley Fertilizers & Chemicals Ltd.	89.65	1393.33	257.80	3.90	7.21	12.44
Chambal Fertilisers & Chemicals Ltd.	65.10	2709.51	54.52	2.92	6.51	10.00
Mangalore Chemicals & Fertilizers Ltd.	83.90	994.34	46.07	1.43	6.18	13.58
Rashtriya Chemicals & Fertilizers Ltd.	66.80	3685.28	46.99	2.25	5.97	11.19
Dharamsi Morarji Chemical Company Ltd.	23.00	48.89	5.82	0.00	5.15	4.46
Shiva Global Agro Industries Ltd.	23.60	22.52	45.58	0.00	1.91	12.38
Basant Agro Tech (India) Ltd.	8.38	75.95	10.10	0.84	1.83	4.57
Teesta Agro Industries Ltd.	13.55	7.60	77.33	0.00	0.93	14.59
Khaitan Chemicals & Fertilizers Ltd.	10.31	100.00	12.59	0.48	0.52	19.78
National Fertilizers Ltd.	38.35	1881.37	102.91	0.00	0.11	352.32
Madras Fertilizers Ltd.	20.30	327.04	-16.21	0.00	-0.01	0.00
Zuari Global Ltd.	100.65	296.32	216.69	0.99	-2.21	0.00
Fertilisers & Chemicals Travancore Ltd.	35.95	2326.22	-8.42	0.00	-3.91	0.00
Rama Phosphates Ltd.	40.45	71.57	70.50	1.24	-5.37	0.00
Tuticorin Alkali Chemicals & Fertilisers Ltd.	7.21	10.67	-111.96	0.00	-14.44	0.00

Source – Ace Equity

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