Press Release

Revival in imported coal-based UMPPs drive 40% surge in Indian coal imports

100% FDI in coal mining expected to offset structural challenges in domestic supply

Acuité Ratings believes that a sharp increase in coal imports witnessed in the first quarter of the current fiscal reflect an improved tariff regime and better operating performance of the imported coal based power plants, a slowdown in production by Coal India as well as an uptick in power demand due to rapid electrification in the country. India's thermal coal imports have jumped by 41% YoY to 18.4 million tonnes (mt) from 13.0 million tonnes during Q1 FY20, despite the slowdown in the economy witnessed over the last two quarters. The key driver for the spike is the pickup in imports by private sector power plants, particularly a few ultra- mega power plants (UMPPs) which have been benefitted from an improved tariff regime that permitted a pass through of increased generation costs despite a competitively bid initial framework. Further, the domestic coal industry continues to be plagued by challenges in supply infrastructure with production in Coal India (CIL) having grown at a mere 0.1% in Q1. Lastly but not the least, electricity generation has actually grown at a healthy rate of 7.4% in the first quarter with a steady progress in power transmission and distribution infrastructure across the country. Acuité is of the opinion that the government's decision to permit 100% FDI via automatic route in coal mining and allied activities will facilitate higher investments in the sector and arrest the increasing dependence on coal imports over the medium term.

A study by Acuité Ratings indicates that coal imports by private sector IPPs have leapfrogged to 14.5 million tonnes from 10.3 million tonnes i.e. over 40%* yoy in April-June 2019. With limited domestic coal linkages, the bulk of India's coal imports (79% as in Q1) are undertaken by the IPPs. Many of the private thermal power plants are configured to use imported or blended coal in their generation process; but such a sharp increase has been primarily due to a quantum jump in imports by two UMPPs of Adani Power and Tata Power. While Adani's Mundra unit imported 4.5 million tonnes representing a multi-fold growth, Tata Power's unit in Mundra imported 3.0 million tonnes of coal, also a strong 38% growth yoy. Another IPP that accounted for significant imports was JSW Energy's Ratnagiri unit importing 1 million tonnes of coal.

The imported coal-based private generation units have ramped up their generation and coal imports following the Supreme Court's directive in October 2018, which facilitated the pass on of increased generation costs to consumers. The beleagured UMPPs located in Mundra had been struggling with lower PLFs (plant load factor) over the past few years owing to low tariffs and under recoveries. These power plants were forced to cut imports and stop or reduce power generation after the court, in its earlier order in 2016, had barred them from passing on increased import costs to end consumers, after their coal supplies from Indonesia became more expensive due to the imposition of a new pricing mechanism.

Globally, the coal prices have been on a downtrend with the headwinds of slowdown in both developed and emerging economies. The benchmark prices of thermal coal (Indonesia, 4200 kcal/kg) has dropped by 16% over the period July-June 2019, rendering imported coal relatively attractive.

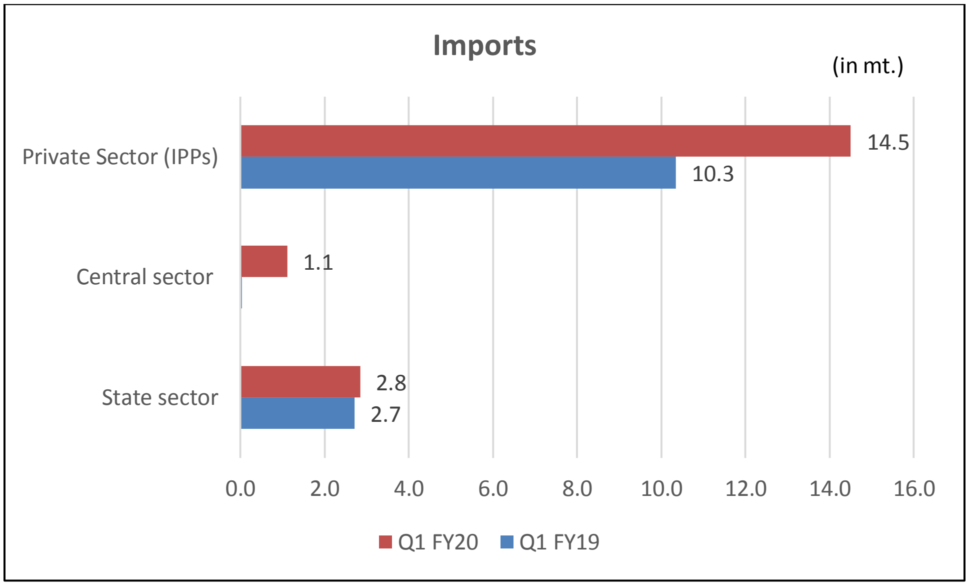
Crippling domestic fuel supply coupled with bottlenecks in transport infrastructure have been the key issues that have continued to hamper coal production in India. Domestic production during the first quarter of the current fiscal has been particularly stagnant, supporting imports. The coal production of CIL and its subsidiaries during Q1 FY20 stood at 137 million tonnes, a meagre 0.1% growth year-on-year. Over the years, there has been a consistent effort taken by the government to increase domestic coal production and reduce dependence on imported coal at least for the power sector. Notwithstanding these efforts, production by CIL has regularly missed its target by a wide margin except in the previous year where it almost managed to reach its target.

