

Fertilizer Industry

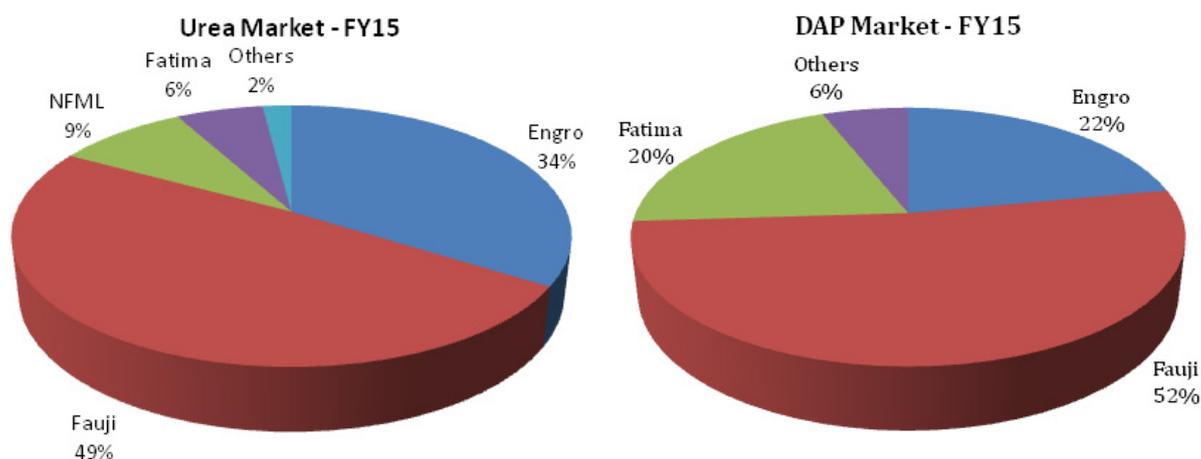
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With almost one-fourth of Pakistan's Gross Domestic Product (GDP) contributed by the agricultural sector, there is significant dependence on agrarian products in the country's economy. Demand of fertilizer products in Pakistan is largely driven by factors including availability of cultivable land, availability of water, prices of fertilizer products, population growth and government policies such as commodity support prices offered to farmers.

Availability of cultivable area bears a direct relation with the demand for fertilizer products. During fiscal years of 2010 - 2014, cultivable area in Pakistan has depicted a nominal growth of 1% on account of damage caused by floods and increasing severity of water-logging and salinity issue. Going forward, area under cultivation is expected to largely remain unchanged provided no natural calamities take place. Largest contribution to the agrarian economy emanates from Punjab followed by Sindh given its sizeable cultivable area.

Commodity support prices offered by the Government of Pakistan (GoP) to farmers have also played a crucial role in fostering demand of fertilizer. Incentive, in the form of higher prices, encourages the farmers to improve crop yield through application of fertilizers. Over the years, support prices offered by the government have depicted an upward trend. This resulted in higher use of fertilizer over the same horizon. Another reason attributable to increase in fertilizer usage is the growing awareness about its benefits by farmers.

Figure 1: Market Share



Nine companies operate in the fertilizer sector of Pakistan, with Fauji Fertilizer and Engro Fertilizer collectively accounting for a total share of 83% in the Urea market. Moreover, these two companies also contribute almost three-fourth of the DAP market. With excess supply and fierce competition in the industry, pricing power of the manufacturers is considered to be on the lower side. As a result of these dynamics, margins of industry are expected to remain under pressure.

