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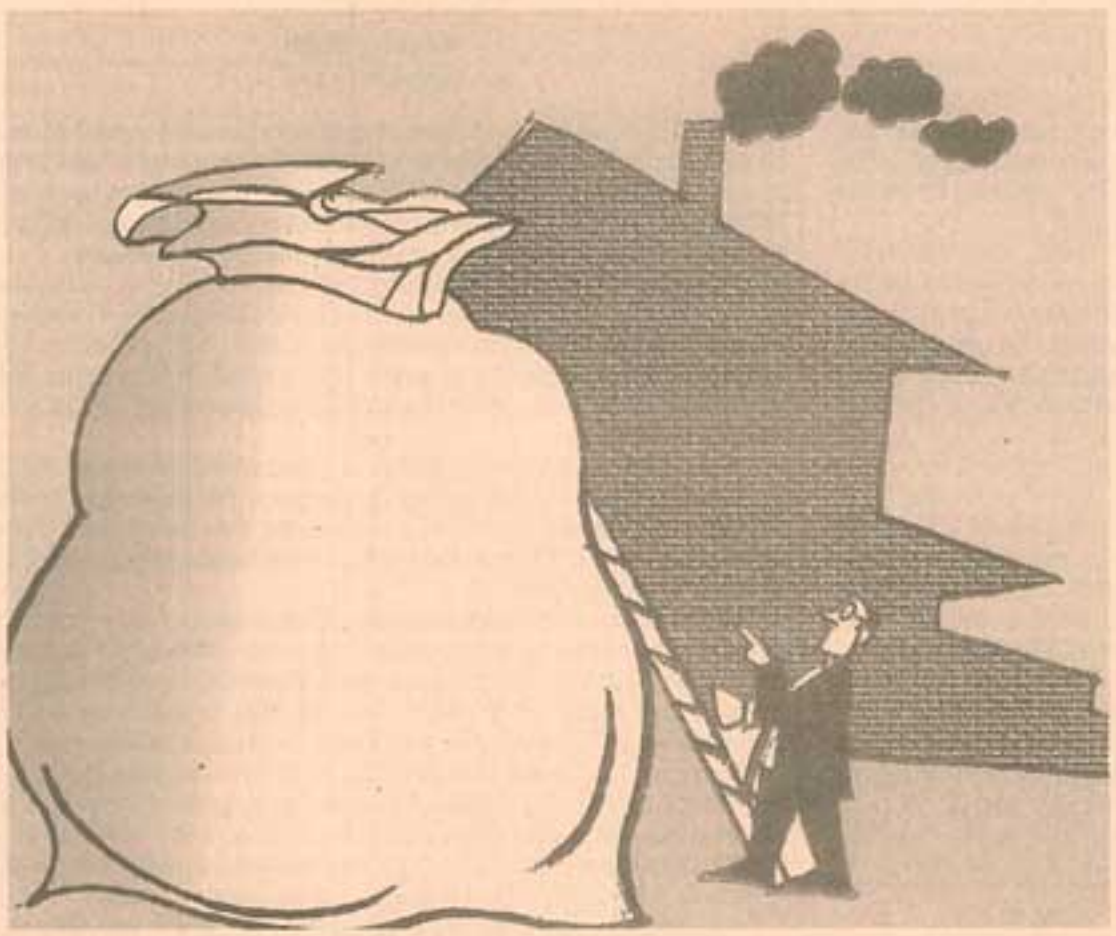
No fat, just bones

Contrary to public perception, fertiliser units do not have higher built-in capacity to exploit the retention price scheme, says **Uttam Gupta**



THERE is an impression that most fertiliser plants have higher built-in capacity than their stated capacity. And they make money from this since the retention price (RP) under the RPS is fixed on the stated capacity.

An article by Kirit S Parikh (*ET*, May 26) buttresses this impression, taking the actual capacity utilisation of nitrogenous plants in '95-96 for argument. Nitrogen production was also taken. Since, these are no longer under RPS — after decontrol in Aug '92 — only urea plants need to be taken.

The method of calculations has not been indicated by him. It seems for the new gas-based plants along HBJ pipeline, the annual capacity for urea is taken at 7.26 lakh tonne. For arriving at this, name plate capacity i.e. 2200 tpd, is multiplied by 330, latter being the number of stream days.

For remunerating fixed cost, including capital servicing charges (CSC), daily urea capacity is taken as 2327 tonne and not 2200 tonne. The logic is as follows. Basically, urea is produced by a reaction of ammonia with carbon dioxide. So the critical factor is the capacity of the ammonia plant, which is 1350 tpd each for all the plants along HBJ. This divided by 0.58 (conversion efficiency) gives the urea capacity at 2327 tpd. For pricing purposes thus, annual urea capacity is 7.68 lakh tonne (2327 x 330), which should be the basis for computing capacity use.

Similarly, there are two large-sized plants, RCF-Thal, Kribhco-Hazira located on shore and using gas from the Bombay High/ South Bassein region. Each of these have two-streams of 1350 tpd ammonia each. This gives a daily ammonia capacity of 2700 tonne leading to a urea capacity of 4655 tpd (2700/0.58) or 15.38 lakh tonne per annum. This level is used for fixing the price, and not the nameplate capacity which is lower. Accordingly, for arriving at capacity utilisation, production has to be related to this capacity.

