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Potash's \$20 Billion Market Transformed by Uralkali: Commodities

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By Yuliya Fedorinova

July 31 (Bloomberg) -- For the first time in eight years, the \$20 billion global market for the crop nutrient potash is set to become freely traded.

In a surprise announcement yesterday, OAO Uralkali, the biggest supplier of the commodity, said it decided to end production restrictions that underpinned global prices and suspend a venture with a Belarusian miner that controlled exports from the former Soviet Union.

Shares of Uralkali and its biggest competitors -- Potash Corp. of Saskatchewan Inc., Mosaic Co. and Israel Chemicals Ltd. -- tumbled as much as 24 percent as investors anticipated a flood of supply overwhelming demand.

The venture that Uralkali is abandoning is one of two that until now have controlled most of the world's supply by negotiating fixed-term supply contracts on behalf of their members. That means the potash companies don't compete with each other individually in export markets, helping them to match production with demand.

The change may drive down prices as much as 33 percent, according to Elena Sakhnova, a VTB Capital analyst in Moscow. Lower fertilizer costs promise to cut farmers' expenses and spur demand from India to China. That in turn may increase the size of crops from corn to soybeans and lower food prices around the world.

'Game-Changing'

"This effectively brings about a transformation of the entire potash industry, shifting it away from what has been a de facto duopoly," Matthew Korn, an analyst at Barclays Plc in New York, said in a note. "This is one of the few occasions of a market truly undergoing a sudden game-changing event, with impacts that cannot be overstated."

Uralkali will no longer sell potash through Belarusian Potash Co., the Minsk-based marketing company it established in 2004 with rival miner Belaruskali. Until yesterday, BPC controlled about 40 percent of global potash exports.

The other group dominating the market is Canpotex Ltd., which since 1972 has exported potash for Canada's Potash Corp. and Agrium Inc. and Plymouth, Minnesota-based Mosaic. Leah Laxdal, a Canpotex spokeswoman, didn't immediately return a call seeking comment.

Potash Corp., Uralkali and other producers have faced a lawsuit in the U.S. court in Chicago from purchasers claiming the companies violated the federal Foreign Trade Antitrust Improvement Act, which can be used to extend the reach of American antitrust laws to foreign anticompetitive conduct that affects U.S. imports.

Lowest Cost

U.S. District Judge Ruben Castillo on June 6 granted final approval to a \$10 million settlement between the suing direct purchasers and producers Uralkali and Silvinit. Six days later, he approved a separate \$17.5 million pact with defendants Agrium, Mosaic and Potash Corp.

Uralkali said yesterday in a statement it broke with BPC after the Belarus government canceled the group's exclusive right to export the nation's potash.

The decision also came after record crop prices last year failed to translate into higher fertilizer prices, Chief

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Executive officer Vladislav Baumgertner said. Too much capacity was added in recent years and rivals started behaving “aggressively” in competing for more market share, he said.

“Uralkali is most favorably positioned being the lowest-cost producer,” Baumgertner said yesterday in an e-mailed response to questions. “High capacity utilization will result in economy of scales and enable us to increase our share in all key markets.”

Belarus Feud

The Russian company was concerned that Belaruskali, which had started selling independently to China, would try to win a bigger share of the Chinese potash market, VTB’s Sakhnova said.

“We’ve been aware that there’s been a feud of sorts under way between Uralkali and Belaruskali,” Mosaic Chief Financial Officer Larry Stranghoener said yesterday in a phone interview. “We didn’t know it would escalate to this level.”

Russia is likely to put pressure on Belarus President Aleksandr Lukashenko to repair the situation, said Raymond Goldie, an analyst at Salman Partners Inc. in Toronto. Philipp Gritskov, a BPC spokesman, and Olga Dolgaya, a spokeswoman for the government of Belarus, declined to comment.

Baumgertner said that from August, Uralkali will use all of its 13 million metric tons of production capacity. The company sold 9.4 million tons of potash last year. Global sales were 51 million tons in 2012, according to the company.

Mining Costs

A few potash supply contracts that set global benchmark prices are typically settled each year. The last accord BPC signed, for sales into China, was agreed at \$400 a ton. That’s one of three price agreements whose terms were published in 2013, according to data compiled by Bloomberg. Prices may now fall as low as \$270, VTB’s Sakhnova said yesterday by phone.

For Paul Jeschke, who farms soybeans and corn on 4,000 acres (1,619 hectares) in Mazon, Illinois, such a reduction would be welcome as grain prices decline while supply recovers from last year’s drought. A \$100-a-ton drop would cut farming costs by as much as \$10 an acre, he said yesterday by phone.

“We need to begin to see input costs decrease if we are going to remain profitable,” Jeschke said.

For some potash miners, the concern is that prices may fall close to, or less than, the marginal cost of production. Uralkali has costs of \$62 a ton, compared with more than \$100 for North American miners and almost \$240 in Europe, according to the company’s July presentation.

K+S AG, Europe’s biggest producer, slumped 24 percent yesterday in Frankfurt, the most in 14 years. Israel Chemicals fell 18 percent in Tel Aviv; Potash Corp. tumbled 17 percent in New York; Mosaic slid 17 percent; Agrium declined 5.4 percent; and Uralkali plunged 19 in Moscow.

Sinofert Holdings Ltd., the Chinese distributor 22 percent owned by Potash Corp., slumped 6.9 percent to HK\$1.22 at 11:46 a.m. in Hong Kong, the lowest since July 4, 2012. The benchmark Hang Seng index rose 0.3 percent. Sinofert is one of the two potash distributors for BPC in China, according to Citigroup Inc.

‘Price War’

Mosaic’s Stranghoener said his company doesn’t plan any specific actions in response to Uralkali’s announcement. Potash Corp. and Agrium said in separate statements there shouldn’t be an overreaction to the move.

“It is not the first time that Russian producers have had disagreements,” Calgary-based Agrium said.

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Uralkali's decision to start a potash "price war" could be a "game-changer" for BHP Billiton Ltd.'s proposed Jansen mine in Canada, Heath Jansen, an analyst at Citigroup Inc. in London, said yesterday in a note. A BHP spokeswoman declined to comment on Jansen, which is projected to cost as much as \$15 billion to build.

Uralkali itself will delay its Polovodovskoye mine project, Baumgertner said. K+S's Legacy project in Saskatchewan looks "increasingly unviable," Sophie Jourdier, a Liberum Capital Ltd. analyst in London, said in a note.

"Uralkali's decision will affect every potash producer on the globe and will completely change the market," VTB's Sakhnova said.

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