

Equities

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NPK Weekly

Potash Prices Drop \$30 in Brazil; North America Potash Producer Inventories Jump

■ Industry Overview

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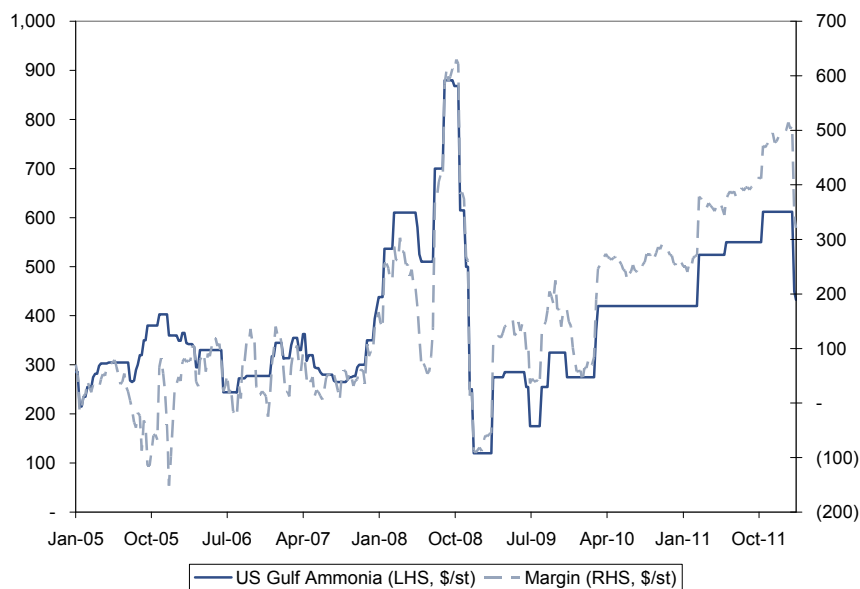
- **What's Next for Potash Prices?** – Trade publications are reporting some potash sales in Brazil at \$520/mt CFR, down ~5% from previous levels. Brazil is one of the largest non-contract markets (the country imported ~7.7mmt in 2011, ~14% of global consumption) and if lower prices stick it could be a catalyst for reduced prices in other markets. More broadly, we believe that the potash market could remain challenged until: 1) China settles its contract and sets a new price floor; or 2) North American spring demand is strong enough to give the market confidence that the recent inventory build will begin to reverse. Although near-term conditions are likely to remain volatile, we like exposure to the nutrient in the long term due to: 1) the consolidated industry structure; 2) high barriers to entry; and 3) delays in potential new supply. Key North America benchmark prices were flat to higher last week, with US Gulf urea increasing ~5% to \$419/st, Central Florida DAP stable at \$480/st, and Saskatchewan potash unchanged at \$533/st. Elsewhere, India settled its 1Q phosphoric acid contract with suppliers at \$960/mt, down ~11% from the previous settlement.
- **North America Potash Producer Inventories Jump** – The slowdown in buying in late 2011 resulted in a build-up of potash inventories at the producer level. While some seasonal build is typical in January, inventories increased 510k metric tons to ~3mmt, the highest since late 2009 and now rest 32% above the 5-year average. DAP inventories remain lean, falling 0.1mm tons to ~0.5mm tons and are 14% below the 5-year average. However, MAP inventories are elevated, increasing ~21k tons last month and are now 35% above the five-year average. In other phosphate news, CF announced this week that it has partially curtailed 1Q production.
- **USDA Updates Forecasts** – This week the USDA released its annual ten-year forecast, which includes the agency's first thoughts on 2012. For the upcoming planting season, the USDA's first estimate of corn planted acreage is 94mm, a 2.1mm acre increase from last year. This would be the largest planted area since 1944. Soybean acres planted are expected to fall 1mm acres to 74mm, while total acreage for the 8 largest field crops in the US is expected to increase to 251mm acres, the second largest area over the past 10 years. Longer-term, one of the most interesting changes to the outlook was the USDA's revised view that China will become an increasingly important corn importer. China is poised to account for 45% of the growth in corn trade over the next decade, with imports increasing from 3mmt this year to 16mmt in 2021 (2x the USDA's forecast last year). Increased exports should help offset slower projected growth in corn use for ethanol.
- **US Farm Income to Drop 6.5% in 2012** – The USDA expects US farm net income to fall 6.5% to \$91.7B in 2012. This follows increases of 24% in 2011 and 28% in 2010. Falling farm income is primarily driven by higher costs, as total input costs are expected to increase 3.7% in 2012. Revenues from crop production are expected to increase ~3%, as a gain in feed crops offsets lower revenues from food grains, fruits and vegetables. Other revenues (livestock, services and forestry) are expected to be stable Y/Y. Finally, fertilizer and lime costs as a percent of crop production revenues (a proxy for affordability) is expected to drop to 13.5% from 13.9% in 2011, but will still be higher than the 10-year average of 11.6%. The USDA will update its outlook in August.

