

Press Release

Fresh iron ore mine auction positive for steel sector but to cause short-term disruptions

Increasing domestic pellet production to offset the likely pressure on ore prices

Acuité believes that around one fourth of the country's iron ore production is likely to witness an impact in the first half of FY21 given the process initiated for fresh mining auctions and the transition of operations to new lessees. India's steel sector particularly the sponge iron and secondary steel producers may face a short-term disruption in their iron ore supplies with the leases of 232 merchant iron ore mines due to expire by March 2020; the expected impact can be to the tune of 25-30% of the aggregate domestic iron ore supply. However, such an impact will be partly offset due to the increasing availability and supply of the ore substitute, iron pellets to the domestic sponge and steel producers. Acuité Ratings estimates that iron ore pellet production in India will reach 68-73 million tonnes in FY20 and a predominant part i.e. 85% of the latter is likely to be available to domestic sponge and steel units.

Indian Government has initiated the process to auction 329 mines including 232 iron ore mines where the leases are set to expire in March 2020. This is a part of its initiative to address the issue of lower mine productivity, lack of adequate investment for mine development along with the need to bring in higher transparency in mine allotment. It is pertinent to note that 208 such mines are currently non-operative and transfer of the leases can lead to fresh investment and development, thereby enhancing domestic iron ore production significantly beyond the current levels of 220 million tonnes. In the opinion of Acuité, expediting the auctions and the subsequent approval processes for mining operations to be undertaken by new lessees will be critical to avoid any longer term supply shortages in the steel sector. Any tightening of ore prices in the currently moderate demand environment clearly may put further pressure on the margins of secondary steel players, which continue to have an overhang of debt.

Acuité, nonetheless believes that the significant increase of iron pellet capacity witnessed in India along with some steps taken by the government should help in offsetting such ore supply risks in the steel sector. The domestic iron pellet capacity has steadily grown and stood at around 86 million tonnes and estimated production of 60-65 million tonnes in FY19. The increased prices of lump ore along with better yield and productivity of pellets in sponge iron production, has led to the increased use of pellets as a substitute in the steel value chain. The availability of iron ore fines for pellet manufacture is not a challenge given the inventories available in the existing captive and merchant mines. Further, increasing demand for pellets from both secondary steel and integrated steel producers is likely to drive capacity utilization levels of pellet

plants who had seen sub-optimal utilisation in the past few years. Steady increase in the availability of iron ore pellets will moderate the demand and prices for iron ore lumps in the longer run.

Further, the government has also taken cognizance of the potential supply disruption by allowing new leaseholders to continue operating on approved mining plan of previous leaseholders and environment clearance (EC) for an initial period of two years. This will prevent any disruption in iron ore production beyond a few months during the period of transition. It has also enhanced the area cap for iron ore mines in the state of Odisha, the country's largest iron ore producer, thereby allowing large integrated player like Tata Steel to participate in upcoming auctions and increase their captive ore reserves; larger players are expected to make the necessary investments and ramp up the production in mines quickly. It is also noted that SAIL, the largest steel producer in the country, has been permitted to sell 25% of its captive iron ore production in the open market and importantly, dispose of the estimated 70 million tonnes of ore fines in its mines and plants through auctions, thereby ensuring abundant availability of feed for the iron pellet plants. If necessary, the exports of the ore, which continue to be under a ban in some states, can be further regulated to ensure minimal disruption in ore supply.

India, with total reserves of 33 billion tonnes is one of the leading producers of iron ore in the world. The government passed the Mines and Minerals (Development & Regulation) Act (MMDR Act) in March 2015. Subsequently, the production in the domestic market witnessed visible improvement as reflected from the rise in output since FY15. While domestic iron ore production has grown at a CAGR of 14.3% over the period FY15-19, the growth has been relatively moderate over the last two years.

Domestic iron ore prices witnessed steep rise in FY18, supported by elevated global iron ore prices coupled with domestic demand pick up and supply disruption on the back of shutdown of mines in Odisha and Goa in H2 FY18. With mine disruptions in Brazil and Australia further crippling supplies in the global market, it tightened the domestic prices that continued their uptrend in FY19 as well despite some slackening in domestic demand. Exports of ores, which had witnessed a declining trend for the past two years with exports plunging 33% year-on-year to 16.1 million tonnes in FY19, has seen a pickup in the latter half of FY19 and FY20 due to the continuing global mine disruptions. The firmness in ore prices in the context of a finished steel demand slowdown and a drop in realisations has already put the margins of steel producers in India under pressure.

