

# PIB's stand on fertiliser projects short-sighted

In a free market scenario, the projects will be 'economically' and 'financially' unviable

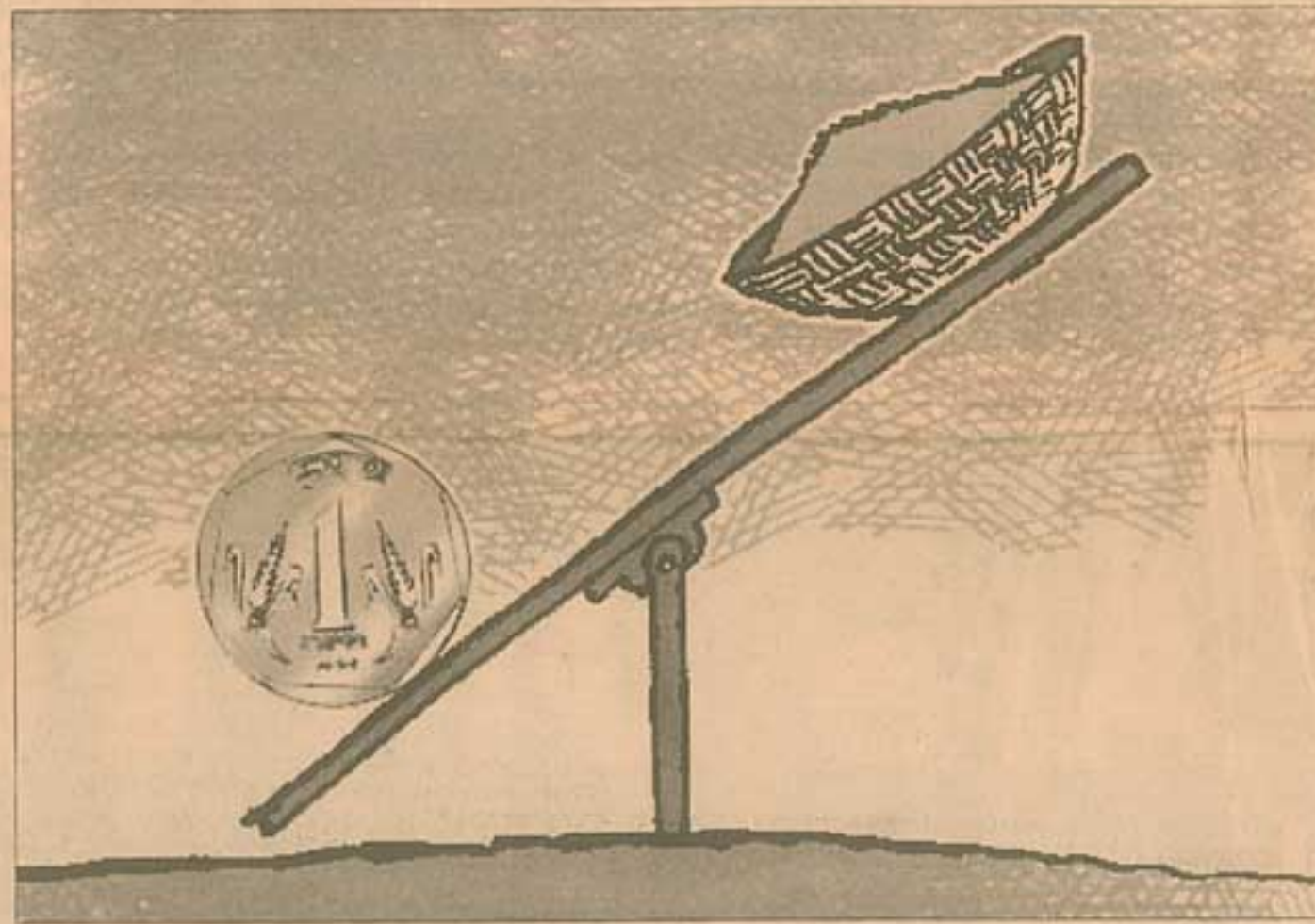
By UTTAM GUPTA

IN a recent meeting, PIB has suggested re-consideration of four projects viz., RCF-Thal III, KRIBHCO-Hazira III, IFFCO-Nellore and KRIBHCO, Gorakhpur earlier approved by CCEA. It has stated that, in a free market scenario, the projects will be "economically" and "financially" unviable. Fertiliser is a strategic input in increasing production of foodgrains and other agricultural crops thereby ensuring food security on the one hand and facilitate rapid and sustained agricultural on the other. In view of this, sole reliance on economic and financial criteria for setting up additional capacity can lead to highly misleading conclusions and policy decisions thereof.

According to economic criterion, a project will be deemed to be viable if reasonable production cost of urea from this is lower than corresponding cost of supplying it from imports. Do the project under reference pass this test? At prevailing naphtha price of about Rs 1100 per million K.cal (delivered at plant site), energy cost is about Rs 6600 per tonne (6 million K.cal for a tonne of urea).

For an expansion project, estimated investment is about Rs 1200 crores. At debt-equity ratio 2:1, loan is Rs 800 crores and equity Rs 400 crores. The cost of servicing these would be interest @ 15 per cent Rs 120 crores, return on equity @ 19.0 per cent (corresponding to 12 per cent post-tax) Rs.76 crores and depreciation @ 6.33 per cent Rs 76 crores. This adds up to capital related charges (CRC) of Rs 272 crores.

Taking normative production 0.69 million tonnes per annum (90 per cent of installed capacity 0.77 million tonnes as per current FICC norm), CRC would be Rs 4000 per tonne. And another



about Rs 1000 per tonne towards conversion cost (CC) viz., wages/salaries, other overheads, chemicals, catalysts, repairs and maintenance etc., and bagging, reasonable production cost would be Rs 11,600 per tonne. Against this, at prevailing C&F cost of US \$85 per tonne, cost of imported urea including handling at port and bagging is about Rs 4400 per tonne.

In view of above and cost of supply from project being a whopping Rs 7,200 per tonne more than cost of imported urea, it will not be viable.