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US Gulf Ammonia is averaging \$453 QTD vs. \$586 in 4Q '11.

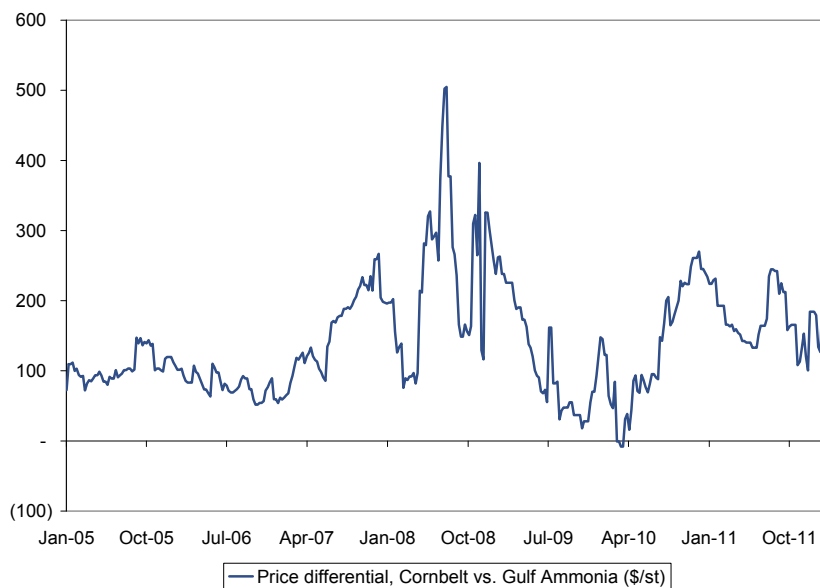
Figure 1. Nitrogen – US Gulf Ammonia



Source: Green Markets and CIRA

The cornbelt vs. US Gulf location premium is averaging \$191/ton in 1Q '12 vs. the 4Q '11 average of \$146/ton.

Figure 2. Nitrogen – Cornbelt Ammonia Price Premium



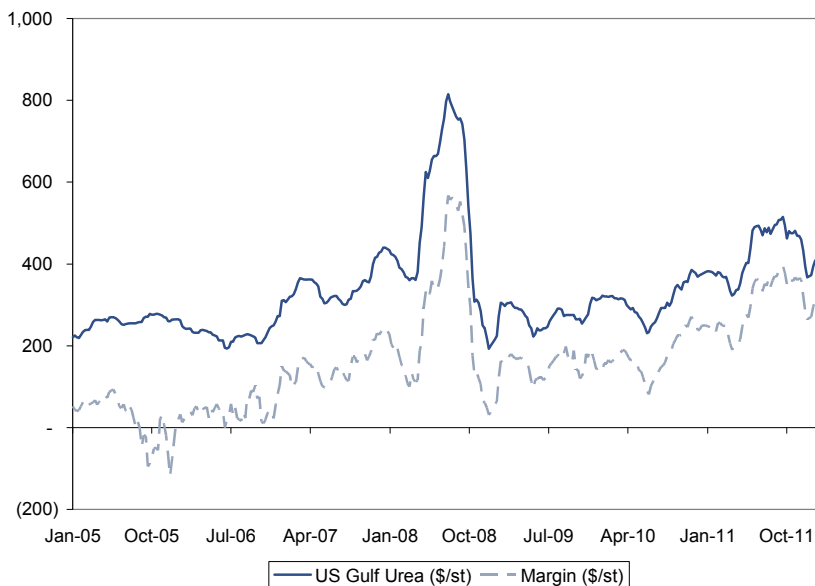
Source: Green Markets and CIRA

US Gulf vs. Middle East is at \$26/ton, which is below the breakeven level of \$32/ton for marginal imports, in our view.

US Gulf Urea is averaging \$402/ton QTD vs. \$445/ton in 4Q '11.

