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Lower subsidy - Negative for complex fertiliser players

- **Government of India (GoI) has negatively surprised by reducing subsidy rates on complex fertilisers by ~20% under Nutrient Based Subsidy (NBS) scheme w.e.f. 1st Apr '2011**
- **Although, the policies indicate GoI moving towards complete decontrol of the fertiliser industry, they are likely to have negative impact on complex fertiliser players in the near term**
- **Impact on earnings will mainly depend on 1) company's ability to negotiate lower prices with global raw material suppliers and 2) price increase to the farmers**
- **We estimate FY12E earnings downgrade by 15-20% for Coromandel and GSFC while Tata Chemicals, Chambal, GNFC and Deepak Fertilisers are unlikely be affected**

Complex fertiliser subsidy reduced by ~20%

Government of India (GoI) has announced revised rate of subsidies under Nutrient Based Subsidy (NBS) scheme effective from 1st April '2011. Under the new subsidy rates GoI has reduced the per kg subsidy on all the four nutrients viz N (Nitrogen), P (Phosphate), K (Potash) and Sulphur (S) (please refer table below). As a result subsidies on all the complex fertilisers are now down by 13-23% across various categories. For example subsidy on DAP, which is largest used complex fertiliser, is down by 20.3% (Rs 3,308 / mt) to Rs 12,960 / mt from Rs 16268 / mt (Please refer to the table in the annexure for the revised subsidy rates on different fertilisers).

Subsidy rates – Rs per kg

Nutrients	Nutrient Based Subsidy (Rs per kg of Nutrient)			
	New	Old	Difference	% chg
N	20.111	23.227	-3.116	-13%
P	20.304	26.276	-5.972	-23%
K	21.386	24.487	-3.101	-13%
S	1.175	1.784	-0.609	-34%

Source: Ministry of Fertilisers, Emkay Research

Government moving towards complete decontrol of the sector however...

We believe that this sharp reduction in subsidy is indicative of GoI moving towards complete decontrol of the fertiliser sector in the country and lowering down the subsidy burden by increasing the fertiliser prices to the farmers in the long run. However we expect that in the near term such reduction in subsidy is likely to have negative impact on companies' profitability. To compensate for lower subsidy (as in case of DAP by Rs 3,308 / mt), companies have to either bring down their cost by negotiating with global raw material suppliers or increase the prices to the farmers. Under the circumstances when these companies are not able to compensate this shortfall fully, there will be likely pressure on their profit margins.

.... Near term profitability may come under pressure

We do not rule out 15-20% earnings downgrade for FY12E based on the assumption that companies' EBITDA margins may come down by approximately Rs 500 / mt. However it will be based on the company's ability to negotiate for lower raw material prices and price increase taken to the farmers. Due to current ambiguity in these two variables we are keeping our estimates unchanged for Coromandel International and GSFC but we believe that there will be likely pressure on earnings in the near future.

Company	Reco	FY12E EPS (Rs)	Target Price (Rs)
Chambal	Accu	8.6	77
Coromandel	Buy	57.9	870
Deepak	Buy	25.2	250
GNFC	Buy	22.4	157
GSFC	Buy	66.3	530
Tata Chemicals	Accu	35.7	393

Possible earnings downgrade - FY12E

Company	Reco	Revised EPS (Rs)	% chg
Coromandel	Buy	50.2	-13%
GSFC	Buy	55.9	-16%

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Impact on FY12 earnings for companies

Impact on companies' FY12E earnings estimates		
Rs	Coromandel International	GSFC
Current assumption EBITDA / mt	2500	3150
Current FY12E EPS est	57.9	66.3
Impact on EPS if Rs EBITDA / mt down by		
	Rs	Rs
Rs 500 / mt	50.2	55.9
EPS impact (%)	-13.3%	-15.7%
Rs 1000 / mt	42.6	45.4
EPS impact (%)	-26.4%	-31.5%
Rs 1500 / mt	34.9	35
EPS impact (%)	-39.7%	-47.2%

Source: Emkay Research

We expect that there will likely pressure on EBITDA margins of Rs 500 / mt. We estimate that companies will be able to bring down their raw material cost by ~ Rs 1200 / mt and will be able to increase prices to the farmers by ~Rs 1500 / mt. to compensate for lower subsidy of Rs 3200 / mt on DAP, we expect that EBITDA / mt will come down by approximately Rs 500 / mt.