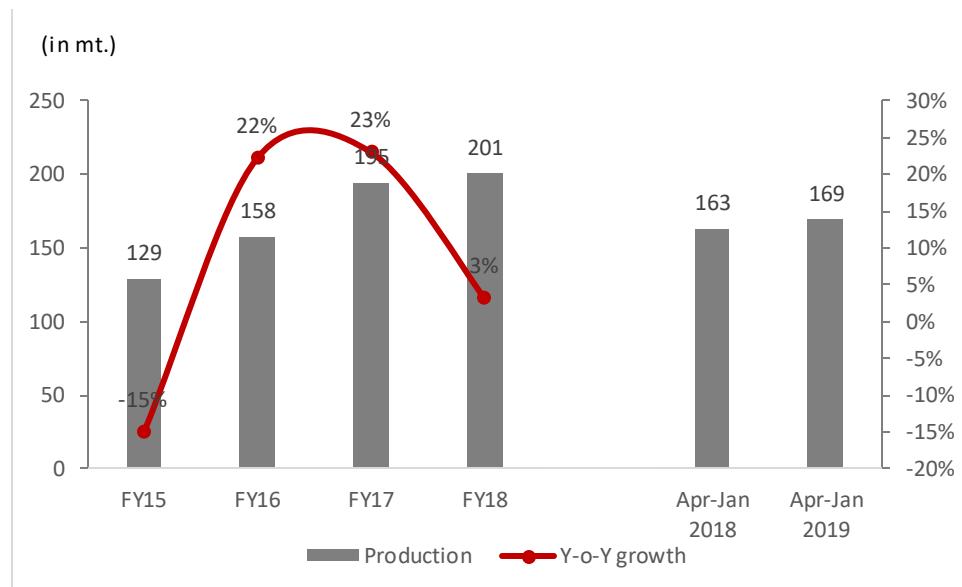
Odisha recorded the highest production of 102.2 million tonnes comprising 51% of the country's overall production with Chhattisgarh producing 34.5 MT (17%) and Karnataka producing 29 MT (14%), the other 2 major producers in FY18. The three states of Odisha, Chhattisgarh and Jharkhand account for almost 80% of the iron ore output in the country and primarily cater to the raw material requirement of integrated and secondary steel manufacturers in eastern region. The government is

set to auction the leases of 24 operational iron ore mines (out of a total 49 mines) held primarily by merchant lessees in the states of Odisha and Karnataka. It is estimated that the said leases account for more than 50% share of Odisha's overall iron ore production.

Thus, the expiring leases can potentially curtail about 25-30% of the country's iron ore production, taking into account the expiring leases of other states as well. Consequently, any significant delay with respect to auctions and more specifically lease transfers will affect iron ore supply and prices, thereby putting further pressure on sector profitability. Non-integrated steel companies, which do not have access to captive iron ore mines, will be relatively more vulnerable in the event of such delay. Therefore, a smooth transition in the lease transfers through the upcoming auction process along with the expected increase in pellet availability will be critical to offset the near term profitability challenges in the steel sector.

Annexure - Charts:

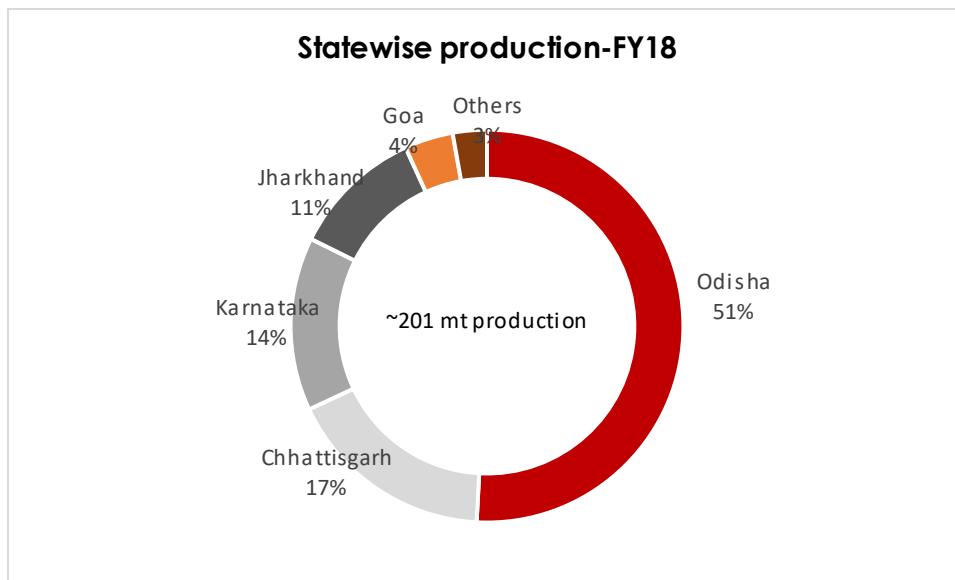
Chart 1: India Iron Ore Production



Note: Data for FY19 pertains to Apr- Jan 2019, the latest available in the public domain

