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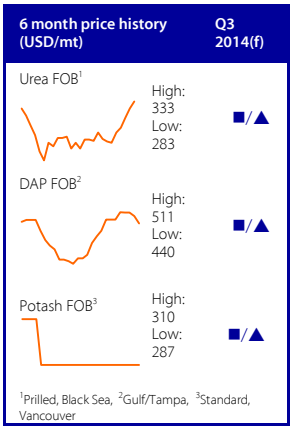
Fertiliser Quarterly Q3 2014

Moving away from floor prices—but upside is limited



Fertiliser prices are slowly rising from the floor prices witnessed earlier this year, driven by both intentional and unintentional supply reductions across the board. Seasonal demand, mostly from China, India and the US, is unlikely to cause any prolonged rise in prices for the fertiliser complex, while bearish sentiment in global commodities is leading to reluctance towards stock accumulation across the fertiliser chains. Rabobank believes that bearish commodity prices will have limited impact on input use in the short term, while the medium-term picture could see farmers reducing fertiliser applications as margins come under more pressure.

Moving away from floor prices—but upside is limited

▼▲■ indicate global price impact

Logistics key driver in US fertiliser prices - again

- ▲ Logistical bottlenecks
- ▲ Depleted stocks after strong spring application
- ▼ Buyer resistance towards higher prices as a result of subdued commodity prices

Brazil unlikely to provide price support

- ▼ Imports in 1H 2014 led to comfortable stocks
- ▼ Lower input use in Safrinha crop
- ▲ Increasing soy acreage and overall 3%-5% increase in fertiliser demand expected

Europe slowly re-entering fertiliser markets

- ▲ Weakening euro
- ▲ Autumn application and some supply chain filling
- ▼ Buyers resisting higher prices

Cautious price support out of China

- ▲ Overestimation of Chinese export availability
- ▲ Lower DAP and urea availability due to increased domestic demand
- ▲ CNFAI warning urea producers of 'serious consequences' if they dip below USD 270/t FOB

It's all about rain in India

- ▼ Record-low monsoon rains
- ▼ Subsidies and INR weakness still limit price upside
- ▲ Earlier tender as traders cannot fulfil commitments based on offered prices

A story of gas and politics in FSU and MENA

- ▲ Increased gas prices and very limited availability out of the Black Sea region
- ▲ Gas curtailments and political conflicts have reduced ammonia and, to a lesser extent, urea output in the Middle East

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Nutrient outlooks

Tight supply provides some positives in urea

Price outlook: ■/▲

Supply disruptions and supply chain management in local urea markets are providing upward pressure. These local drivers could prove insufficient, slowing the bull run, and thus stabilising prices.

A tight supply in granular markets is more evident than for prills. Seasonal demand pull from India and the US is unlikely to be sufficient to initiate prolonged higher prices. While there may be some scope for price increases, mostly driven by a few regional markets, the general tone in urea remains cautious given that already low commodity prices and the lurking possibility of further price decreases are not exactly incentives to accumulate stocks.

China is steering the direction of urea prices, and it seems traders have overestimated this source of seemingly infinite cheap urea. Indeed, traders with short positions in Indian tenders are unable to deliver on earlier price commitments given the urea price increases in China. As a result of the momentum that has gathered pace in terms of supply chain management and prices, China will likely force India to prematurely retender to secure sufficient volumes, albeit at higher prices.

Seasonal demand pull and logistical bottlenecks are turning the US into a premium market for granular material, but timing will once again prove crucial. The fertiliser game in the US depends on timely delivery of inputs and a potentially squeezed window of application, the latter being a matter of harvest timing and weather. Depleted stocks following substantial application in the spring will also provide demand support

Slight price support for phosphates in Q3

Price outlook: ■/▲

The overall phosphate price trend is seasonal and fragile. India will provide some upside in the east, combined with tighter supply from China. In India, the situation depends mainly on how monsoon rains progress.

Rabobank sees some potential for phosphate prices to continue to trade at higher prices. Huge price hikes appear unlikely, but there is a slight price support from India, China and the US.

In India, Rabobank sees fragile price support. For phosphoric acid, elevated import prices and a price ceiling as a result of India's subsidy system provide downside. However, upside comes from hopes of recovering monsoon rains and low DAP stocks throughout the chain.

The autumn application of phosphates in the US will provide additional demand pull. Combined with the logistical issues of congested barge and rail markets, this will support prices in the Americas. Tighter DAP availability from China appears imminent as their domestic season is about to begin, and improved logistics will make a stronger focus on directing volumes to the domestic market more likely.