On making adjustments for the above plants, the utilisation-wise spread of the 34 urea plants is indicated in the *table*. During '95-96, only three plants with a share of 11.4 per cent in production operated above 120 per cent capacity.

Operating levels above 100 per cent are not unjustified. Of 15 plants in the 100-120 per cent range, eight are old, mostly set up before the introduction of RPS in November '77. So it is wrong to impute that they have built in over-capacity for seeking higher subsidy. Prior to that, they operated below 100 per cent for many years. RPS incentives prodded them to improve their working.

For the new gas-based projects that came up after RPS, technology was selected on a standardised basis, and even the engineering and procurement contracts (EPC) were scrutinised and approved by the government. Sound plant design has to be based on end-of-run conditions which provide for sustained production even when ambient conditions such as maximum temperature, humidity and the like are adverse, and catalyst is due for replacement. Also, utilisation can be stepped up by shutting down the plant once in two years, instead of once in a year.

Under RPS, a 12 per cent post-tax return on net worth is allowed. Taking corporate tax at 46 per cent ('95-96), a corresponding pre-tax return works out to 22.22 per cent (12/1 — 0.46).

Contrary to belief that at 90 per cent utilisation, this return is guaranteed and that beyond this, companies make extra money, they do not get it even at higher capacity. Had the plants operated at only 90 per cent, some of them would have made losses.

Capacity utilisation of urea plants '95-96

Range	Number of Plants	% of total output
Less than 90%	15	12.3
90-100	1	9.5
100-110	6	20.6
110-120	9	46.2
120-130	1	2.6
above 130	2	8.8
Total	**34**	**100.0**

The reason for this is huge under-recoveries, under-pricing under various heads. To quote a few examples, revised prices for VIth pricing period, that is April 1, '94, were notified in January '95. Thus, during the entire pricing period and even thereafter, the units were paid conversion and capital related charges on the basis of '86-87 — costed year for Vth pricing — leading to huge losses in interest alone.

Because of the delay in VIth pricing — April 1,'94 to March 31,'97 — has been treated as an extension of VIth pricing or VI-A. This means that payment towards conversion charges *et al* continued to be related to '89-90. Losses thus continued even during '94-97.

Several claims remain pending for years, like expenses towards repairs and maintenance (R&M), impact of increases in interest rate, impact of rupee depreciation on foreign currency loan liabilities, depreciation on additions to capital, impact of levies like turnover tax and differential sales tax on gas.

For some of these items, payments, when made, are short of actuals and without interest. For R&M, for instance, either some of the items are arbitrarily disallowed or treated as deferred revenue expenditure (DRE), which means the sum will be paid back over 10 years in instalments.

Then, there are items like turnover tax levied by several states, which cannot be passed on to the farmer as state legislation prohibits this.

Even escalation claims are settled after a big time lag. For instance, prices of naphtha, fuel oil and LSHS were raised by 30 per cent from July 3, '96. But fertiliser units are yet to be compensated for that. The annual impact of the hike on the industry is about Rs 500 crore.

For new plants, the period involved in finalising RP is unduly long. It involves three stages —. notification of ad hoc RP, provisional RP and then, final RP. Each stage takes about six months, 2-3 years and 3-5 years from start of commercial production respectively. Moreover, RP is fixed at an artificially low level. Because of disallowances in capital expenditure alone, the shortfall would be Rs 1,000 to 1,500 per tonne. Due to this, at 90 per cent — production of 6.91 lakh tonne (7.68 x 0.9) — under-recovery works out to about Rs 70-105 crore. The loss would be even greater if disallowances in fixed cost other than CSC are also taken into account. By operating at higher capacity, companies only endeavour to cut this potential loss and maintain a reasonable level of profitability.

Far from growing fat, fertiliser industry in India is fighting a battle for survival. Remember, Peregrine, an international investment analysing agency, has recommended 'sell' of all fertiliser shares, except TataChem's.

According to Parikh, refixation of capacity at the highest production level achieved in any past year and feedstock/fuel norms at actual or design, whichever is lower, would yield a saving of about Rs 2,500 crore. This is highly inflated. To arrive at likely savings, let us take production above 110 per cent, and multiply it by the corresponding CSC. For all concerned plants put together, this will work out to about Rs 160 crore, which is the so-called 'unintended benefit' to be denied, according to Parikh's prescription.

The above is on the assumption that plants will continue to produce above 110 per cent. This is unlikely. Why should the plants be slogged when there is no incentive. In that case, loss of production will be about 6.1 lakh tonne, which has to be imported. At prevailing farm gate cost ('95-96), this would entail an additional subsidy outgo of about Rs 330 crore against a subsidy of about Rs 210 crore paid under RPB. Then the net loss to the exchequer would be Rs 120 crore.

Implementation of Parikh's proposal will impair the viability of existing units even as no new investment will be attracted.

The RPS should be seen as an instrument of ensuring continued health and growth of the industry and not of saving subsidy. So the efforts should be to make return attractive. Already, with the reduction in corporate tax to 35 per cent, the pre-tax return linked to 12 per cent post-tax, is down to 18.46 per cent which is unattractive.