Editorial

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Feedstock price hike

Spells doom for fertiliser industry?

The steep increase in the prices of feedstock/fuel has led to a turbulent situation in the fertiliser industry. While for some units the threat of imminent closure looms large, for others a significant curtailment in production cannot be ruled out. Nevertheless, almost all manufacturers are bound to suffer varying degrees of erosion in profitability, says Uttam Gupta.

THE steep increase in the prices of petro products, with effect from September 2, has struck yet another blow to the fertiliser industry. The basic price (ex-refinery) of naphtha has been increased from Rs. 4,840 per tonne to Rs. 7,624 and of furnace oil from Rs. 3,916 per tonne to Rs. 5,507. The price of low-sulphur heavy-stock (LSHS) is up from Rs. 3,707 per tonne to Rs. 6,089.

The increase in the landed cost basis (factory gate) is much higher in view of the cascading effect of sales tax, which is levied on percentage basis, as well as the increase in the transport charges resulting from the substantial increase in diesel prices by about 26 per cent. While the exact impact may vary from unit to unit depending on location and, consequently, the differential effect of freight and local taxes, in the case of Zuari Agro Chemicals (ZACL), for instance, the cost of naphtha went up from Rs. 5,804.64 per tonne to Rs. 9,286.92 and that of furnace oil from Rs. 4,827.0 per tonne to Rs. 6,953.08.

Such hefty increases in the cost of feedstock/fuel to the fertiliser industry have resulted in a corresponding substantial increase in the production cost of urea and various complex phosphatic fertilisers produced from domestic ammonia based on naphtha/fuel oil/LSHS. Again, in the case of ZACL, in view of the increases in the landed cost, and taking the consumption norm at 0.63 tonne naphtha and 0.24 tonne furnace oil for one tonne of urea, the resultant increase in the cost of production will be about Rs. 2,700 per tonne.

In view of the control on the selling price of urea (at a low level), the increase in the production cost will have to be reimbursed as additional subsidy under the retention price scheme (RPS). For ZACL, the annual impact works out to about Rs. 100 crores, for Duncan Industries Ltd about Rs. 102 crores, and for Shriram Fertilisers, Rs. 53 crores. Other plants using naphtha/furnace oil as feedstock and fuel will be similarly affected.

In respect of gas-based plants also, which have been forced to use alternative fuels — naphtha, fuel oil/LSHS — for running their captive power and steam generation plants due to unilateral curtailment in supply of natural gas, since 1994, the production cost and, consequently, the additional subsidy payable under the RPS will increase significantly due to a rise in the cost of these feedstock/fuels.

At the aggregate level, using the projected consumption of naphtha, fuel oil and LSHS by the fertiliser industry, in 1997-98, and after making adjustments for quantities of relevant feedstock/fuel used in running offsite facilities, these are already being charged at non-concessional rate (the industry, on the whole, will be loaded with an additional burden of about Rs. 1,500 crores per annum). Of this, about Rs. 1,100 crores will be on urea having to be reimbursed as additional subsidy under the RPS; and the balance Rs. 400 crores on decontrolled complex phosphatic fertilisers.

On the face of it, it might appear that urea manufacturers will not be affected even as they are protected under the RPS. A scrutiny of the mechanisms involved, however, reveals that this is not so. Under the present FICC's policy since 1991, of adjusting retention prices (RP) for increases in variable cost on quarterly basis, the delays in notification of revised RP and payments on that basis are unavoidable. For instance, the steep increase in the prices of naphtha, fuel oil and LSHS by 30 per cent each, with effect from July 3, 1996, was adjusted in the revised RP in March and payments received only in May, leading to a delay of almost 11 months.

Faced with increasing expenditure commitments, including the impact of revision in the Pay Commission's recommendations, the Government is contemplating a package of measures to ensure that the fiscal deficit does not go out of control. And one such measure is to postpone liabilities on account of the increase in the fertiliser subsidy to next year — 1998-99. In view of this, it is unlikely that the Budget allocation would be increased to cover additional requirements.

The majority of naphtha/fuel oil-based plants are old, fully depreciated and with low net worth. Consequently, their generation of cash from operations is meager in relation to the additional cash requirements because of the price increase. For instance, in the case of Duncan Industries, the former is only Rs. 25 crores and the latter more than Rs. 100 crores. The serious bind will hamper the ability of these plants to maintain production as it is not possible to arrange for working capital from banks on such a large scale.

The situation has been aggravated by oil companies insisting on advance payments or bank guarantee for additional amount, consequent to the price hike. In the case of Mangalore Chemicals and Fertilisers (MCF), where the cash credit account has been frozen by the banks and the company has no credit facilities in view of being with the BIFR, the additional outflow — estimated at about Rs. 60 crores per annum — will virtually cripple operations. Even a contemplated move to rehabilitate the company could be in jeopardy.

Apart from liquidity problems, any delay in the release of payments will lead to substantial erosion of profitability as the Government does not pay interest on delayed payments. In fact, considering that the financial impact is much more this time — about Rs. 1,100 crores per annum against Rs. 550 crores due to the price hike in July 1996 — the implications of the delayed payment will be much more severe.

