Sinkhole swallows Uralkali’s profits and boosts potash rivals

Russian fertilizer giant Uralkali (LI: URKA), just a year after shaking the potash market by terminating its strategic pricing alliance (BPC) with the Belarusian potash concern Belaruskali announced that it has been struggling with a temporary closure of a major mine, Solikamsk-2, located near Perm. Should the problem turn out to be a long term or even permanent failure there is the risk that the Russian potash producer will incur significant losses. Of course, this could benefit the competition and cause a significant price hike in the price of the popular mineral fertilizer. The mine affected by the shutdown is of considerable importance for Uralkali, covering a fifth of the company’s capacity. On Tuesday, production at Solikamsk was stopped after high levels of brine were discovered. Water dissolves the potash salts (potassium-laden salts) damaging a mine’s structure and causing sinkholes. This is not unusual for Uralkali, but this time the scale of the problem has been more severe than usual. In 2006, Uralkali suffered a similar incident in the same region and the closure lasted a very long time causing a 5% drop in production (but not as great a financial loss, given that potash prices were typically below USD$ 200/ton then).

The market’s reaction was immediate: Potash Corp (NYSE: POT) gained 6% percent in New York, an intraday jump not seen since 2012 while its CANPOTEX ‘cartel’ partners Mosaic (NYSE: MOS) and Agrium (TSX: AGU) enjoyed similar increases of 4.4 and 4.1 respectively. Indeed, Uralkali did not venture to suggest how long it would need to fix the problem and this is also good news for the smaller potash producers such as Germany’s K+S Group and even for potash juniors such as IC Potash (“ICP’, TSX: ICP | OTCQX: ICPTF) and Allana Potash (TSX: AAA | OTCQX:

ALLRF). These juniors are among the nearest to production stage of all the new potash companies. The breakup of the BPC potash cartel that was announced on July 30, 2013, resulting from OAO Uralkali’s decision to ‘go it alone’ had shaken the potash sector.

Investors and sector executives alike feared a collapse of the sector with prices falling below USD$ 200/ton. Nevertheless, the market dynamics triggered by Uralkali’s move may have benefited the overall potash sector by lowering prices in the short term so as to increase them in the long term. In this sense the 25% average drop in potash shares in reaction to the Uralkali bombshell, helped make potash more affordable for those many potential customers who have stayed away because of prohibitive economics. The chance to sample the goods and see the agricultural benefits will have generated more demand while emphasizing the value of ‘project economics’. Now, the favorable economics for the emerging juniors and production capacity of Uralkali’s international competitors, will raise potash’s value as an investment commodity. Should Uralkali fail to control the flow of brine, it could lose up to 30% of its net profit in the coming year. Meanwhile, the prospect of a tighter supply on the world market is expected to help fertilizer manufacturers to charge higher prices in the forthcoming negotiations with India and China, which usually take place between December and January.

In July 2013, Uralkali adopted a new strategy of pushing production levels higher to bring down prices of potash and conquer new markets, sacrificing margins in the process. That decision led to a stock market collapse of major industry players, who were accustomed to controlling and adjusting production to support prices. China had already been slated to pay 10% more for the 2015 contract to secure its supply of potash. Uralkali’s drop will surely play in favor of CANPOTEX and that price increase will surely be greater than 10%. Increasing tensions between Russia and the West will also raise potash prices. After Canada, Russia is the world's largest producer of potash. The country also provides 7% and 8% of the supply of fertilizer phosphorus and nitrogen. Brazil has been gradually increasing potash imports used especially to grow soybeans, used for food and fuel. Demand has increased steadily from 2012 to 2014 while areas used to plant soybeans are expected to grow 4%. Already, fertilizer orders for the first half of 2014 gained 7% over 2013, and a corresponding increase is expected in the second half of 2014.