How much price increase farmers can absorb?....

Since the introduction of NBS from Apr '2010, companies have taken price increase for complex fertilisers by approx 6-10% under different categories. To compensate for the lower subsidy, we expect that companies can initially increase complex fertiliser prices further by ~10%. Possibility of further price increase later on, also can not be ruled out.

We expect that companies should be able to increase prices by ~10% initially

... And how much raw material cost can be brought down?

India accounts for approximately 40% of global trade for phosphatic fertilisers and commands strong bargaining power with raw material suppliers due to high import volumes. However recently phosphatic fertiliser prices have started increasing since DAP prices increased by 15% to US\$ 575 / mt by Nov '2010 (from Jul-Sep 2010 average prices at US\$ 500 / mt). We believe that under the rising price scenario, negotiating for lower raw material prices will involve key challenges for complex fertiliser players and failing which companies may see adverse impact on their profit margins and subsequently adverse impact on their earnings.

We expect that companies should be able to bring down the raw material cost by approximately 10%

Base rates assumptions are at significant discount to prevailing global prices

We believe that the current subsidy rates announced by the GoI assume significant discount to prevailing global prices. Base rate for DAP (for deriving subsidy on P) assumed at US\$ 450 mt (under the revised rate) is at 22% discount to prevailing global DAP prices of US\$ 575 / mt. Similarly base rate for urea (for deriving subsidy on N) assumed at US\$ 280 / mt is at 27% discount to prevailing global urea prices at US\$ 384 / mt. However price taken in consideration for the previous subsidy rates announcement (effective from 1 Apr '2010) were in line with global raw material prices at that time. This wide discount vis-à-vis prevailing global prices is likely to reduce companies' ability to bring down their raw material cost by large amount.

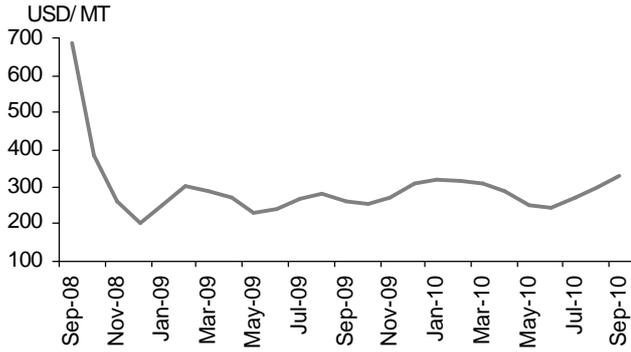
Revised Nutrient Based Subsidy (NBS) scheme's assumptions are at discount to current global prices by ~25%

IPP prices assumed for subsidy computation**US\$ / MT**

Nutrient	Product	Current NBS			Previous NBS		
		Base rate	Prevailing prices	Premium/ (Discount) %	Base Rate	Prevailing prices	Premium/ (Discount) %
N	Urea	280	384	-27%	310	305	2%
P	DAP	450	575	-22%	500	500	0%
S	Sulphur	125	NA	-	190	NA	-

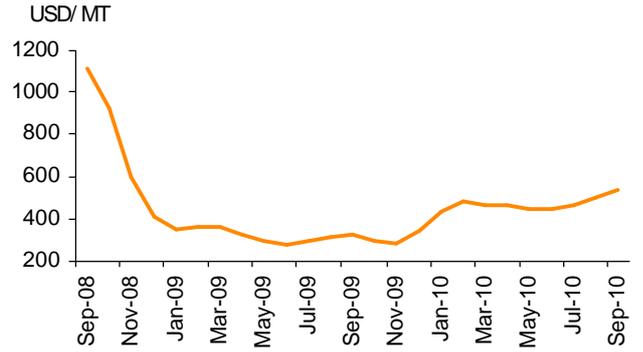
Source: Ministry of Fertilisers, Emkay Research