Both Brazil and Morocco could limit substantial price increases. To pre-empt any logistical bottlenecks ahead of planting, Brazil appears to have covered a substantial amount of its import needs in the first half of the year and, as a result, is in a relatively comfortable stock position. A new million tonne DAP/MAP facility in Morocco could also inhibit further price increases.

Potash prices stable this quarter

Price outlook: ■/▲

Rabobank forecasts relatively stable potash prices in the Southern Hemisphere, with some temporary price increases in North America, Europe and China.

Any temporary price increases for potash in North America (due to logistical bottlenecks) and Europe are not expected to drive potash prices up in the spot markets of Latin America and Southeast Asia.

As supply contracts with China will likely be extended until the end of this year and India's contracts run until March 2015, there is no expected impact from these traditional benchmark prices and, as such, Rabobank expects stable prices in the Southern Hemisphere in the coming months. However, increased demand in China will support margins for domestic potash producers and importers/wholesalers.

Even the price momentum in Brazil—the most important bullish potash market this year—is fading to below average on the back of lower agricultural commodity prices and relatively high imports of stocks in 1H.

Ideal growing conditions for US summer crops have supported the outlook for yields, driving a widespread sell-off across grains and oilseeds over the month.

Quarterly agricultural commodity prices, Q4 2013-Q2 2015f

Commodity	Unit	Q4'13	Q1'13	Q2'14	Q3'14(f)	Q4' 14(f)	Q1'15(f)	Q2'15(f)
Wheat	USc/bu	655	617	650	540	540	560	570
Corn	USc/bu	499	453	480	370	350	370	390
Soybeans	USc/bu	1305	1357	1470	1200	1000	1060	1075
Sugar	USc/lb	17.7	16.4	17.3	16.5	17.5	18.2	18.5
Cotton	USc/lb	80.3	88.0	89.0	66.0	70.0	73.0	75.0

Source: September 2014 ACMR forecast, Rabobank 2014

Regional outlooks

Logistics key driver in US fertiliser prices—again

Congested barge and rail markets are prompting increased fertiliser prices in the US. Stocks have decreased throughout the supply chain but buyers remain reluctant to take on huge stocks.

Logistical bottlenecks are likely to become the key driver for US fertiliser prices in the coming quarter. Higher barge freight costs will limit the spot availability of barges within the US fertiliser system. Grain traders with forward positions need to move grain cargoes and bid on pricey shuttle carriages that have inflated to close to USD 4,000/carriage. Rail companies struggling with backlogs mean that only a limited number of carriages are available to ship potash volumes out of Canada to the US. The congested barge markets make delivery through New Orleans an unattractive alternative.

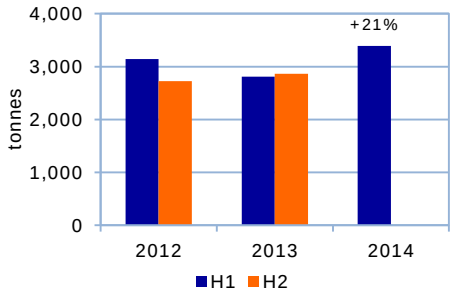
From a fertiliser perspective, the US is likely to once again form an isolated and inflated fertiliser destination, albeit with a limited concrete impact on global price dynamics. A price hike in the US during the next months is likely, but prices are expected to return to lower, more subdued levels again in the low season.

A record harvest in the US is also set to put pressure on domestic logistics. The timing of crop harvests will also influence prices in the sense that a delayed harvest could squeeze the application windows in the autumn, potentially boosting prices. Of course, the weather will play a huge role in this as well.

Since substantial application in the spring in the US has depleted all fertiliser stocks, retailers will now be looking to replenish ahead of autumn application, leading to an increase in demand and, consequently, prices. The three major US nitrogen producers saw ammonia deliveries increase by 21% YOY on the back of a substantial spring application in the first half of 2014, which will have depleted stocks throughout the whole supply chain (see Figure 1). Retailers are likely to be cautious about supplementing their stocks to any significant extent, since lower crop prices would prompt buyer resistance to higher prices and pose the risk of write-downs on these stocks. Buyers are also waiting to see the effects of forward offers—for urea these are now in the USD 350/st range for this quarter.