Demand of fertilizer products is met through local production and foreign imports, with the former accounting for majority of demand. Domestic production amounted to approximately 7.6m tonnes while imports were recorded at 1.8m tones during FY15. Domestic production stood at 6.1m tonnes during 9MFY16. Despite slowdown in the local demand, the increase in production is on account of improved gas availability due to LNG import. Moreover, two of the fertilizer plants which were closed due to gas shortage became operational due to LNG supply. Higher production led to high inventories; year-end inventory of the industry is estimated to remain around 1m tons. Given the high level of inventories, the Government is likely to allow export of urea to ease the oversupply situation in the industry

Table 1: Annual fertilizer production (excluding opening stock of inventories)

Domestic Production (000 tonnes)	9MFY16	FY15	FY14
Urea	4,497	5,285	4,896
DAP	579	769	702
SSP	48	83	86
NKPs	56	76	71
NP	456	681	464
CAN	456	670	479
Total	6,092	7,564	6,698

Source: National Fertilizer Development Corporation (NFDC)

Despite weak agronomics and decline in global commodity prices, fertilizer off-take (consumption/demand) in Pakistan increased in FY15 vis-à-vis the preceding year. Fertilizer sale during the first half of the ongoing year remained depressed owing to price uncertainty and weak crop dynamics. During 3QFY16, urea sales picked up pace owing to drop in prices from Rs. 1,400 per bag to Rs. 1,200 per bag as a result of direct subsidy announcement by Government. Sales tax on Urea was reduced from 17% to 5% while Nitrogenous fertilizers were included in the new subsidy regime. Resultantly, the average prices of the fertilizer products witnessed sizeable decline particularly in the 3QFY16. On an aggregate basis, urea industry sales during 9MFY16 are estimated at 3.7m tonnes.

Table 2: Fertilizer off-take

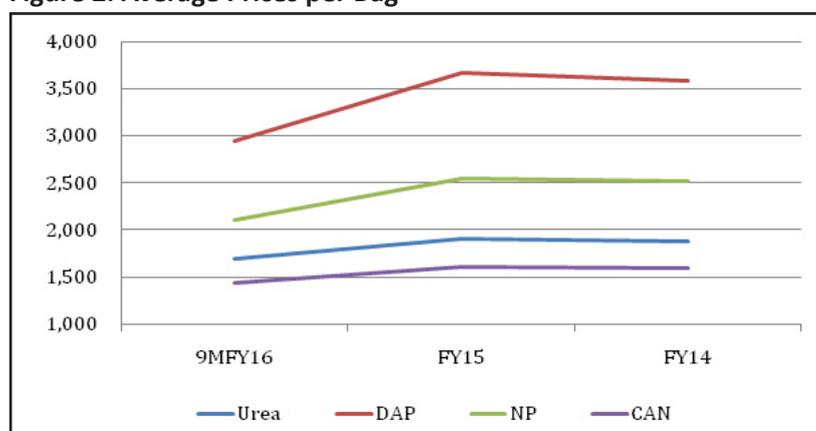
Domestic Consumption (000 tonnes)	9MFY16	FY15	FY14
Urea	3,678	5,936	5,747
DAP	993	1,801	1,623
Nitrogen	2,067	3,308	3,184
Phosphate	575	975	880
Potash	17	32	23
Total	7,330	12,054	11,459

Source: National Fertilizer Development Corporation (NFDC)

Key Risks

- **Gas unavailability:** Unavailability of gas supply to fertilizer plants remains a key risk, especially for companies which are catered through SNGPL network. However, LNG import agreement with Qatar is likely to ease gas crises.
- **Reduction in Prices:** Margins of fertilizer companies are under pressure on account of reduction in fertilizer prices. This is a direct outcome of measures introduced in fiscal budget for FY17. Going forward, high level of inventories carried by the fertilizer manufacturers and lower international prices of fertilizers presents challenges to the fertilize sectors. Also, there is a vast disconnect between local and international prices of fertilizers. Average price trend across various fertilizer products is tabulated below:

Figure 2: Average Prices per Bag



- **Agricultural policies:** Existence of commodity support prices and other favorable policies have mitigated the impact of decline in global commodity prices on agricultural sector. Changes in government stance in this regard could prove to be detrimental for fertilizer industry. However, we expect that probability of such an event is low considering that Pakistan is primarily an agrarian economy.

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