

# Urea output will be hit under HPC package

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**T**HE high powered fertilisers pricing policy review committee (HPC) has recommended discontinuation of unitwise retention pricing and subsidy scheme (RPS) and its replacement by a system of uniform normative referral price (NRP) determined on the basis of long-run marginal cost (LRMC) method for existing units. The ex-factory NRP has been proposed at Rs 6,050 per tonne for urea produced by all gas based plants as on 1.1.1998.

It has further recommended feedstock differential cost reimbursement (FDCR) of Rs 1750 per tonne and Rs 1300 per tonne for units using naphtha/coal and fuel oil FO/LSHS, respectively, for a period of 5 years. This implies that uniform ex-factory NRP would be Rs 7,800 per tonne for naphtha/coal based plants and Rs 7,350 per tonne for FO/LSHS based plants as on 1.1.98.

The NRPs are lower — in some cases, substantially lower — than retention price (RP) under RPS for 7 out of 15 gas plants, all plants based on naphtha and coal and all but one plant on FO/LSHS. The RPs as on 1.10.97 do not reflect current reasonable cost of production which is higher in view of the impact of increase in price of various inputs since then for example hike in gas price w.e.f. 1.1.98. Consequently, shortfall will be even higher than indicated by comparison with notified RP.

In view of the above, barring a few plants — primarily gas based units located onshore/landfall point which may gain — adoption of the system of uniform NRP recommended by the committee would render majority of the plants unviable.

The units will also face serious liquidity problems. For instance, a

new gas based plant along HBJ pipeline has reasonable energy cost of about Rs 3,150 per tonne, bagging Rs 250 per tonne, and other operating cost (OOC) about Rs 800 per tonne. This takes away Rs 4,200 per tonne out of NRP of Rs 6050 per tonne. The balance Rs 1,850 per tonne will be inadequate to even fully service the loans.

For a majority of naphtha/FO/LSHS based plants, after meeting variable cost (energy plus bagging) (VC), there will be little money left to cover fixed cost including CRC. For a number of plants, even VC would remain uncovered by huge margin leading to immediate closure.

The committee has computed long-run average cost (LRAC) of 4 new gas based plants along HBJ pipeline — two grassroot units and two expansion — following the BICP method. This involves calculation, in stage I, of weighted average cost of servicing the capital — interest on long-term loan/working capital (WC) and return on shareholders' funds — over life of project taken as 15 years.

In stage-II, the rate thus computed is used for discounting streams of investment, WC and operating cost (energy/bagging, conversion, marketing, etc.) (OC) and projected production. The sum total of discounted values of investment, WC and OC divided by sum total of discounted values of production gives LRAC. The average of 4 such LRAC works out to Rs 6,035 per tonne. This is rounded off to Rs 6,050 per tonne.

The new gas based plants are severely hit because for determining LRAC, CRC is evenly spread over 15 years even though loans have to be repaid over much shorter period, i.e. generally 8 years on domestic and 5 years on foreign loans. Besides, assumed investment is much lower than reasonable actuals for respective plants.

Clubbing grassroot unit with expansion results in further lowering of average CRC.

Whereas, under RPS, allowable return is 12 per cent post-tax on net worth linked to capacity utilisation of 90 per cent, the committee has taken production at 100 per cent of capacity even as the return is kept unchanged at 12 per cent. This results in further pulling down the CRC.

For working out energy cost, almost unattainable consumption norms have been assumed. For instance, for a recent unit along HBJ, consumption of gas for a tonne of urea has been taken at 0.60669 thousand cubic metre at CV of 9250 K.cal which translates to 5.61 million K.cal.

The energy cost is further lowered artificially by assuming that the plant gets its full requirement of gas at optimum load. In reality, all HBJ units are denied — as per GOI order — gas supply for running captive power and steam generation plants. This forces them to use costlier naphtha which remains uncovered.

In the formula for allowing FDCR to naphtha/coal and FO/LSHS based plants, energy consumption for one tonne urea has been taken at 5.523 million K.cal and 6.763 million K.cal respectively. These are unattainable numbers even by new plants. The assumed norm for naphtha based plant is even lower than for gas based unit which defies logic.

With these highly theoretical norms and taking uniform delivered cost of energy expressed in Rs per million K.cal — while, this varies from unit to unit, lowest number is used — the committee has computed FDCR of Rs 2060 per tonne for units on naphtha and Rs 1,530 per tonne for FO/LSHS based plants. These are then arbitrarily reduced to 85 per cent to arrive at Rs 1,750 per tonne and Rs

1,300 per tonne, respectively.

Considering that majority of naphtha/FO based plants are old and, therefore, fully depreciated, uniform pricing on LRMC principle would give them higher contribution towards CRC. However, this is more than offset by huge underrecovery in energy cost due to artificially low FDCR resulting in overall net loss.

While the committee has described its package as forward looking, it would play havoc with a majority of plants — old and new alike. The problem arises because it pushes the so-called forward looking perspective to a point where it touches the boundaries of imagination — far divorced from the ground reality.

The irony is that plants cannot be run as per theoretical perception of the committee. If a unit has an investment cost of about Rs 1,400 crore, CRC are related to this level. Taking a lower number for pricing is bound to put it into serious trouble! An old naphtha based plant cannot achieve energy consumption of 5.523 million K.cal per tonne urea — indeed, even a few unit cannot — simply because the committee decides to restrict energy cost to this level.

Before finalising its stand on the committee's recommendations, the Government should re-work the NRP/FDCR for naphtha/FO/LSHS based plants using numbers on investment cost, normative production, return, energy consumption norm and delivered cost of energy, etc., which reflect the ground reality.

Alternatively, the RPS may be continued with necessary refinements/modifications to make the system more normative, transparent and less cumbersome. Whichever dispensation is adopted, there should be no compromise on continued health and growth of the industry.