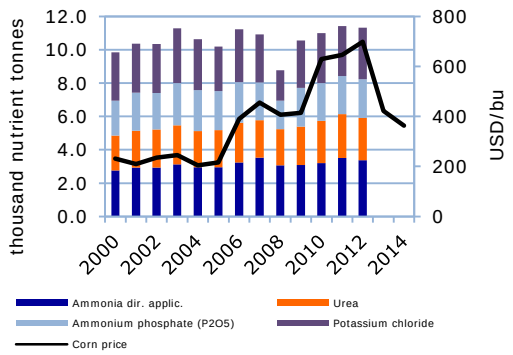
Farmers thinking about applying fertiliser in the autumn are likely to exercise some caution, given the recent fall in crop prices. In Rabobank's view, lower crop prices will not force farmers to radically reduce fertiliser application in the US in the short term. Since 2008, total farm sector equity in the US has risen by 34%, according to the USDA. This likely leaves farmers sufficiently equipped to spend money on inputs. If farmers save anything on fertiliser application at all, this is most likely to concern P and K application (as was the case in 2008), but not N application (see Figure 2). Even tighter storage regulations for ammonium nitrates are likely to reduce demand for the product further, potentially benefitting UAN. In potash, tighter granular MOP markets could provide some future price support in the US.

Figure 1: US ammonia producers saw increased YOY deliveries as a result of strong spring applications in the US



Ammonia deliveries CF, Agrium and PotashCorp
Source: Quarter Earnings Releases, Bloomberg, 2014

Figure 2: Historically, farmers do not necessarily reduce nitrogen fertiliser application significantly when corn prices are lower



Source: IFA, Bloomberg, 2014

Brazil unlikely to push up prices

With improved fertiliser imports in the first half of the year, comfortable stocks will limit the need to import significant volumes this quarter. Farmers are most likely to reduce input use in Safrinha corn and, to a lesser extent, soybeans.

To pre-empt logistical constraints at the start of the actual growing season, imports in the first half of this year increased significantly (see Figure 3). Q3 is traditionally the main import period for Brazil, although this year, the South American country will probably be a relatively quiet player in the global fertiliser complex. Imports for all fertilisers in this quarter could come under further pressure from a lower corn price, which will likely force farmers to consider lower input use in the Safrinha crop in the first quarter of 2015. As in the US, the most likely candidates will be P and K nutrients, as farmers do not necessarily have to apply these each year. Bearish sentiment could be partially offset by demand pull prompted by recovery in sugarcane and coffee prices.

In all, Rabobank expects Brazilian fertiliser demand to increase between 3% and 5% in 2014. Even though soybean prices are lower, margins are likely to remain positive for now. Against this backdrop, the planted area for the 2014/15 season, starting in September/October, is expected to increase once again. Initial forecasts point to 30 million hectares of soybeans this year, 3.5% up on last season.

From a supply perspective, cheaper urea from the Middle East is increasingly replacing Russian urea. Potentially tight MAP markets as a result of Morocco preferring phosacid are unlikely to have any significant impact on Brazil as the country has secured a significant part of its needs and produces about 50% of its demand locally. For potash, comfortable stocks, allied to concerns about grain prices and margins on the farm, could also affect the customary Brazilian buying habits in Q3/2014 and eventually curtail international price rises normally generated by South American imports before the Brazilian season.

Cautious price support from China

Supply chain management for urea is setting the tone in China and is further enhanced by impending domestic demand.

Urea prices in China continue to edge higher, driven by imminent autumn applications starting this month. In recent weeks, the Chinese Nitrogen Fertiliser Industry Association (CNFIA) urged producers not to go below USD 270/tonne FOB in Indian urea tenders at the end of July, and warned Chinese urea producers of the serious consequences of not adhering to WTO principles and exporting urea at 'dumping' prices. Additionally, it seems some market players have overestimated China's seemingly infinite urea supplies. With higher prices, traders short on Chinese material are looking at losses on their positions, as the prompt availability of prilled and especially granular volumes is lower than expected and other sources of cheap urea are not globally available. China appears to combine this difficult position that traders with short positions are in, with gathering momentum east of Suez, for instance by replacing more and more Ukrainian volumes in Europe for further price increases closer to home.

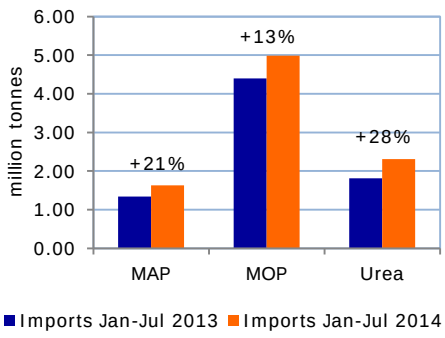
With the continued weakness in Chinese anthracite coal markets and higher urea prices, producers will be looking at improved financials in this second half of 2014 (see Figure 4).