Even if plant is gifted by some one and concerned philanthropist undertakes to bear conversion cost in perpetuity, then also it will remain unviable. This is because energy cost alone exceeds cost of imports by a huge Rs 2200 per tonne. An obvious question arises as to why project should not use domestic gas or imported LNG, which are cheap and efficient feedstock? In this context, situation on the ground is far from encouraging. Domestic gas for any new project is just not available. This is as per Government dictate. As regards LNG, while,

there are big plans by MNCs, Petronet LNG, consortium of fertiliser majors etc., the moot question here is when it would be on tap and at what price?

Even as promoters talk of a minimum time frame of five years, considering the pace at which things move, especially, the process of getting various approvals, it will be much longer than that before any LNG project takes shape. In regard to price, in a free for all scenario, it is unlikely to be less than naphtha. Consequently, use of LNG would not materially reduce production cost.

Much ado is often made about achieving high efficiency to reduce cost. The critical question is how much effort do we expect units to make? In view of CRC and CC alone exceeding import cost by significant margin, any talk of improving efficiency makes no sense. In fact, even with 'nil' energy consumption, the project will not be viable. Assume for a moment, CRC and CC as NIL (i.e., plant is gifted), then, at prevailing naphtha cost of Rs 1100 per million K.cal, for energy cost alone to match cost of import, energy consumption for one tonne urea will have to be 4.0 million K.cal (4400/1100). This is technically impossible. Thus, there is no way that indigenous cost can match that of import. The financial criterion has not been spelt out. While, this may have to do with minimum acceptable rate of return, crucial point is still ex-factory price realisation. Currently, selling price of urea is Rs 4000 per tonne. Deduct Rs 500 per tonne towards freight and distribution margin, net back (ex-factory) will be Rs 3500 per tonne. This is lower than production cost by Rs 8100 per tonne. Thus, on price paid by farmers too, project cannot be sustained. ♦

The author is chief economist, Fertiliser Association of India