

# Higher Uralkali sales and global trend suggest higher potash prices for 2015



Russian fertilizer giant Uralkali, a year after shaking the potash market by terminating its strategic pricing alliance (BPC) with the Belarusian potash concern Belaruskali announced that it expects better results for the final quarter of 2014. Global potash sales have reached record levels. This an

important indicator for the potash market in general because Uralkali is the world's largest producer of potash. Its profits were down year to year, but they beat analysts' expectations. Significantly, Uralkali has seen a reversal of last year's trend, as revenue grew 7% to \$ 1.7 billion, supported by a 42% surge in sales of potash volumes to 6.1 million tons; profits were lower because of a 30% export price drop. This suggests that the potash market is seeing signs of recovery both in terms of volumes and prices. The lower prices, meanwhile, are helping to spread potash use, widening the market and the basis of future demand. 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. Potash prices have since fallen sharply, but Uralkali suggests that its shift of strategy made it possible for demand to resume after hitting a 'dull' period in 2013. Uralkali noted that global potash consumption increased,

potentially exceeding the record set in 2011 of 57 million tons.

This is good news for farmers. The potash cartel has weighed on agriculture. Potash is an important raw material for fertilizer, and thus determines the cost of crops. Competition in this market is highly regulated. Uralkali worked with Belaruskali within a cartel like organization (BPC) representing 43% of the global market. While in Canada, CANPOTEX (Potash Corp, Mosaic and Agrium) controlled over 20% of potash demand. Together, BPC and CANPOTEX accounted for two thirds of the world potash market, helping to maintain high potash prices, which rose to USD\$ 900/ton in 2009 – today they are hovering around USD\$ 400. Uralkali preferred to leave the PCB agreed to sell larger quantities and take advantage of its favorable cost structure. Nevertheless, grain prices have declined significantly since the spring, and many producers prefer to wait rather than gamble as to whether or not sales will cover the costs of production.

Traditionally, the farming community works along the assumption that higher grain prices lead to higher fertilizer demand while the more they recede, the more fertilizer prices drop. However, the fertilizer market is more complex than it seems, and if grain prices have undoubtedly some influence on the fertilizer in fact fertilizer supply itself is controlled by many other factors that disrupt that linear relationship. Rebounds in the price of wheat have generally prompted a rebound in fertilizer prices but global factors have been weighing considerably. One of these is Chinese demand. This year, there is good news. Chinese demand is growing and that is having a decisive effect on fertilizer prices globally.

It is expected that China will pay the 2015 contract up to 10% more than last year to secure its supply of potash. Ukraine, a major player in the production of nitrogen fertilizer, will have difficulties producing, given the expected cuts in Russian gas supplies. 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. There is even talk of a return of the BPC cartel between Uralkali and Belaruskali; talks are under way and it remains to be seen what will emerge in the coming months. 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. Finally, difficulties in transporting fertilizer in some areas due to the overload of rail and waterway networks have also exerted upward pressure on fertilizer prices.

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## **Uralkali boss arrest sparks potash 'Cold War'**

✘ The dispute between Russia and Belarus over potash holds the cards for the future of the potash fertilizer market and its implications are wrought with geopolitical risk that could spark a trade war – if not worse. The circumstances behind the arrest of Uralkali CEO, Vladimir Baumgartner have all the makings of a John Le Carré spy novel. Baumgartner was arrested on August 26 after talks with Belarusian Prime Minister Mikhail Myasnikov at the airport in Minsk. The authorities accuse him of having damaged Belarus's economy after he opted out of the potash consortium with Belarusian state owned potash produced Belaruskali. The Russian government reacted immediately to the arrest, turning the issue away from OAO Uralkali and its shareholders to a dispute

between Moscow and Minsk. Russian President Putin himself has warned of serious diplomatic consequences should Baumgartner not be released promptly.

Belarusian authorities pulled quite a caper, apparently bypassing the very acute Russian intelligence. In fact, Baumgartner was literally lured into a trap. On August 26, Baumgartner flew to Minsk at the invitation of Belarus's Prime Minister Mikhail Myasnikovich, who met him at the airport for a meeting that evidently did not go in Belaruskali's way. The meeting was designed to persuade Baumgartner to restore the Uralkali-Belaruskali alliance. Instead, the one-hour conversation proved to be less than "constructive" leading to criminal charges and an immediate arrest. This suggests that no less than the authoritarian Belarusian President Alexander Lukashenko got involved.

Baumgartner faces up to ten years in prison after having been charged with fraud against Belarus to the tune of USD\$ 100 million. If the charges stick, companies such as K+S AG in Germany, whose shares plummeted in the wake of Uralkali's BPC breakup, could also add its own lawsuit; however, Belarus, faces a number of European Union sanctions for human rights violations, and it would be difficult for the EU and K+S to pursue a eventual case. The 'arrest of company executive' technique has actually been fined tuned in Russia and it is more of a 'kidnapping' in its dynamics. It is used to obtain certain concessions after the breakup of negotiations as part of government pressure mechanisms on key industries. Belarus will probably demand, if not a restoration of the BPC mechanism, something that approaches it, such as a guaranteed slice of the market in key export markets such as China. The Belarus-Uralkali dispute has officially turned into a turf war and the Belarusians have captured the potash 'Godfather'.

Belaruskali is one of the few profitable companies in Belarus, providing the bulk of hard currency for the country, whose economy remains dominated by state enterprises. Essentially,

potash and Uralkali (because of the BPC pricing mechanism) is crucial for the Belarusian state budget. Until a few weeks ago, BPC controlled almost half of the world market for potash. The alliance is broken and has led to the former partners – and increasingly their governments – to become enemies. Taking a cue from the OPEC playbook, Russia has already deployed its diplomatic weapon of choice: oil. The state-owned pipeline company Transneft announced that it would cut oil supplies to Belarus to cut by 400 000 tonnes, or about a quarter of September deliveries.