The increase in the cost of feedstock has also led to a rise in the production cost of complex phosphatic fertilisers which are: 28-28-0, about Rs: 1,300 per tonne to Rs. 1,750 per tonne; 20-20-0, Rs. 700 per tonne to Rs. 1,100 per tonne; and DAP, about Rs. 950 per tonne. Consequent to the steep increase in the diesel price, leading to a rise in the transport cost on both inputs and finished products, the cost of supplying these materials to farmers will be even more.

Unlike urea manufacturers, whose increase in production cost is covered under the RPS by way of corresponding adjustments in RP and differential subsidy payment, the concession amount under the scheme of *ad hoc* concession for de-controlled complex phosphatic fertilisers is fixed on a uniform basis — linked to the cost of imported ammonia. In view of this and even the selling price fixed on an uniform basis, using domestic ammonia based on naphtha, fuel oil/LSHS, remains unprotected.

The problem is particularly acute for a manufacturer such as FACT, which will draw ammonia from its newly-commissioned revamped Alwaye (Kerala) plant and, therefore, be saddled with the additional handicap of high capital-servicing charges. The fate of MFL, which too depends on ammonia from its recently-commissioned revamp/expansion project, will be similar.

About 9,00,000 tonnes of indigenously produced ammonia is used in the production of DAP and complex phosphatic fertilisers, of which 5,00,000 tonnes is from plants based on naphtha fuel oil/LSHS. The production of DAP and complex phosphatic fertilisers from such plants contribute about 30 per cent of the total *P2O5 production through DAP and complexes in the country.

Consequent to the steep increase in the cost of production and in the absence of support on an urgent basis, production by these units will be rendered unviable. In fact, considering the steep hike in prices and with the oil companies insisting on advance payments/bank guarantees for additional liabilities, on the one hand, and meager cash with companies, on the other, production will virtually come to a grinding halt almost immediately.

The manufacturers of AS, CAN and ACI will be the worst affected. Already, following their decontrol and removal of the RPS cover in June 1994, resulting in the steep increase in their selling prices, they are at a serious disadvanage *vis-a-vis* urea, which is heavily subsidised translating into low prices for farmers. Moreover, unlike decontrolled P and K fertilisers, these products do not even get *ad hoc* concession support.

Against this backdrop, the increase in the production cost due to a hike in the prices of naphtha fuel oil/LSHS will further accentuate their disadvantage especially when similar increase in production cost of urea is absorbed by corresponding increase in subsidy, leaving its selling price unchanged. The steep increase in the prices of feedstock/fuel has led to a turbulent situation in the fertiliser industry. Whereas for some units the threat of imminent closure looms large, for others a significant curtailment in production cannot be ruled out.

Almost all manufacturers are bound to suffer erosion in profitability though the degree may vary. For extreme cases such as MCF, already with the BIFR, the chances of evolving a suitable rehabilitation package will be jeopardised. Such will be the fate of FCI and HFC group of plants.

Following the noise made by industry and its apex body — the Fertiliser Association of India (FAI) — certain reliefs can be expected, say, by way of reducing the time lag in the release of payments to urea manufacturers under the RPS, an increase in the concession amounts for manufacturers of complex/phosphatic fertilisers and timely payments or, perhaps, some support to the beleaguered ACI and CAN manufacturers. The extent of relief/support would be known only when it comes. Notwithstanding this, the all-pervading debilitating effect of feedstock price hike is so intense that the injury is likely to be felt over the long term.

The worst is, perhaps, yet to come. Already, there is mounting pressure to do away with controls and RPS for urea and force the industry to compete with global suppliers. A number of economists expressed such views at a recent seminar in New Delhi. If that comes about, say, even three years from now, the very survival of the industry will be at stake.

This is not because the Indian industry is inefficient — our plants (excluding sick units) compare with the best in the world — but, primarily, due to the feedstock cost being several times more than in major exporting countries. Expressed in dollars per million Btu, at revised rates, the cost to Indian industry is naphtha 6.0; furnace oil 4.8; natural gas 3.7 (HBJ plants); 2.8 (on-shore plants); as against feedstock cost (through gas) of 1.0 in Iran, Indonesia, Bangladesh and Russia; 0.77 in Oman; 0.5 in Saudi Arabia; and 0.25 in Qatar.

In the past, the Government had laid emphasis on maximising indigenous production of fertilisers to reduce dependence on imports and resultant exploitation in the world market. This paid rich dividends, as in 1990-91, when urea imports were reduced to nil. Thereafter, wavering on this strategy has led to the slackening in the build-up of domestic capacity and increasing imports. Things should not be allowed to slip out of control and go back to the days of the 1970s, when the dependence on imports was heavy and prices exorbitant.

There is a paramount need to take a re-look at prices of feedstock on supplies to fertiliser industry and to set these at par with prices at which feedstock is available to plants in exporting countries. If, however, this cannot be done and at the same time, if we do away with subsidy — as some economists would press for — it will be a sure disaster on the fertiliser front, and, in fact, on the food front as well.

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