Although gas prices in China were recently raised by CNY 0.40/m³, urea producers that use natural gas as a feedstock will retain a preferred price level. Market sources suggest that producers are taking precautionary measures and are seeking possibilities to diversify product portfolios or integrate upstream.
With stronger seasonal domestic and global urea demand, Chinese prices could continue to find support this quarter, but they are not likely to be very sustainable going forward. Oversupply is still looming over the Chinese urea markets and is likely to provide bearish undertones to global prices when seasonal demand fades.

Prices for DAP in China remain firm on the back of forthcoming domestic demand and global supply management. Indian demand could provide a bit of support, but the monsoons rains have been the worst in five years. Halfway through August, DAP port arrivals in India for the month were estimated at 214,000 tonnes, 85% of which came from China. Typhoon damage to ports carrying DAP stocks in China appears limited for now and is only likely to cause minor shipping delays. All in all, with India now willing to pay USD 480/tonne to USD 490/tonne CFR, China appears to be in a comfortable position in DAP.

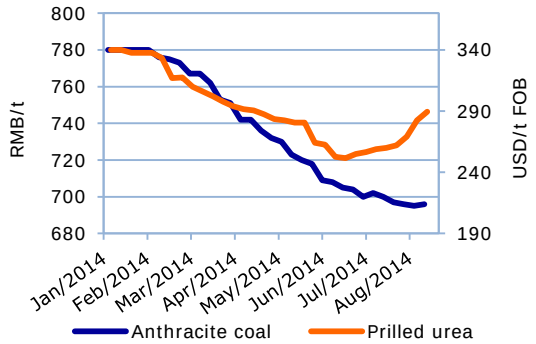
Increased domestic potash production in China is increasingly proving to be a price tool in setting global potash contracts in China. It is unlikely that palm oil producers in Southeast Asia will enable a price hike in 2H, as palm oil prices are unfavourable. MOP prices in Malaysia remain around USD 290/tonne to USD 300/tonne CFR. Contract negotiations in China have not yet been finalised, and the most likely potash scenario appears to be that 1H contract prices will roll over into the second half of the year. Uralkali wants to raise potash prices by 10% in China in 2015, but settling a new contract at USD 335/tonne might prove ambitious, especially given a lack of momentum in potash globally. The opening of a new 480,000 tonne SOP facility in Qinghai will likely alleviate some of the pressure on Chinese SOP prices.

Figure 3: Increased YOY imports has left Brazil with comfortable stocks



Source: ANDA, 2014

Figure 4: A widening spread between Chinese prilled urea and coal prices will improve the margins of Chinese urea producers



Source: CRU, Bloomberg, 2014

Europe slowly re-entering fertiliser markets

European fertiliser markets are still not very active. Some pre-planting and supply fill buying is occurring, but major nitrate application will not occur until spring. A weaker euro is making imports in US dollars more expensive.

Limited summer fill activity has set the tone in European fertiliser markets in recent weeks. Fertiliser producers mostly used this period to gauge sentiment by floating new price ideas for the forthcoming autumn application season. The quoted prices are said to have encountered some resistance. Calcium ammonium nitrate prices of around EUR 230/tonne are said not to be attracting much buyer interest for the moment.

Sentiment in Europe is being negatively affected by the Russian trade restrictions. While so far, inputs have not been included in the trade bans and European farmers are one of the most stable users of fertilisers, cheaper produce could imply fertilisers are being applied with more caution. How nitrate prices will move remains uncertain for now, although they could be supported by higher ammonia prices and generally tighter markets. Nitrate premiums on urea are decreasing on the back of higher urea prices that are also being driven by a depreciating euro (see Figure 5).

With Europe becoming more active from September onwards, there could be more upward price pressure in already thin global potash markets. In the coming months, some pre-plant application will occur to optimise nutrient levels, but the major application of nitrates will not occur until spring 2015.

With Europe's slow return to urea markets, buyers will be looking mostly at the Middle East and China to replace East European (Romania, Croatia) and Ukrainian volumes. The loosening of Iranian sanctions has made it easier for Iranian volumes to reach Europe.

It's all about rain in India

India will likely to be the main driver of global urea demand in the coming months. By contrast, India's potash and phosphate demand might fall during the next quarter.

As a result of the supply chain management that has been implemented by the Chinese Nitrogen Fertiliser Industry Association (CNFIA), there is a possibility that traders who committed volumes in India's latest urea tender will default, thereby forcing India to re-tender a significant volume in September as urea stocks are already very low in India. Tight supply outside of China and managed supply in China will probably increase India's import price for urea.

