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Victim of unattractive policy

The fertiliser industry is a victim of uncertain governmental policies and a prejudiced outlook by investors and rating agencies, says **Uttam Gupta**

CLOSE on the heels of Tata Group chairman Ratan Tata directing all its group companies to toe its line, apart from other criteria, which involve an uncompromising stand on good performance, Tata Chemicals Ltd (TCL) managing director Manu Seth has tendered his resignation, which has been accepted.

Tata Chemicals, in which the Tatas have 30 per cent stake, is engaged primarily in manufacturing urea and soda ash. Even as soda ash activities are governed entirely by market forces, urea is still under the government control. In recent years, operations in both the segments have come under stress resulting in a declining trend in profitability.

While, pressure on the margins in soda ash is mainly due to the flooding of cheap imports, in urea, the company has attributed the decline in profitability to the inadequate price realisation under the retention pricing scheme (RPS).

The problems in the administration of the retention pricing scheme are well known. Because of these, it is not merely Tata Chemicals but also a majority of the companies in the fertiliser sector are sailing in troubled waters.

Despite operating at high capacity utilisation and achieving energy consumption levels comparable to the best in the world, fertiliser corporates are barely able to reach the contemplated 12 per cent post-tax return which, by itself, is un-attractive.

Imagine their plight if, they were to operate only at the normative utilisation levels, namely 90 per cent, for gas-based plants, this would have led to measly returns or even losses in some cases.

Recently, based on an interim re-assessment of the capacity of urea manufacturing units reporting high capacity utilisation, the government notified provisional retention prices which are significantly lower than the existing levels. It has also restricted production to only 100 per cent of interim re-assessed capacity. As a consequence, returns will get further eroded during the current year.

In view of the above restrictions and the continuing uncertainties in the field of policy environment, the perception about fertiliser shares in the market is very negative. Based on their prevailing low prices, generally, the market capitalisation is a small percentage, of say between 20-25 per cent of their respective asset value. Ironically, even at these low levels, there is not much demand for these shares. This is in sharp contrast to other old economy stocks, not to talk of the new economy shares like the Internet, telecom, electronics, entertainment etc, which are showing unprecedented buoyancy.

Even the foreign institutional investors have become increasingly disinterested in fertiliser scrips.

This is amply demonstrated by a substantial reduction in the exposure by foreign institutional investors (FIIs) in the fertiliser stock in the recent years. In sharp contrast, in other areas, particularly the new economy and the fast moving consumer goods (FMCGs) sectors, the foreign institutional invetors have been taking unprecedented exposures which are said to be largely responsible for their high valuations.

Even the perception of rating agencies about investment in fertilisers has changed for the worse. In a paper presented at a seminar in New Delhi about two years ago, the Crisil had virtually forewarned prospective investors about the risks involved in investing in the fertiliser sector in the country in view of the continuing policy uncertainties and resultant unattractive and inadequate returns.

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Unfortunately, even the domestic financial institutions are also reluctant to a take significant exposure in fertiliser-related activities including revamp, expansion/modernization of existing plants.

The government has been looking for an alternative to the RPS for almost a decade now. When, the high-powered Fertiliser Pricing Policy Review Committee (HPC) under the chairmanship of Dr C H Hanumantha Rao, a former member of the Planning Commission, had submitted its report on wayback on April 3, 1998, it appeared that the new policy would soon see the light of the day. Unfortunately, it has been a long wait of almost two-and-a-half years since then.

The recent release of the background paper on long term fertiliser policy by the minister of chemicals and fertilisers at a seminar organised by the Federation of Indian Chambers of Commerce and Industry (Ficci) has re-kindled the hope. However, considering the fact that the government proposes to hold a series of seminars in different parts of the country and intends to finalise the policy thereafter, it would appear that various stake holders may have to wait longer.

While it is imperative to prevent further delay, the new policy should be positively announced before the end of this year. Even as the background paper is devoted mostly to road map for phased decontrol, it does not give the details of the new pricing regime that would replace the RPS. It is this which should receive immediate attention as, from the point of view of companies' bottomlines what matters it the ex-factory price realisation.

While, considering the contemplated package, the government would be well-advised to avoid getting carried away by certain theoretical calculations (in an article published in a leading financial daily some time back, an eminent economist had talked of the possibility of fertiliser units making profits as high as 78 per cent) in regard to likely profit margins and instead, take into account realities on the ground. In other words, its endeavour should be to ensure reasonably attractive returns to all efficiently operated units.

[Views expressed are personal]