

Fertilizer Industry Q1-FY19 update

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Domestic Fertilizer Production, Import and Sales during Q1FY19

Table 1: Production, Import and Sales of key fertilizers (LMT*)

	Q1-FY18	Q1-FY19	Y-O-Y Change
Overall Fertilizer Production	95.2	99.5	4.5%
Overall Fertilizer Imports	44.6	63.2	41.6%
Urea Production	55.6	60.6	9.0%
Urea Imports	17.0	21.4	25.6%
Urea Sales	52.1	62.5	19.9%
Non- Urea Production**	40.3	39.6	-1.9%
DAP Production	13.3	8.1	-39.4%
DAP Imports	11.0	20.6	87.9%
DAP Sales	15.7	18.6	19.0%
SSP Production	9.5	10.1	6.9%
MOP Imports	12.9	13.0	1.2%
MOP Sales	7.0	7.4	6.2%

Source: Department of Fertilizers, CMIE, Office of the Economic Adviser (figures do not add up due to different sources)

Note: LMT*- Lakh Metric Tonnes, Non-Urea** Fertilizers include NPK fertilizers, Ammonium nitrate, ammonium sulphate, DAP and SSP

The overall production of fertilizers has increased by 4.5%. Fertilizer production has increased on account of restocking for the sowing season.

Domestic production of **urea** (which constitutes about 60% of the overall fertilizer production) has increased by 9.0%, and imports have increased by 25.6%. Increase in production can be attributed to the reopening of certain urea plants which were kept shut for operational maintenance purposes during the previous year. This has led to better operational efficiencies resulting in better capacity utilization.

Import dependence of urea (imports as a proportion of production plus imports) increased from 24% in Q1FY18 to 27% in Q1FY19 while share of domestic production decreased from 77% to 73% during this period. Presently India mainly imports Urea from Oman, Iran and China.

Diammonium Phosphate (DAP) production has fallen on account of higher raw material prices and also as the raw material sourced for manufacturing of DAP (phosphoric acid) was diverted for the production of NPK (nitrogen (N), phosphorus (P) and potassium (K)) grade fertilizers. Imports on the other hand have risen sharply by 87.9% to make up for the domestic shortfall and also because it was more

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conducive to import the finished product rather than to manufacture it. India mainly imports DAP from China, Saudi Arabia, USA and Jordan.

India meets its **Potassium chloride (commonly referred to as Muriate of Potash or MOP)** requirements completely through imports from Canada, Russia, CIS+ Belarus, Israel, Jordan and Lithuania. MOP imports have increased moderately by 1.2%

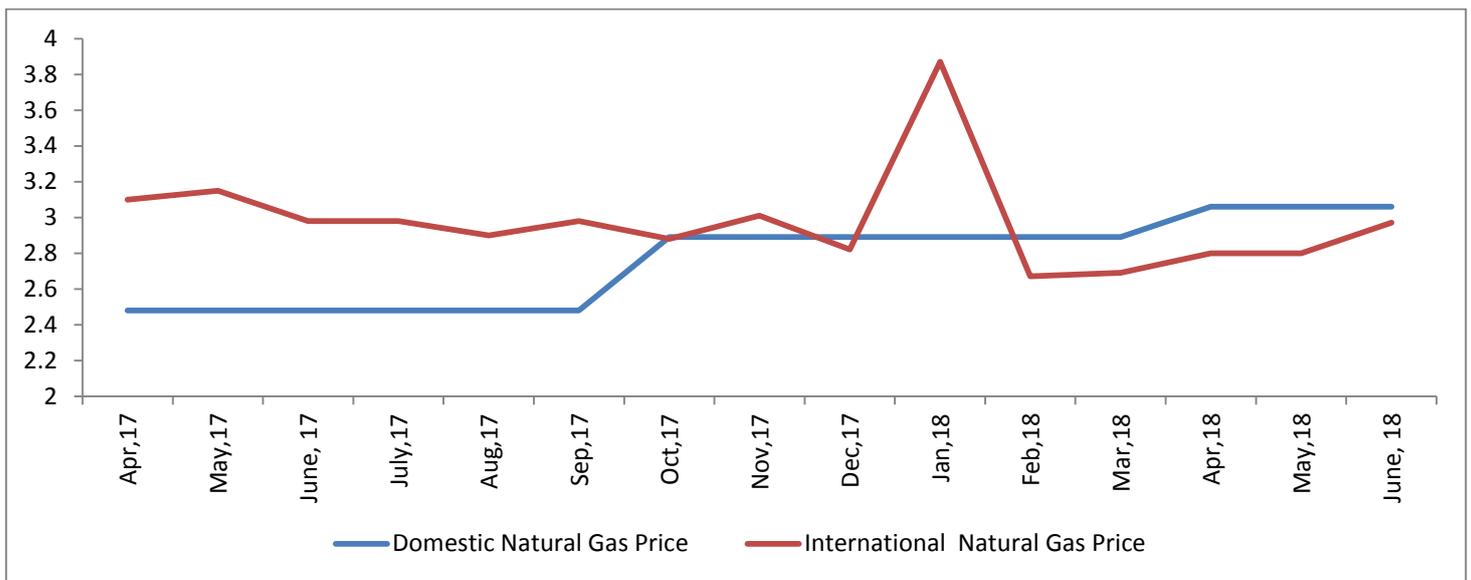
Single superphosphate (SSP) production has increased due to the increase in demand for phosphatic grade fertilizers. SSP is indigenously produced and procured.