The structural weaknesses in domestic coal supply is also leading to rising imports by the state and central generation companies. Acuité believes that supply bottlenecks coupled with the high load period during the summer and the pre-election months have led PSUs to opt for imported coal. For example, Mahagenco (Maharashtra) faced coal supply crunch in the second quarter of FY19; its Koradi and Chandrapur power plants had witnessed a significant reduction in generation during the said period despite the fact that they constitute more than half of the state's public sector installed capacity. Subsequently, the state resorted to imports in order to push up the generation levels of Mahagenco; it imported 1.04 million tonnes of coal in Q1 against no imports during the corresponding period of last year and generated 13.8 billion units in Q1FY20 as compared to 12.2 billion units in Q4FY19, a 13% growth quarter-on-quarter. Even from the central sector, NTPC—the country's largest electricity generator, imported 1.1 million tonnes in Q1 as compared to an almost negligible amount in the previous year.

In order to boost domestic coal production, there has been an urgent requirement for reforms relating to prioritising efficient coal linkages and its delivery and promoting competition in the sector by way of allowing commercial mining through entry of private and foreign firms. The sector continues to face production and expansion problems involving the requisite forest and environmental clearances, frequent labour strikes and rehabilitation of affected people. In this context, the decision to facilitate 100% FDI in the coal mining sector is significant; however, Acuité believes that the shortfalls in domestic coal production are likely to continue at least over the medium term.

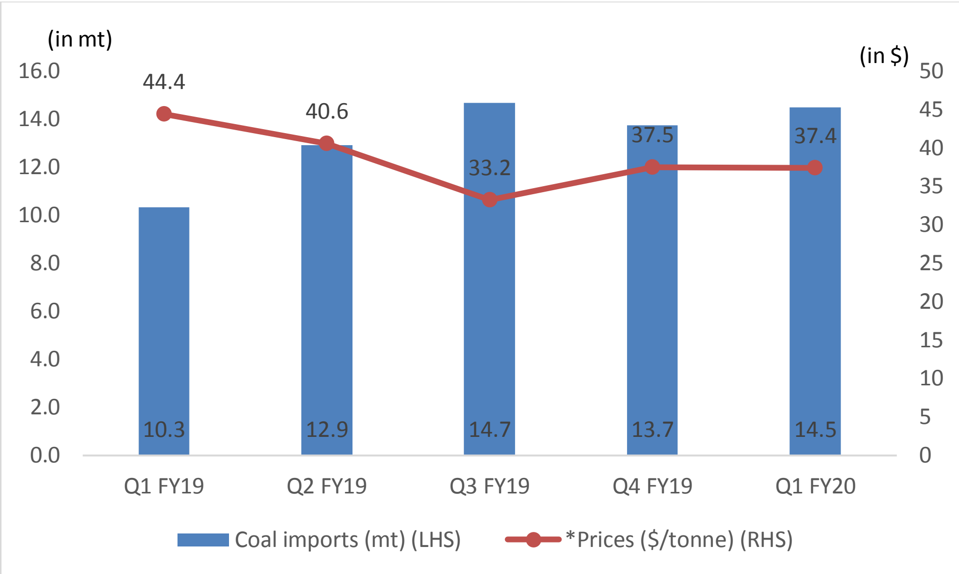
According to the 19th Electric Power Survey (EPS) report, electrical energy requirement till FY22 is expected to grow at a CAGR of 6.18%. The healthy growth in demand is likely to be supported by several policy initiatives of government such as Power for All (PFA) providing 24x7 power to all Indian households, industrial and commercial demand, adequate supply of power to agricultural consumers, dedicated freight corridors, 'Make In India' initiative and rising trend towards electric vehicles (EVs). As per CEA, power demand has grown at a healthy 7.4% YoY in Q1 FY20. While the contribution from renewable sources are on a rise, India will continue to have a predominantly coal-based energy mix at least in the medium term and quick reform measures in the coal sector is more critical today than ever before.

