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## Page 1 of 2 Kremlin's potash war picks its prisoners

By John Helmer

MOSCOW - Uralkali, Russia's potash monopoly, has been spending heavily for months - more than US\$1.3 billion - not so much to buy back its free-floating shares, as to let its controlling shareholders escape. The cash has come from new bondholders and from state banks, Sberbank and VTB. Bank of America Merrill Lynch and Goldman Sachs have played along helpfully, too.

Since Tuesday, July 30, we know why. That's the day Uralkali announced to the rest of its shareholders that it was leaving the Belarusian Potash Company (BPC), the long-time export joint venture with Belaruskali, the Belarusian producer, and abandoning the scheme of production and marketing control that has supported the potash price above \$400 per tonne. In short, bye

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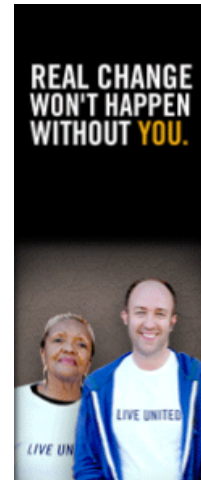


bye BPC - hello potash at \$200 per tonne.

[Shares of Potash Corp, Mosaic and Agrium fell as much as 26% in one day on the news. The three North American producers together account for about 38% of global potash capacity.]

At \$200 per tonne, Uralkali imagines it can ramp its mine output of potash up to maximum; lower its unit costs; and beat everyone else in the market to sales. What this does to Eurochem, owned by Andrei Melnichenko, is not so positive.

Although potash sales amount to zero on Eurochem's current balance-sheet, it is planning to produce and sell 8.3 million tonnes a year, putting Eurochem a close second behind Uralkali's current production level of between 10 and 11 million tonnes. Since 2011, when Uralkali took over Silvinit, the second active Russian producer of potash, Belaruskali has been producing between 9 and 10 million tonnes per annum. This year, according to announcements before last week, Belaruskali is planning on a one million tonne increase, or 10% annual growth in production.



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The Eurochem threat to Uralkali's sales strategy is not less than the threat from Belaruskali. But Eurochem has also acknowledged that its cost and profitability calculations require potash to stay well above where Uralkali's action is putting it.

"When we studied the profitability of this project," Eurochem chief executive Dmitry Strezhnev has said, "it was profitable even at a potash price of \$500. We do not expect prices to go lower than \$700-\$800, so our investments carry almost no financial risks."

What chumps Uralkali is making of Melnichenko and Strezhnev. Should they have suspected in advance what was going to hit them on July 30?

In September 2011, Uralkali's chief executive, Vladislav Baumgertner, told an Indian newspaper: "We follow a global pricing policy that is determined by supply-demand balance and not cost of production. Currently, all potash producers are operating at near full capacity and the options for brownfield expansions are limited. Greenfield investments will not come unless manufacturers get a net-back [ex-factory] price of \$450-500 a tonne."

At the time, Uralkali told the Indians it was planning soon to invest \$2.5 billion over five years to add 2.5 million tonnes per year in new mine production. At that point, two years ago, the table below indicated how the global potash market appeared in terms of annual production, with the North American exports controlled by Canpotex, and the Russian and Belarusian exports by BPC. (For more on how these cartel arrangements have been evolving until now, read the archive [here](#).)

GLOBAL POTASH MAJORS	
Combine/Company	Capacity*
<b>1. Canpotex (Canada)</b>	<b>23.8</b>
Potash Corporation of Saskatchewan	11.3
The Mosaic Company	10.4
Agrium Inc.	2.1
<b>2. BPC (Russia/Belarus)</b>	<b>19.8</b>
Uralkali	5.5
Silvinit**	5.1
Belaruskali	9.2
<b>3. K+S (Germany)</b>	<b>7.5</b>
<b>4. ICL (Israel)</b>	<b>4.1</b>
<b>5. Arab Potash Company (Jordan)</b>	<b>2.2</b>
<b>6. SQM (Chile)</b>	<b>1.3</b>

\*Million tonnes of MOP; \*\*Merged with Uralkali.  
Source: Hindu Business Line

From last week, Uralkali says it has decided to go on the market offensive, alone against both Belaruskali and against the Canpotex alliance. So there is reason to suspect that Melnichenko's ambition to become a major potash producer on his own - counting both Eurochem's new Russian mines and Melnichenko's 10% stake in K+S - is doomed; and that he too is a target of the new Russian strategy.

