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# No need for guarantee

**The Omanese should consider RCF and Kribhco's financial soundness and the demand for urea, says Uttam Gupta**

THE high profile Oman-India joint venture is an outstanding example of India going global. Likely to cost about $1.2 billion (at current prices), it envisages setting up of an ammonia/urea complex in Oman with an installed capacity of 3,500 tpd ammonia and 4,400 tpd urea. While the Omanese side is represented by the Oman Oil Company (OOC), the Indian presence is through the public sector companies of RCF and Kribhco, which have the same equity holding as OOC. The MoU between the two sides proposes 100 per cent buy-back of the urea produced by India.

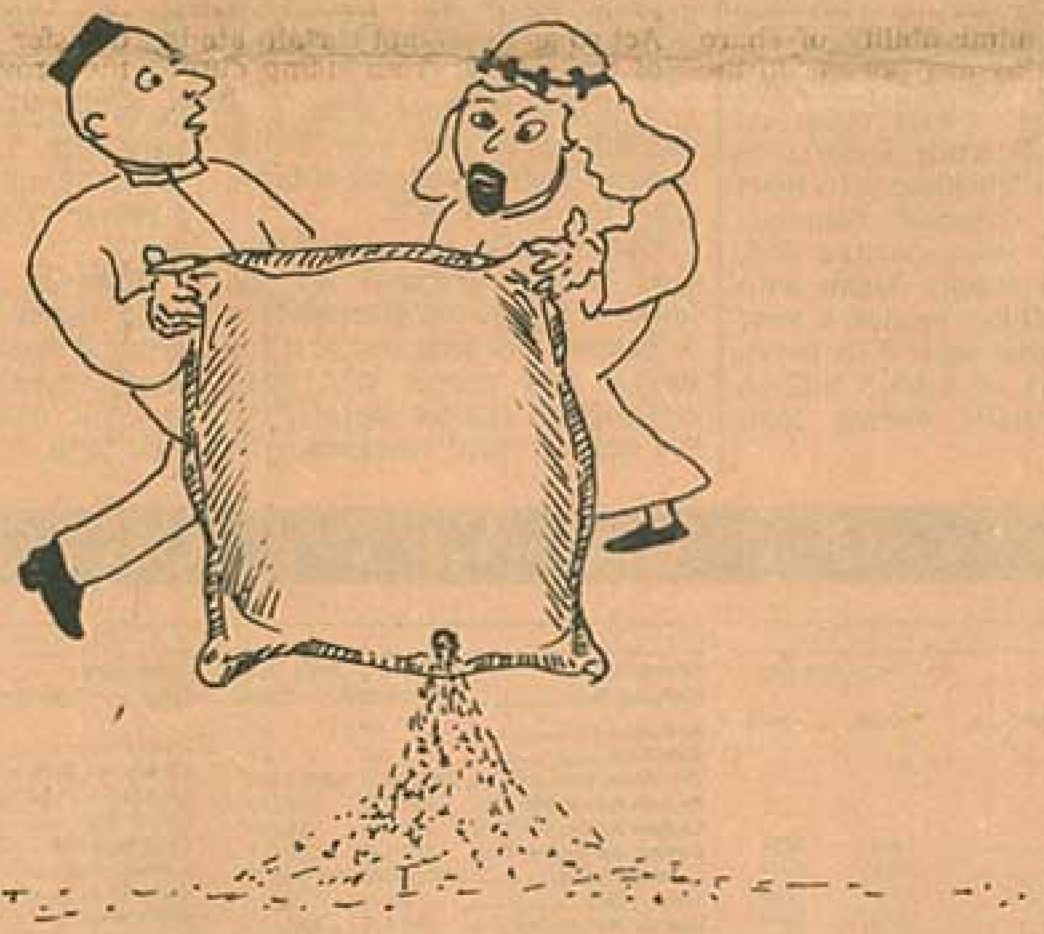
The Indian side has, however, faced several impediments from the word go. Initially, the problems arose over the price of natural gas, the basic feedstock of ammonia/urea production, apart from the sensitive issue of management control and the related question of the price at which India would get the urea supplies. Reportedly, these have been resolved. However, recently, a fresh point has been raked up by the Omanese side that may jeopardise the project itself. This relates to the OOC demand for a counter-guarantee from the Government of India on the buy-back arrangement, which the latter has categorically refused to concede.