The implied margin based on spot urea and Henry Hub natural gas is averaging \$309/ton in 1Q '12 vs. \$336/ton in 4Q '11.

Figure 3. Nitrogen – US Gulf Urea

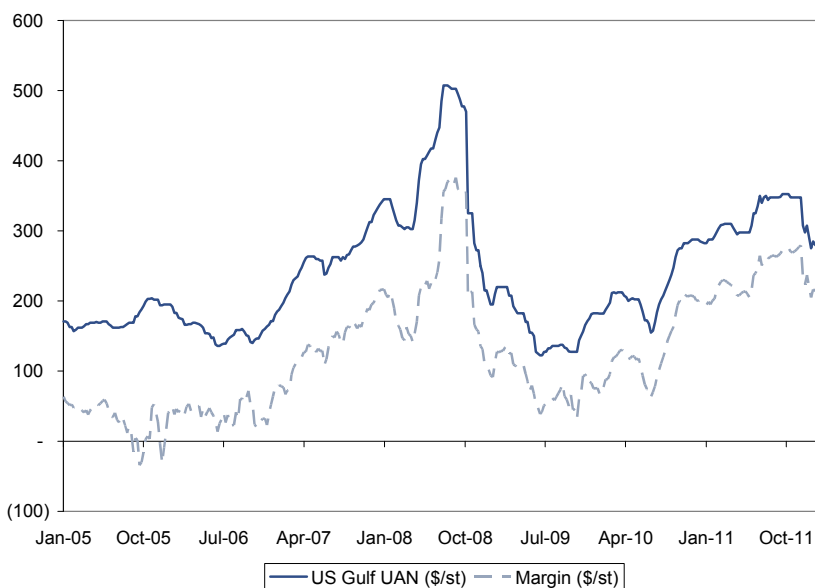


Source: Green Markets and CIRA

US Gulf UAN is averaging \$273/ton QTD vs. \$331/ton in 4Q '11.

The implied margin based on spot UAN and Henry Hub natural gas is averaging \$208/ton QTD vs. \$258/ton in 4Q '11.

Figure 4. Nitrogen – US Gulf UAN

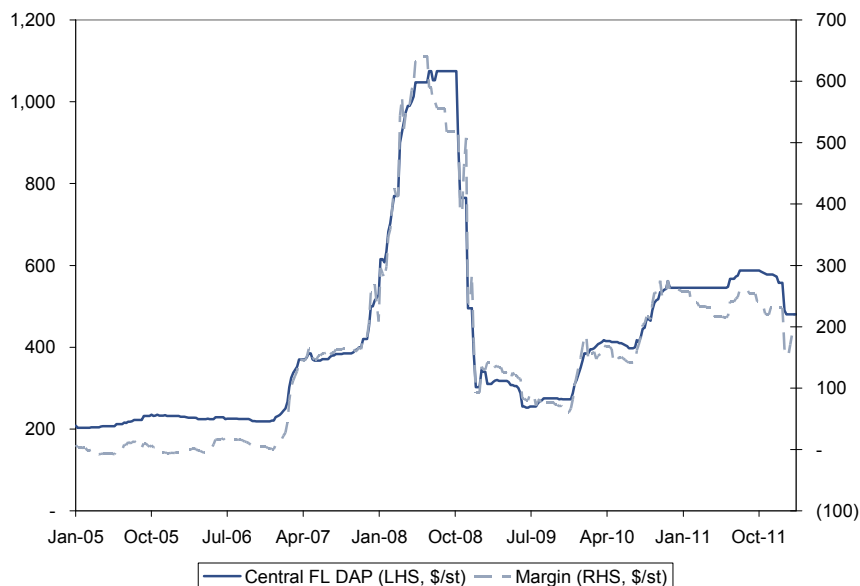


Source: Green Markets and CIRA

FL DAP price is averaging \$481 QTD vs. \$576 in 4Q '11.

The implied margin on domestic DAP sales is averaging \$175/ton QTD vs. \$229/ton in 4Q '11.