Is Suleiman Kerimov, the control shareholder of Uralkali, planning to oblige Melnichenko to halt his new Russian mines, abandon his promised Kazakh projects, and force Eurochem to sell out to Uralkali? Melnichenko's spokesman in Moscow Vladimir Torin, and his London public relations firm FTI Consulting, were asked whether he and Eurochem had advance inking of Uralkali's change of strategy, and what change of strategy they plan

change of strategy, and what change of strategy they plan themselves now. They have declined to answer.

At its most optimistic - according to a study released by Renaissance Capital (Rencap), which is partly owned by Kerimov - sales revenue for Russia's current potash monopoly will rise on a 50% increase in production, though earnings will dwindle as the potash price falls, and net profit will be cut in half from last year's bottom-line of \$1.6 billion. The cash position of Uralkali will go from a positive \$1.1 billion in 2012 to a negative \$961 million this year. The debt to earnings (Ebitda) ratio will jump from 1x in 2012 to 3x this year.

The good news, according to the report by Rencap analyst Boris Krasnojenov, is that as potash prices collapse towards \$200 - the Rencap prediction is \$258 per tonne this year, \$224 in 2014 - most of the higher-cost potash producers in the rest of the world will fail to find customers; new mines will be shut down; and the Chinese, Indians and Brazilians, who dominate the potash consumers' market, will lift their import volumes.

When that happens, Uralkali will have taken a much larger market share and be able to capitalize on the potash price growth disproportionately.

"We support management's decision to change strategies," writes Krasnojenov, "and terminate its [share] buy-back programme ... The reduced potash supply in the future may support potash prices later this decade, while Uralkali's new strategy may help maximize its market share."

The official Uralkali statement of July 30 claimed: "Unfortunately, we should state that our cooperation with our Belarusian partners within BPC framework has come to a deadlock. It has always been Uralkali's position that export activities of both producers should go through the unified sales network. This fundamental principle of partnership was violated by the Decree No 566 issued by the Belarusian President [Alexander Lukashenko] on 22 December 2012, which cancelled the exclusive right of BPC to export Belarusian potash. Following the issue of the Decree, Belaruskali has made a number of deliveries outside BPC."

Seven months since the Minsk decree is a long time in potash politics. For years before that, in fact, Uralkali has known, as has everyone in the potash market, that Lukashenko and his son, Victor, have been authorizing special cargoes of potash for export outside the BPC arrangement.

Also, Kerimov had been to talk to Lukashenko more than once in the interval - as publicly announced on December 28, and again on May 20. The Belarus television footage of their second meeting reveals the assertive Lukashenko lecturing the timid Kerimov. Belarus television showed Kerimov's lips moving - something almost never shown on Russian television by Kerimov, a senator for the Dagestan Republic in the upper house of the Russian parliament. Nothing he said can be heard, however.

According to the latest announcement from Uralkali, Kerimov was just pretending to be timid for the Minsk television camera. In fact, says Uralkali's July 30 statement, off-camera with Lukashenko he got tough indeed. Claims Uralkali: "We have repeatedly informed our Belarusian partners that such actions were unacceptable and they have ultimately destroyed the fundamentals of our prolonged fruitful cooperation. In this situation we have to re-direct our export deliveries through our own trader. Still, we thank our Belarusian partners for cooperation within the BPC framework and do not exclude the possibility of cooperation on a mutually beneficial basis in future."

It sounds like Kerimov warned Lukashenko not to increase output and sales outside the BPC, and threatened him with a break with the BPC. On July 31, the day after the break, Belaruskali claimed it had not been "consulted". There are also reports in Moscow that Kerimov has been pressing Lukashenko to accept a merger between Uralkali and Belaruskali: Kerimov's price is reported to have been \$15 billion; Lukashenko has reportedly asked for \$30 billion. But that was before.