<u>Graph 1: Growth of Coal Imports</u>



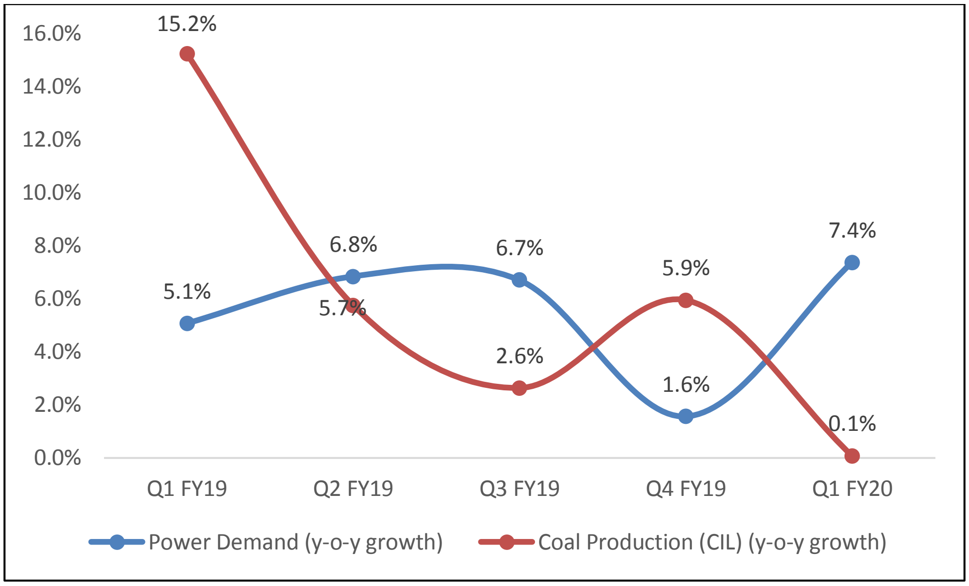
Source: CEA, Acuite Research

<u>Graph 2: Trend in coal imports by the private sector plants with prices of coal in the international market</u>



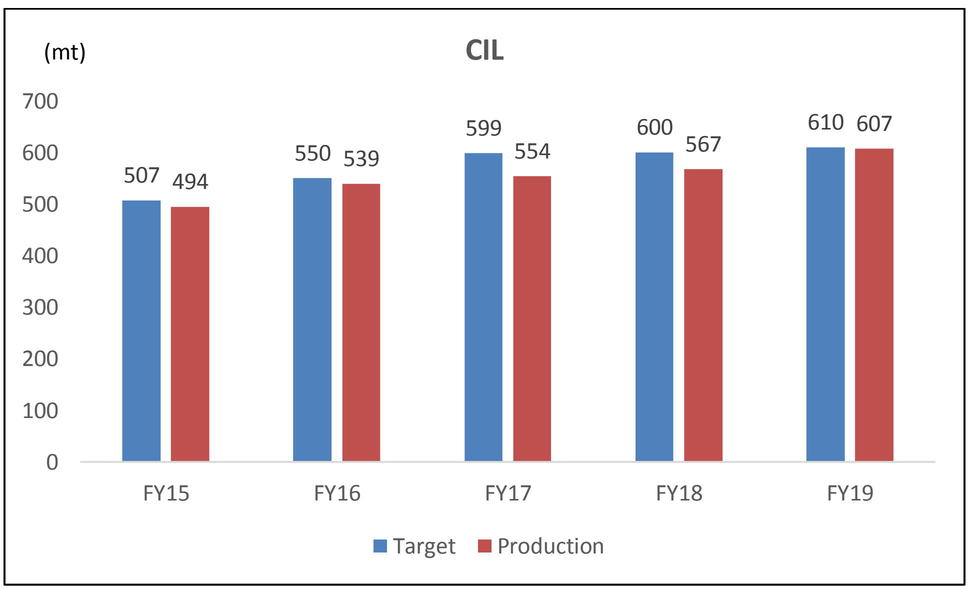
Note: *- Price pertains to Indonesia 4,200 kcal/kg coal grade and is taken as an average for the quarter.
Source: CEA, Acuite Research

Graph 3: Power Demand Vs Domestic Coal Production Growth



Source: CEA, Ministry of Coal, Acuite Research

Graph 4: Coal India (CIL) Production Vs Targets



Source: Government press releases, CIL, Acuite Research

About Acuité Ratings & Research Limited:
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