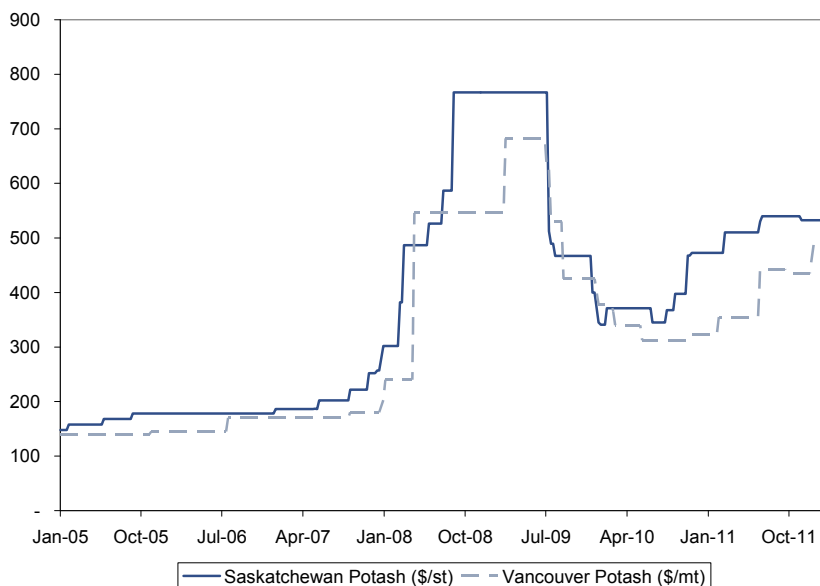
Figure 5. Phosphate – Florida DAP



Source: Green Markets and CIRA

Saskatchewan price is averaging \$533/t QTD vs. \$536/t in 4Q '11.

Figure 6. Potash - Saskatchewan and Midwest

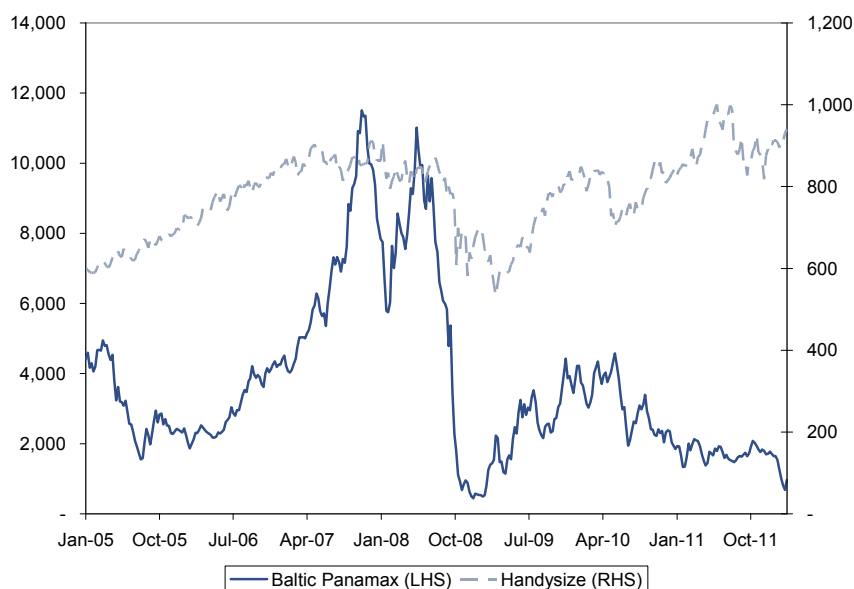


Source: Green Markets and CIRA

Falling ocean freight tends to lift margins for potash and DAP/MAP exporters because their product is typically sold on a delivered basis. Thus net-backs to the producers rise.

For North American nitrogen producers, falling freight enhances the competitiveness of imports.