Urea Granular Bulk US Gulf FOB Spot Price

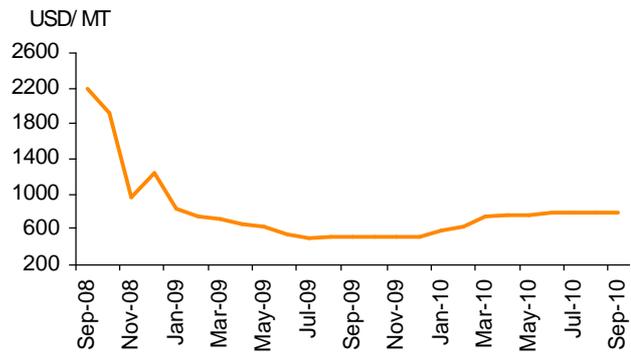


Source: Bloomberg, Emkay Research

Phosphate DAP Bulk US Gulf FOB Spot Price

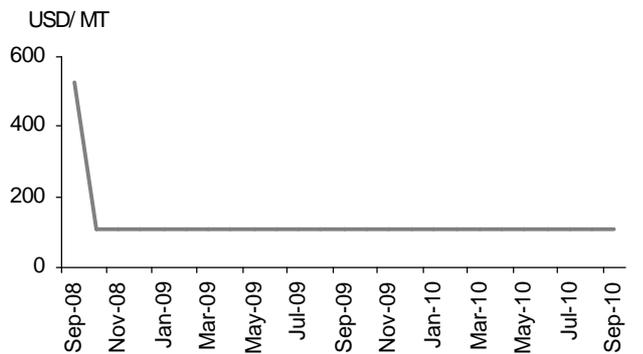


Phos Acid P205 Fert Grade India C&F

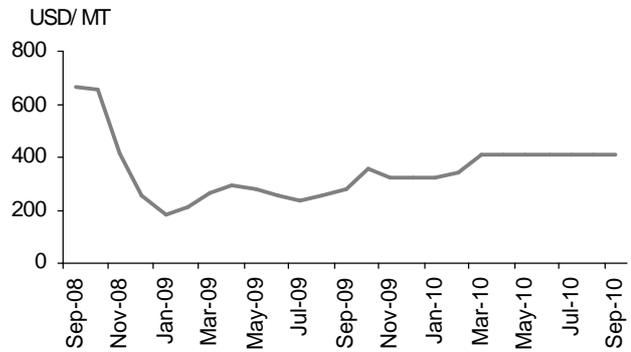


Source: Bloomberg, Emkay Research

Sulfur Fertilizer fob Vancouver Price US\$ / Ton

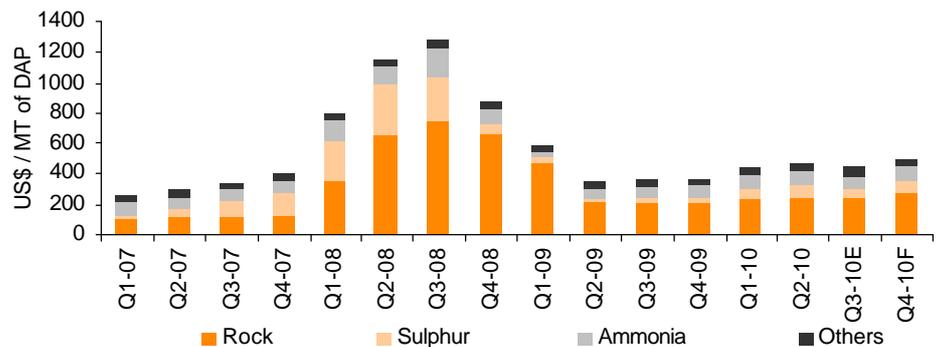


US Price : Ammonia US\$ / net ton



Source: Bloomberg, Emkay Research

Impact of rising costs for global producers



Source: Potash Corp, Emkay Research

Due to strong contribution to global trade, we expect that Indian companies will be able to negotiate for lower raw material prices to bring down their costs

India contributes ~45% to global phosphatic fertiliser trade

India accounts for approximately 45% of the phos acid global trade, ~16% of the global rock phosphate trade, ~9% of ammonia trade and ~11% of MOP trade. With such a strong participation on global trade we expect that India should enjoy strong bargaining power with global raw material suppliers and we expect companies to negotiate for lower raw material prices for FY12. However negotiations will also depend on their input cost and global demand – supply scenario. We expect companies may be able to bring down their raw material cost by approximately by 8% - 15% based on their individual bargaining power with suppliers.