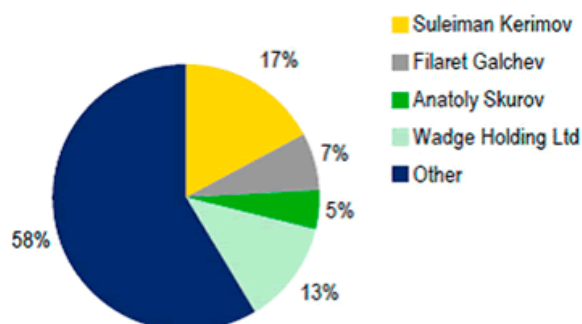
Kerimov holds 17.2% of Uralkali's stock and directly controls four of the current eight-member board of directors. He has issued his own statement, implying that Uralkali's decision might have been

known to the insiders well before the announcement: "We also have high regard for the level of corporate governance at Uralkali and intend to continue to be actively involved in the work of the Board of Directors and its Committees, cooperating with the representatives of all shareholders to make decisions ensuring the long-term sustainable development of both Uralkali and the global potash industry."

In case Kerimov himself might be suspected of shorting the stock, when he knew it was about to fall, the statement claimed: "Our purchase of a stake in Uralkali in 2010 was a strategic long-term investment for Nafta Moskva [the Kerimov-owned investment and holding company]. We view the fundamentals of the potash industry as strong and have confidence in the growth potential of this market, which makes the investment in Uralkali extremely attractive. Nafta Moskva supports Uralkali's new strategy, considering it to be in accordance with the interests of all stakeholders and aimed at maximizing shareholder value."

### Key Shareholders Own 42%

#### Shareholders of Uralkali as of 26 July 2013



Source: Company, URALSIB estimates

Wadge Holdings has been a combination of Kerimov, Filaret Galchev, Anatoly Skurov, and until he sold out recently, Zelimkhan Mutsoev. The story of how this combination, plus Alexander Nesis, got together, and with VTB financing acquired Uralkali from its former owner, Dmitry Rybolovlev, and then merged with Silvinit in 2010, was told [here](#). How Mutsoev combined again with Kerimov at the start of this year, and again with state bank money bought Mikhail Prokhorov out of Polyus Gold was told [here](#).

Mutsoev's reward for borrowing so heavily from the state has been to exit profitably, and of course patriotically and philanthropically. Last November, Kerimov, Mutsoev & Co sold an option for the Chinese sovereign wealth fund, China Investment Corporation (CIC), to buy up to 12.5% of Uralkali's shares in 2014. No price was disclosed, but it is likely to have been at or above market value. That hit a peak of \$43.49 per share on November 9; it had averaged \$40 per share over the three months preceding the CIC deal. So this ought to have cost the Chinese \$2.9 billion.

That outlay in convertible bonds is now worth \$1.8 billion. Have the Kremlin, the Russian state banks, and Kerimov combined to pull such a costly surprise on Beijing? Or were the Chinese willing to part with their money in November at a billion dollars more than their stake is now worth, because they were assured that potash would become significantly cheaper for China to buy when the bond conversion into shares falls due in a year's time?

The likelihood is that the Chinese government was an insider in this deal too - but in league with which side? The thinking in Minsk is that Lukashenko made his own deal with the Middle Kingdom when he visited Beijing on July 16. According to one Belarus source, "If you look at the rhetoric from Minsk over the last year it was clear that Kerimov was trying to force Lukashenko to sell Belaruskali. He has been to see Lukashenko in Minsk and even then the TV showed the grim faced Lukashenko lecturing Kerimov on the advantages of strategic cooperation. Obviously, they failed to persuade him."

to persuade him.

When Lukashenko's visit to China followed in mid-July, "this looks to be the straw that broke the camel's back." That's to say, the Russian camel.

According to an analysis by another source: "Given that Belaruskali announced its decision to sell its product by itself in December of last year, and Uralkali has been making arrangements to go solo for a few months now - they were already sending cargos out outside of the BPC earlier this year - why such a high-handed response by Uralkali only now? I can only speculate that Belarus President Lukashenko's visit to China resulted in a contract signed outside of BPC, and this was the last stroke that broke Uralkali's patience."

The Belarus theory isn't taking into account CIC's stake in Uralkali. So unless the Chinese miscalculated that their deal with Lukashenko and Belaruskali would not have the costs Uralkali has now inflicted, the Chinese are now calculating that they will gain if they play both sides against the middle.

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