Steadily increasing Chinese FOB urea prices are rendering significant losses for traders that come up short in India's latest tender. Traders who committed volumes at USD 275/tonne CFR India face FOB China prices that exceed 280 USD/tonne. With freight costs from China to the east coast

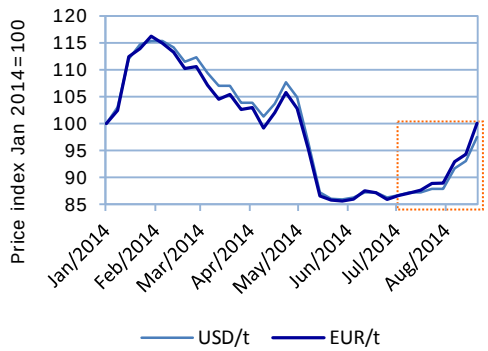
of India estimated at USD 25/tonne, traders with sales shortfalls will have to swallow up losses of at least USD 30/tonne.

This scenario will only become fact if China's fertiliser suppliers all adhere to the CNFIA price guideline. Decreasing utilisation rates and potential oversupply might rescue traders short on sales to India, as they might find suppliers willing to sell at prices below USD 260/tonne. That is still a real opportunity based on Rabobank's estimated cash cost for sub-bitumous and gas-based production of USD 220/tonne for almost 30 million tonnes of China's urea production.

India imported relatively high volumes of potash during the summer on the back of a supply agreement negotiated last April. MOP imports, at 1.5 million tonnes since April, are up 14% on last year. However, the disappointing monsoon will probably limit farmgate demand ahead of the Kharif planting season that starts in September (see Figure 6). This might slow the pace of MOP imports in the next few months. Further depreciation of the Indian rupee adds pressure on importers' margins. On average, India's monsoon rains are 66% behind YOY, although minor improvement was witnessed through August, with 11% more rainfall than the month before.

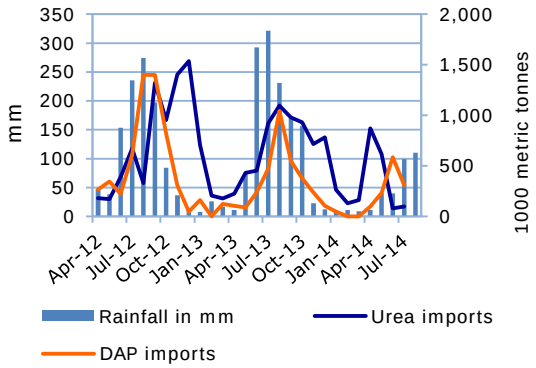
The price pattern for phosphates in India will be fragile—demand is apparent and July DAP imports were strong, but weak monsoon rains in the first half of the year, a continued weak Indian rupee and a subsidy system that continues to cap import prices will challenge any higher prices. Concerns have been sparked by 7% lower YOY DAP stock levels in July, but importers remain wary of accumulating excess stocks, given the uncertainty in DAP demand prices. Lower stock levels and an improvement in the monsoon rains could support global DAP prices. Some producers in the Middle East are said to have mooted price ideas towards the USD 500/tonne CFR level, but prices are much more likely to remain capped around USD 485/tonne CFR, given India's subsidy constraints. High prices in India could also be alleviated if the country were to change its requirements on nutrient contents, thereby allowing lower grade phosphates from China to enter into India as well.

Figure 5: A weaker euro is making fertiliser imports into Europe more expensive



Source: Egypt Granular FOB, CRU, 2014

Figure 6: Indian demand will, to a large extent, depend on monsoon rains



Source: FAI, Bloomberg, 2014

A story of gas and politics in MENA and the FSU

Increased and disrupted gas flows in the Middle East and the former Soviet Union (FSU) make the nitrogen market even tighter. Demand might deteriorate in Russia as access to finance becomes limited for farmers.

The Middle East and North Africa region also dictate the tightness in the ammonia market. Producers are struggling with gas supply and operational issues. This tightness in global ammonia and urea markets is being exacerbated by the FSU region, where sentiment is obviously dictated by the political situation in Russia and Ukraine. Russia stopped gas deliveries in June and production is therefore coming to a halt at most nitrogen fertiliser producers in Ukraine.

Some nitrogen trade around the Black Sea region is also limited by US bans on trade with a number of individual players. Sanction will also result in deteriorating demand in Russia as farmers find credit hard to come by in less liquid financial markets and are less able to purchase inputs as a result. The very limited trade from the Black Sea region will support urea prices. Morocco is further strengthening its position in the global phosphate markets with another one million tonnes added to its finished phosphate production capacity scheduled for the third/fourth quarter of this year.

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