

Is Uralkali aiming to join Canpotex? The intrigue behind the breakup of the potash duopoly

✘ Uralkali's sudden decision to leave the BPC potash pricing mechanism (the Russian/Belarusian equivalent of the North American Canpotex) has, judging by the markets' reaction, sent the potash mining sector into an apparent crisis. However, it appears that, as noted in more than one article published on InvestorIntel, that investors reacted with excessive fear. Surely, potash shares have fallen – they did not collapse; some juniors like Allana Potash or IC Potash did not even hit their yearly lows, while majors such as K+S have decided to push ahead with major expansion projects, despite the fact that its share price has fallen some 40% in the past week. Perhaps, K+S knows something that most potash investors and analysts don't? In fact, K+S is concerned that its potash resources in Europe have already passed peak production levels and about to deplete in the next 30-40 years. Last year, the K+S Board approved capital spending of up to CAD\$ 3.25 billion for the project, known as Legacy, which represents the first major greenfield potash play in Saskatchewan in the past 40 years. The mine is estimated to have an annual production capacity of 2.7 million tons.

A hint comes from the fact that while the news has focused on the fortunes of Uralkali-the Russian component of the BPC pricing organism that until last week's dissolution controlled some 42% of the global potash market-its former partner Belaruskali, now left stranded, have found a new partner in the form of the Qatari trading firm Muntajat, specialized in the distribution of nitrogen fertilizers. The fact that Muntajat acted very quickly to make the deal with the

Belarusians suggests that those on the selling side of the fertilizer business have remained confident. Indeed, Muntajat plans to sell three million tons, or 40% of Belaruskaly's annual production to what it describes as the "markets that have not yet been covered". One of the areas for potential expansion is Brazil, thanks to the fact that Vale SA has effectively abandoned its ambitious Rio Horizonte potash project early in the year. Meanwhile, Uralkali's CEO, Vladislav Baumgertner, hinted that his Company's decision to abandon BPC was prompted by the fact that Belaruskaly had bypassed the pricing 'cartel' by selling some of its production through independent distributors, weakening its negotiating position in relation to demand. In other words, Uralkali did not simply choose the high road because of unbridled confidence; rather, it appears to have had problems with its Belarusian partners, who, in turn, had their own grievances with the Russians. Belaruskaly accused Uralkali of having secured better markets and sometimes paralyzed the alliance by failing to transfer funds on time.

There are even grander geopolitical ambitions at play. Belaruskaly accounts for some 10% of Belarus's foreign exchange earnings, which Russia would be most happy to take over, inspired by the new wave of nationalism pursued by President Vladimir Putin. Ultimately, all intrigue suggestions aside, it is clear that BPC has collapsed because neither one of its two member parties was happy. With the temporary demise of the potash dupoly system, there is room for much speculation. None of the potash players have an interest in prices falling. Today, Uralkali fired the first warning shot, blaring that potash prices could fall to USD\$ 250/ton (last week the predictions were for a price floor of USD\$ 300/ton). Is Uralkali flexing its muscles like Putin, demonstrating unbridled market strength, or is it calling out for a lifeboat? Surely, Uralkali does not want prices to want any more than do the Canpotex cartel members (PotashCorp, Mosaic and Agrium).

One possibility is that Uralkali may make try to take over Belaruskali, effectively reviving the Canpotex-BPC duopoly, perhaps making it even more capable of raising potash prices again. This thesis is supported by the fact that 'oligarch' Suleiman Kerimov, a Kremlin insider, owns some 17.2% of Uralkali, suggesting that Uralkali's move may, indeed, have been an orchestrated manouver to force the Belarusian dictator, Aleksandr Lukashenko, to give up Belaruskali. Alternatively, it could try to join Canpotex. Indeed, it could do both things at which point it would leave the market with a potash equivalent of OPEC, allowing for prices to rise far above production costs. Until such time, the potash market will experience a bit of a price war that may lower prices, though these are unlikely to go as far down, or to stay down (as Uralkali's CEO has claimed) for long. As for the junior plays; by the time those who survive (the key is in maintaining below average production, or CAPEX, costs) they reach production stage, this game of international potash fueled intrigue will long have been over with prices back up to current levels or higher.