The official reason for the cuts is maintenance; Transneft excused itself noting that it has to replace 700 miles of old pipelines in order to avert possible threats to the environment. How considerate! In fact, the unexpected cuts are the first signs of a trade war. The reduction in oil supplies through the raw power of Russia is not the first pinprick against Minsk. Russia also threatened to stop importing Belarusian dairy products, which would have serious consequences for the Belarusian economy. Nevertheless, while the diplomatic saga continues what is clear is that Uralkali's plans to change the potash business will not proceed as smoothly as it had expected. A month ago, Uralkali's departure from the BPC price mechanism represented a revolution in the industry; until then the potash business world was controlled by a few large corporations that were keener about price control through supply quotas than they were on good old fashioned market competition. The BPC breakup is estimated to have cost potash investors some USD\$ 20 billion in market value. In fact, Uralkali shares were among the biggest losers taking Russian oligarch, Suleiman Kerimov, Uralkali's largest shareholder, by surprise. He was forced to sell some of his most prized personal assets such as shares in his prized soccer team.

The Baumgartner debacle and the sharp drop in Uralkali's value beg the question of why Uralkali instigated the price war in

the first place. The most logical explanation is that Uralkali wanted to lower potash share prices to make it easier to take out, and absorb, some competitors (K+S AG in particular) while also deterring newcomers from entering the lucrative potash business – newcomers such as BHP Billiton, which actually decided to remain in the potash game, announcing it would continue to invest in its Jansen Mine project in Saskatchewan; Uralkali, whose main customers are in China, also feared Chinese plans to develop potash deposits in neighboring Laos. For its part, Belaruskali, in need of hard currency, has long been interested in finding buyers for the company, holding frequent meetings with potential buyers from Russia and Singapore. The strong reaction from the Belarusian government to Uralkali's moves has only shown how valuable potash can be. The situation remains interesting as some buyers may start to come out to 'kick the tires' at Belaruskali. In the rest of the world, the arrest of Uralkali's CEO means that potash prices will not be dropping as fast or as low as some had predicted on when BPC was dissolved.

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## **BHP adds pressure on potash prices but some relief is on the way**



**Potash & Phosphate Week-in-Review:** The InvestorIntel potash members gained +0.92% for the week ending on August 23rd. Agua Resources (ASX: AGR) saw the biggest gains at +19.30% for the week after it announced new and very favorable phosphate intersections with a peak of 16 meters at 14.4% P<sub>2</sub>O<sub>5</sub>

from surface at its Três Estradas South Project in Brazil. Aguia says the resource's mineralogy is similar to what is produced at world-class mines worldwide including Yara's Siilinjarvi mine in Finland and Vale's Cajati mine in Brazil. The second stage of drilling confirmed the initial findings showing a continued strong phosphate mineralization ranging from 9.5% to 23.2% phosphorous penta-oxide ( $P_2O_5$ ) and all within a high-oxide area extending from the surface. Aguia's geographic positioning gives it a clear advantage. Aguia's phosphate resources are close to Brazil's main fertilizer consuming states of Rio Grande, Santa Caterina and Parana which alone account for 30% of Brazilian agricultural production.

Brazil is also considered one of the top growth markets for mineral fertilizers, such as phosphate and potash. However, Allana Potash (TSX: AAA | OTCQX: ALLRF) was the one that made the most significant gain, at +5.38%, because that increase brought the share price closer to the yearly average of about CAD\$0.50/share. Allana shares could see a steady increase over the next few weeks and as the project moves closer toward the mine construction phase. Allana announced that it has secured financing to begin mine construction securing "loans in excess of the target amount of 60-65% debt contemplated to finance the initial construction of Allana's Danakhil potash project." The lenders include large multilateral and regional development finance institutions and export credit agencies from North America, Europe and Africa. Allana's CEO expects that the credit metrics will be in line with the Company's targeted amount of project debt financing in order to increase "the potential returns to Allana shareholders."

Allana's gains last week might have been greater if not for the fact that BHP Billiton said it would pursue plans to open its huge potash mine in Saskatchewan (the Jansen mine), even if the production stage has been delayed until 2020 – at the earliest. BHP has already invested CAD\$1.2 billion into the

Jansen mine project and will invest an additional CAD\$2.6 billion over the next four years. BHP's announcement put more pressure on the potash market, which saw a dramatic change last month, and has put all potash company valuations under pressure following the breakup of the Russian/Belarusian BPC pricing cartel last month. Incidentally, the fact that Allana managed to overcome the downward pressure that OAO Uralkali's decision, with relatively minor price drops in comparison to the rest of the sector, is testament to the confidence that its investors have in the project.

The sudden arrest of Uralkali's CEO Vladislav Baumgartner on August 26th in Belarus has already started to boost potash prices across the board, and signals the return of a cartel pricing mechanism that will stress high prices rather than high volumes. Uralkali's decision had sent the potash market in turmoil as Uralkali decided to increase its sales, acting on its own, by boosting production and by forcing a lower potash price, taking down all other potash producers. Since Baumgartner's arrest, prices have started to recover and the assumption is that Belarusian President Aleksandr Lukashenko, fearing the economic collapse of his country (potash represents an major percentage of foreign-currency earnings for Belarus), will succeed in persuading Uralkali to rethink its entire strategy. Certainly, investors in the West are hoping for this very development – further warranted by the fact that more Uralkali officials are being investigated and that the company's investors and officers appear to have lost confidence in the new strategy.



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# 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.