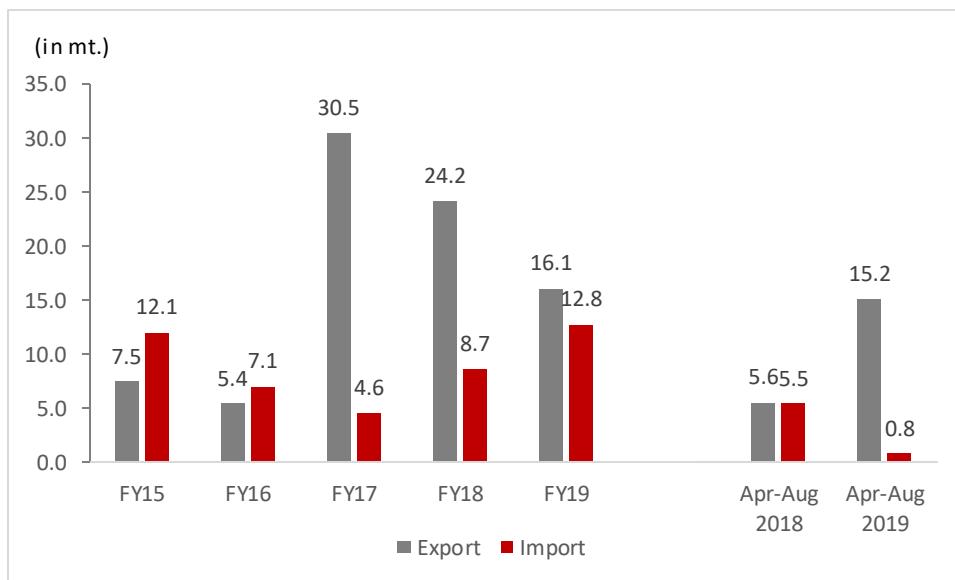
Source: Indian Bureau of Mines, CMIE, Acuite Research

Chart 2: State-wide Ore Production-FY18



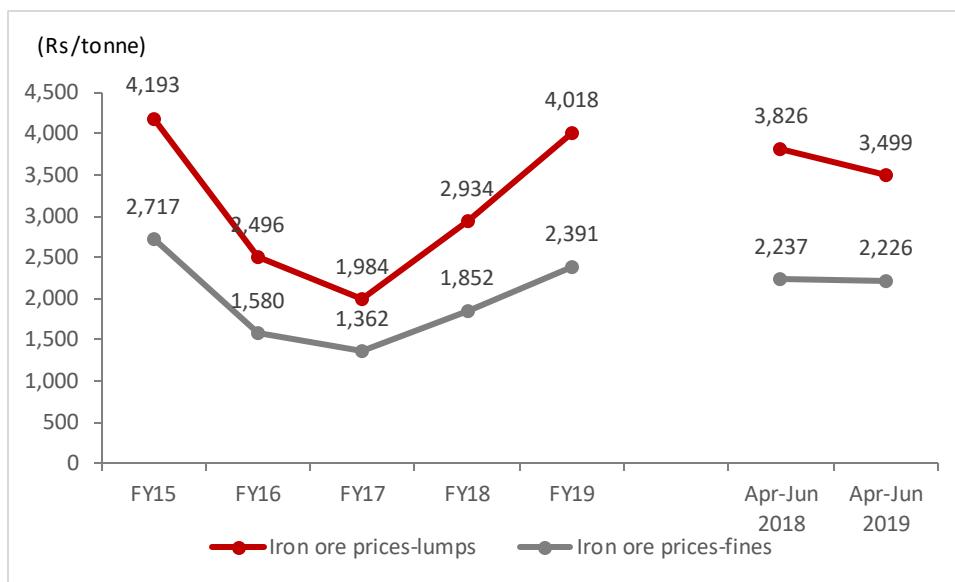
Source: Indian Bureau of Mines, Acuite Research

Chart 3: Iron Ore Exports-Imports



Source: CMIE, Acuite Research

Chart 4: Iron Ore Prices FY15-19



Source: CMIE, Acuite Research

About Acuité Ratings & Research Limited:

Acuité Ratings & Research Limited (*Erstwhile SMERA Ratings Limited*) is a full-service Credit Rating Agency registered with the Securities and Exchange Board of India (SEBI). The company received RBI Accreditation as an External Credit Assessment Institution (ECAI), for Bank Loan Ratings under BASEL-II norms in the year 2012. Since then, it has assigned more than 6000 credit ratings to various securities, debt instruments and bank facilities of entities spread across the country and across a wide cross section of industries. It has its Registered and Head Office in Mumbai.

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