



FERTILISERS

Gas price hike to impact adversely

India Equity Research | Fertilisers

The Government of India notified the gas price hike on Jan 10, 2014 (Domestic Natural Gas Pricing Guidelines, 2014) as suggested by the Rangarajan Committee. Effective from April 01, 2014 and applicable for a period of five years, gas price would be based on an average price of liquid gas imports into India and benchmark global gas rates. We believe this move will lead to increase in the government's fertilizer subsidy on urea from FY15. It would also adversely impact stressed balance sheet of urea players as there will be an increase in working capital (primarily government receivable) requirement. The non-urea players who use gas as a raw material (like Deepak Fertilisers, RCF and GSFC) would also be hit. This will not have any significant impact on pure non urea players like Coromandel International. However, better gas availability in the long term will be a key positive.

Pricing policy applicable to all gas producers

The notified gas pricing policy will be applicable for all domestic natural gas producers and from all sources – conventional, shale and CBM. For fields like PMT, where price has been contractually fixed till FY16, the price will be applicable after end of the contract period. The price is uniformly applicable to all consuming sectors. Natural gas pricing will be a simple average of the following: a) weighted average of netback prices of all Indian LNG imports, and b) weighted average price of: (i) Henry Hub, (ii) National Balancing Point (NBP), and (iii) netback wellhead price for supplies to Japan. All prices are to be estimated for trailing four quarters with a lag of one quarter.

Effective FY15, fertiliser subsidy burden to shoot up

We believe that the gas price hike would result in an increase in government's fertilizer subsidy on urea from FY15. Our sensitivity analysis indicates that every increase of USD1/mmbtu in the gas price will push up the fertiliser subsidy by ~INR26bn (~4% of FY14 budgeted overall fertiliser subsidy or ~7% of urea subsidy) assuming INR/USD of 60. To compensate this, the government has to hike the urea price at the farmer level. We believe that to offset every increase of USD1/mmbtu in gas price, the government will have to raise the urea farm gate price by INR1,300-1,400/MT (~25% of present urea price).

Negative for urea players and few non-urea players too

The move is expected to affect stressed balance sheet of urea players (like Chambal Fertilisers, RCF, Tata Chemicals etc.), as it will increase the working capital (primarily government receivable) requirement. Non-urea players using gas as a raw material (like Deepak Fertilisers, RCF and GSFC) would also be impacted negatively. This will not have any significant impact on pure non urea players like Coromandel International. However, we believe that better gas availability in the long term will be a key positive.

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