Having already agreed to provide a counter-guarantee to fast track power projects and considering its overall fragile finances and resultant unwillingness to accept more exposures, the government's reaction was not wholly unexpected. However, the issue needs to be considered strictly on merits. The government has argued that the Indian companies participating in the project are financially sound (both being cash rich companies) and therefore, they are fully capable of absorbing any risk that might arise on account of non-performance of the terms in the agreement.

The OOC does not appear to be fully convinced. Its persistence for a counter-guarantee gives rise to certain apprehensions, which need to be set at rest urgently. It is not merely a question of ensuring smooth sailing of this particular project, but more of maintaining India's credibility as a safe bet in respect of other joint ventures and long term contracts with foreign companies.

The doubts border on the perception of the Omanese that the Indian companies will not be able to lift the 100 per cent production (about 1.5 million tonnes per annum) in full or may not be able to pay or a combination of both.

The presumption that the urea produced at the plant may not be bought back in full is without basis as India is perennially deficit in domestic availability of urea. In fact, during 1994-95, we imported about 2.9 million tonnes to meet the shortfall in domestic production. For the current year, 1995-96, imports are likely to exceed 3 million tonnes.



With demand continuing to rise and production not keeping pace, the deficit is expected to increase further. Estimating demand conservatively at about 11.7 million tonnes of nitrogen fertiliser (urea being its predominant source of supplying it) by 1999-2000 and likely production, including contribution from projects already under implementation, we will have an uncovered deficit of about 1.9 million tonnes nitrogen or 4.2 million tonnes equivalent urea.

In view of this, finding market for the 1.5 million tonnes urea produced by the Oman plant will not be a problem. In fact, the very raison d'etre for contemplating the joint venture, apart from abundant and cheap gas, was to develop a captive source of supply and thus avoid heavy dependence on the highly uncertain and unpredictable world market.

Does the OOC fear that we may not be able to arrange foreign exchange needed to buy urea on the required scale? This again is unfounded as we are in a free market exchange rate regime with no government restrictions/quotas. All you have to do is to arrange for equivalent rupee resources. Considering that both RCF and Kribhco are financially sound and demand is not a limitation, there is absolutely no reason to doubt their capability to generate the resources.

What we also need to consider is that, at present, urea is covered by pricing and distribution controls. The government controls the selling price to the farmer at a low level on the one hand and reimburses the excess of the cost of production (C&F landed cost in respect of imports) and distribution as subsidy on the other hand.

This would mean that any increase in cost, whether due to an increase in the basic price in dollar terms or due to depreciation of the rupee, will be paid for by additional subsidy payment by the government.

The selling price to the farmer will, hence, remain unaffected. In fact, the increase, if any, would be dependent solely on the administrative action of the government. While deciding on the price level, the government can make sure that demand is not adversely affected. Therefore, from this angle also, there is absolutely no reason to worry.

Even in the situation of ultimate decontrol of urea, although there may be some adverse effect on the overall demand due to consequential increase in prices, the financial health of RCF and Kribhco is unlikely to get affected. This is because the domestic plants of both these companies are fully depreciated and consequently, the cost of urea produced by them is substantially lower than newly commissioned plants. The fact that these are based on gas it gives them advantage even over the earlier vintage naphtha/fuel oil based plants as these alternate feedstocks are inferior to gas in terms of conversion efficiency.

Even if the price of urea bought from the Oman plant tends to be high, the weighted average cost of supplies i.e. through domestic production and imports, will still be lower vis-a-vis supply from other producers or pure imports.

Another apprehension may emanate from whether the Indian ports are equipped or geared to handle the imports. This too is without any basis. It should be clear that imports from the Oman joint venture will not be over and above the normal level of urea imports. In fact, to the extent we have urea supplies from the joint venture, purchases from the international market will correspondingly decrease. So, there will be no additional strain on the existing port infrastructure.

Finally, the Omanese side also needs to recognise that the Indian companies are equal partners in the project. In the event of any financial loss to the project that might arise due to non-observance of the terms of the agreement or any other factor, they will suffer as much as the OOC. Consequently, the question of the Indian side reneging on its buy-back commitment even partially is absolutely hypothetical.

Quite clearly, the fundamentals bearing on the joint venture are quite strong. The Government of Oman should recognise this and avoid raising the demand for a counter-guarantee, which is patently unjust and unwarranted.