Figure 7. Ocean Freight



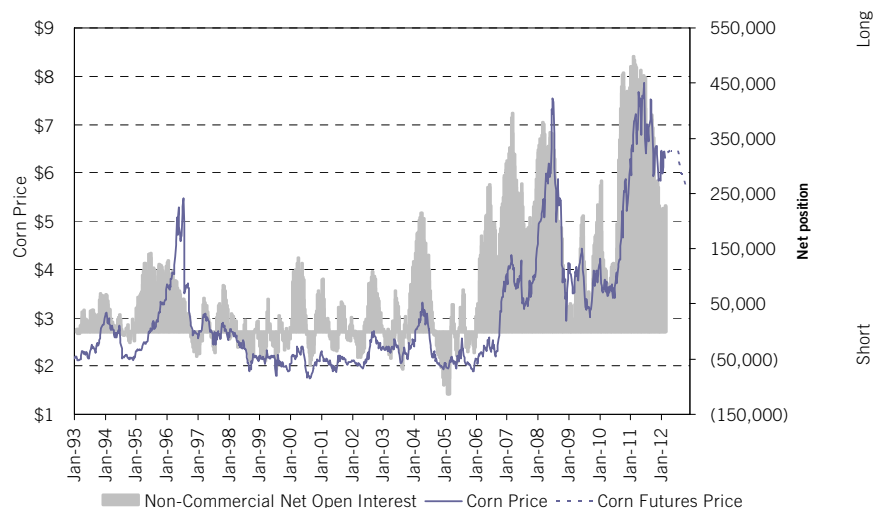
Source: Bloomberg

The corn net non-commercial open interest provides a measure of speculative interest.

The net-long position decreased 1% from last week to 226k contracts compared to the recent net-long record of 498k contracts during Feb-11.

Since 1998, the correlation between corn prices and net non-commercial open interest is a high 0.82.

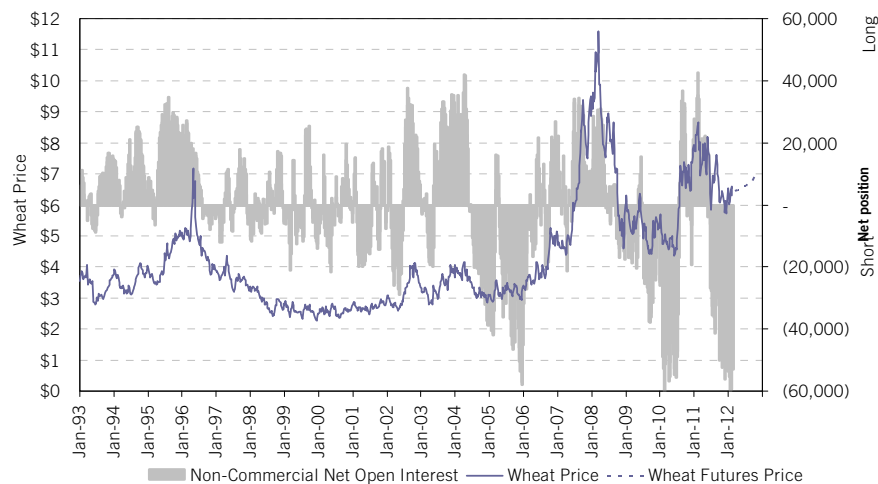
Figure 8. Corn Non-Commercial Open Interest and Pricing



Source: CFTC and CIRA

The wheat net-short position increased 27% from last week at 53k contracts. This compares to the recent net-long record of 43k contracts during Feb-11.

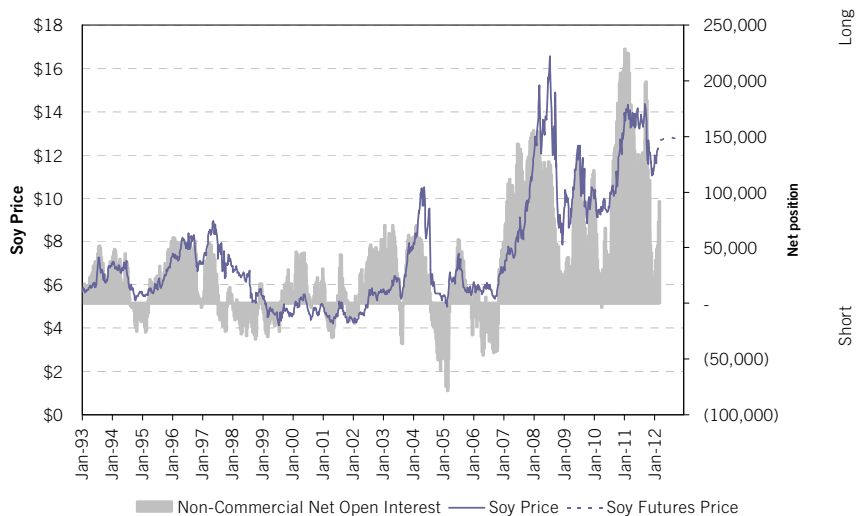
Figure 9. Wheat Non-Commercial Open Interest and Pricing



Source: CFTC and CIRA

The soybean net-long position increased 24% from last week to 92k contracts compared to a recent high of 228k contracts in Dec-10.

Figure 10. Soy Non-Commercial Open Interest and Pricing



Source: CFTC and CIRA

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Appendix A-1

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