Primary fertilizer sales increased mainly on account of low channel inventory at the beginning of the season. Sales of urea, DAP and MOP have increased by 20%, 19% and 6.2% respectively

Trend in prices of key input raw materials

Natural gas is used as feedstock for the manufacturing of urea and accounts for 80% of the raw material cost. The fertilizer industry is the leading consumer of domestic natural gas. Additional requirement of natural gas is via imports of natural gas in the form of RLNG. Out of 31 urea plants in India, 28 are gas based.

Chart 1: Trend in Domestic and International Natural Gas Prices (USD/MMBTU)



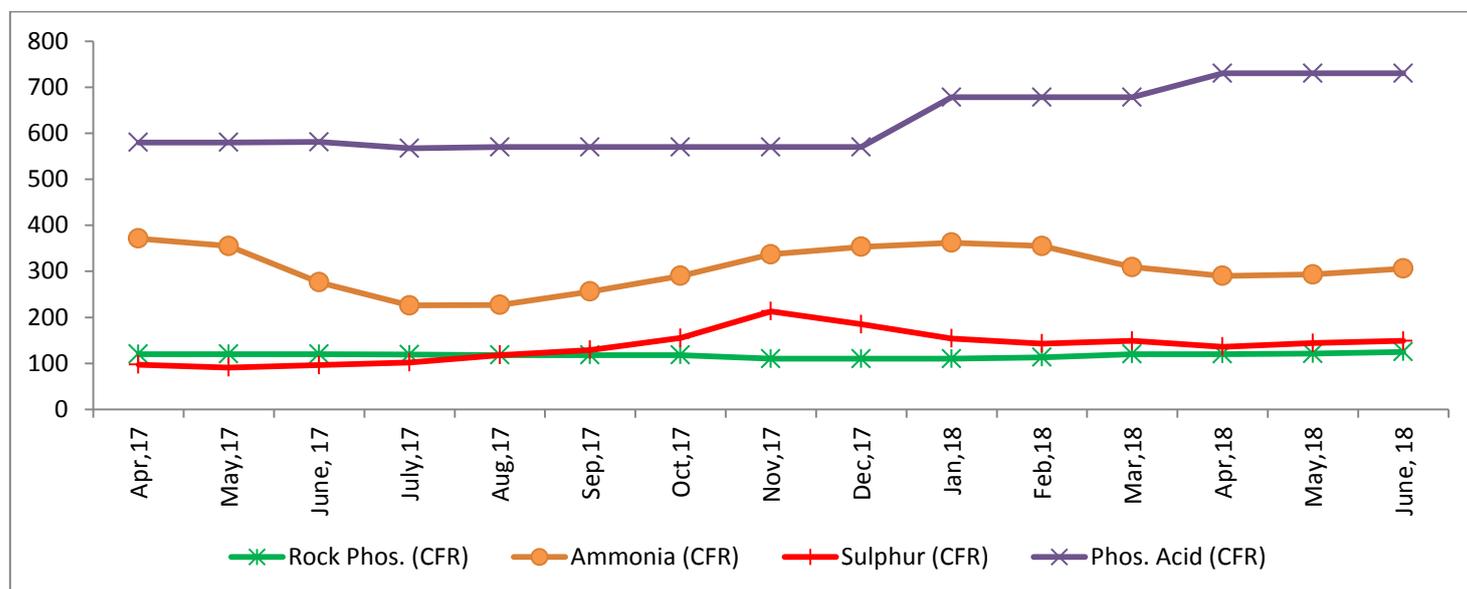
Source: PPAC, EIA

The price of natural gas was the lowest during Q1-FY18 (USD 2.48/mmBtu), which aided in improving the profitability of urea manufacturers. As per the New Domestic Gas Policy, price of domestic natural gas is revised every 6 months and currently (Q1-FY19) the price of domestic natural gas is USD 3.06 mmBtu (which is 23.4% higher as compared with the price prevailing during the corresponding period in the previous quarter). Prices of natural gas have risen on account of a sharp increase of crude oil prices.

