Flashnote

HSBC Global Research

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India Fertilizer

Takeaways from our meeting with key fertilizer participants

- **Government and producers do not seem to be asking for an increase in subsidy**
- **We expect positive announcements on Urea in the short term**
- **Monsoon and not price will likely be the major factor in determining demand for complex fertilizer**

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We met with key policymakers, producers and traders in the fertilizer sector during our visit to Delhi. Our discussions largely focused on participants' views on policy and demand for fertilizers. We highlight the key takeaways:

The Nutrient-Based Subsidy (NBS) scheme is working well for the government and producers. The government fixed the subsidy per nutrient for complex fertilizers in the beginning of the year. With rupee depreciation, the cost of raw materials has gone up. This cost increase has been passed on to farmers as the government's contribution in the form of subsidy has declined yoy. As a result, the price to farmers has now increased by c25% to INR24,000/t (USD436/t) for DAP and to INR16,000/t (USD290/t) for MOP. Prices have more than doubled in just one year. Despite this, neither the producers have approached the government to increase the subsidy nor has the government itself been keen to initiate an increase in the subsidy. We believe this is good for the industry as producers are now relying on free market forces and consequently, the government contribution to total revenue will decrease, leading to better working capital.

Urea price hike deferral is only temporary. While an NBS for Urea seems to be almost ruled out in the short term, the possibility for a modest 10% increase in the price of Urea, an additional INR350/t increase in the fixed cost compensation and New Investment Policy (NIP) for Urea, is likely. While, the same was not approved in the Cabinet Committee of Economic Affairs meeting held on 14 June 2011, the expectation is that it will eventually be approved in the near future. The revised NIP is likely to allow freedom in gas prices with no cap and floor, which participants believe will encourage at least some investment.

Monsoon is key (risk) to demand. The market seems to be concerned that the increase in the price of fertilizer will lead to demand destruction. However, we found that concerns regarding demand are more on account of the monsoon than on prices. We found that participants expect some demand revival once the monsoon starts compared to the significant fall the industry experienced in April/May 2012.

Other takeaways

No margin pressure fears. The industry seems to be passing on the increase in costs to end consumers. Also, despite the expectation of new capacity, producers will likely continue to maintain their margins as it is still a sellers market.

Units that have been closed down will take longer to revive. India has substantial amount of capacity which were closed as units became unviable to operate. These plants will likely need to be revamped and will need additional investment before they can be revived. This is unlikely to happen in near future.

Rising prices have raised concerns of a potential black market emerging. Fertilizer producers appear concerned that some of the product available in the market is priced at old rates of INR18,000-20,000/t. However, the latest product is available at a maximum retail price of INR24,000/t. With dealers holding inventory at multiple price points, there are growing concerns of a potential black market emerging.

Disclosure appendix

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