India's share in global trade

MOP					Mn MT
	2004	2005	2006	2007	2008
World's Total Production	51.6	54.3	48.8	55.4	53.7
World's Total Export	42.3	41.9	38.4	45.0	41.2
Indian Import	3.4	4.5	3.4	4.4	4.1
Average International Prices (US\$/MT)	180	215	213	256	815
Indian Import as % of Total World Export	8.1%	10.8%	9.0%	9.8%	10.6%
Phosphoric Acid					Mn MT
	2004	2005	2006	2007	2008
World's Total Production	32.8	33.8	35.1	37.2	34.2
World's Total Export	5.0	5.0	4.8	4.7	4.2
Indian Import	2.6	2.8	2.3	2.3	2.0
Average International Prices (US\$/MT)	403	445	464	562	1714
Indian Import as % of Total World Export	52.9%	55.3%	48.6%	48.7%	45.2%
Ammonia					Mn MT
	2004	2005	2006	2007	2008
World's Total Production	140.3	145.2	148.0	154.3	153.0
World's Total Export	17.8	19.0	19.4	19.2	18.7
Indian Import	1.5	1.6	1.7	1.7	1.7
Average International Prices (US\$/MT)	244	260	300	318	460
Indian Import as % of Total World Export	8.6%	8.3%	8.8%	8.9%	9.1%
Rock Phosphate					Mn MT
	2004	2005	2006	2007	2008
World's Total Production	165.3	172.1	167.6	176.1	173.6
World's Total Export	30.9	30.8	29.7	31.3	30.6
Indian Import	4.8	4.8	5.3	5.0	5.0
Average International Prices (US\$/MT)	59	80	81	90	352
Indian Import as % of Total World Export	15.7%	15.6%	17.9%	16.0%	16.3%

Source: Ministry of Fertilisers, Emkay Research

Will increase in fertiliser prices lead to demand contraction of complex fertilisers?

We have witnessed that despite the increase in complex fertiliser prices by 6-10%, complex fertiliser consumption has gone up in H1FY11. DAP consumption has increased by 9% yoy in H1FY11 and complex fertiliser consumption has gone up by 40% yoy in H1FY11. On the other hand urea consumption increased marginally by 2% in H1FY11 over last year.

Fertiliser consumption in H1FY11

In '000 MT	H1FY10	H2FY10	H1FY11	% YoY
Urea	11,826	13,408	12,018	2%
DAP	5,783	4,062	6,286	9%
Indigenous	2,605	1,694	1,911	-27%
Imported	3,178	2,367	4,375	38%
Other Complex Fertilisers	5,052	7,624	7,079	40%
Indigenous	3,386	4,701	4,532	34%
Imported	1,666	2,923	2,547	53%
TOTAL	22,661	25,093	25,382	12%

Source: Ministry of Fertilisers, Emkay Research

In H1FY11, DAP and complex fertiliser consumption increased by 9% and 40%, respectively despite increase in fertiliser prices

Annexure: Old v/s New Subsidy rates for complex fertilisers

Rs / MT

Product	New Subsidy	Old Subsidy	Difference	% chg
DAP	12,960	16,268	-3,308	-20%
MAP	12,770	16,219	-3,449	-21%
TSP	9,340	12,087	-2,747	-23%
MOP	12,832	14,692	-1,860	-13%
SSP	3,378	4,400	-1,022	-23%
Complex Fertilisers				
16-20-0-13	7,431	9,203	-1,772	-19%
20-20-0-13	8,236	10,133	-1,897	-19%
20-20-0-0	8,083	9,901	-1,818	-18%
23-23-0-0	9,295	11,386	-2,090	-18%
28-28-0-0	11,316	13,861	-2,545	-18%
10-26-26-0	12,851	15,521	-2,671	-17%
12-32-16-0	12,332	15,113	-2,781	-18%
14-28-14-0	11,495	14,037	-2,543	-18%
14-35-14-0	12,916	15,877	-2,961	-19%
15-15-15-0	9,270	11,099	-1,828	-16%
17-17-17-0	10,506	12,578	-2,072	-16%
19-19-19-0	11,965	14,397	-2,432	-17%
11.5-23-18.5-0 (ANP)	10,939	13,245	-2,306	-17%
Ammonium Sulphate	4,413	5,195	-782	-15%

Source: Ministry of Fertilisers, Emkay Research

Recommendation History: Sector Update

Date	Reports	Reco	CMP	Target
19/02/2010	<u>Fertiliser Policy Update</u>			
21/10/2010	<u>Coromandel Intl Q2FY11 Result Update</u>	Buy	674	870
22/10/2010	<u>GSFC Q2FY11 Result Update</u>	Buy	370	530
28/10/2010	<u>Deepak Fertilisers Q2FY11 Result Update</u>	Buy	177	250

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