India imports the raw materials needed for manufacturing of fertilizers. Raw material prices remained firm during the quarter, as plant closures in China and higher global demand impacted the availability. Prices of phosphoric acid, rock phosphates, and sulphur have increased by 26%, 2% and 51% respectively. Ammonia which is one of the raw materials used for the manufacturing of urea registered a drop in price by 11%.

Note: We have compared the y-o-y average prices prevailing during Q1-FY19 vis-à-vis with the prices prevailing during Q1-FY18.

Chart 2: Prices of Raw Materials used for Fertilizer Production (USD/MT)



Source: Department of Fertilizers

Phosphoric acid prices for Q2 have been finalized at USD 758/ MT (up by 4% from USD 730 level). This could add pressure to the margins of DAP producers. The only relief for the manufacturers is that the subsidy for the raw material phosphorus (P) has increased by 26.7% for FY19. Nutrient based subsidies for nitrogen (N) and potash (K) have been reduced by 0.5% and 10.4% respectively whereas subsidy for sulphur (S) has been increased by 20.5% for FY19.

GST Update

Revision in the rates of Phosphoric acid: The GST council further revised the GST rate of phosphoric acid and reduced it from 12% to 5%. With the easing of the GST rates, we expect the credit accumulation on account of inverted duty to come down substantially, which will further ease the working capital situation of the phosphatic fertilizer manufactures.

Policy Update

Direct Benefit Transfer (DBT): DBT has now been rolled out on nationwide basis as all the states are now under the ambit of DBT. Fertilizer companies have started aligning their sales through the DBT mechanism. The initial challenges with respect to connectivity at farmers' ends have been resolved (technology, compliance and recording of transactions on the POS machines); however, there are still some system-related issues relating to opening stocks during Q1, which is now being addressed by the Department of Fertilizer. The subsidy payout under DBT has started, and the government has been to settle the claims within 2-3 weeks.

Challenges

Rise in global oil prices which has led to the rise in natural gas prices and R-LNG prices will affect urea manufactures.

- As per our estimates the raw material cost for the fertilizer industry could increase by 5% due to the increase in gas prices. This could pressure on fiscal spending of the government while disbursing the subsidies. The fertilizer subsidy

for FY19 has been fixed at ₹70,090 crore out of which ₹44,989.50 crore is earmarked as the urea subsidy and the remaining ₹25100.5 crore as the nutrient based subsidy.

The fertilizer sector could face issues regarding the liquidity of working capital and credit accumulation.

- The fertilizer sector still faces an inward duty structure with the raw materials being taxed at 18% (except phosphoric acid which is now taxed at 5%) and the final product being charged at 5%. Ammonia, sulphur and rock phosphates are still being taxed at 18% which could lead to a temporary liquidity crunch and an increase in credit accumulation.

Concluding remarks: CARE Ratings Views and Opinions

The Government of India is focused towards the development of the agricultural sector and on improving the rural economy. So far the FY19 quarter has commenced on a positive note with an almost near normal monsoon and a healthy hike in the MSP of major crops.

- Given the importance towards the agricultural sector and the impetus given in increasing crop production we estimate the **overall fertilizer production to increase during FY19 to 422-425 LMT.**

The government is extremely committed in improving the quality of soil and in bringing it to its ideal NPK levels. The ideal NPK ratio is 4:2:1 whereas Indian soils the ratio is 6.8:2.7:1.

- We can expect the usage of non- controlled fertilizers to increase given the importance of balanced usage of fertilizers.
- **The domestic production of DAP is to remain depressed in Q2FY19 as the prices of phosphoric acid has been increased again by 4% (to USD 758).**
- Demand for DAP to be offset by the increase in use of NPK fertilizers and SSP.

With the commencement of the Gorakhpur, Sindri and Barauni urea gas based plants we can expect an incremental increase in urea production for FY19 by 6%.

- **Urea production to be around 254-257 LMT by the end of FY19**