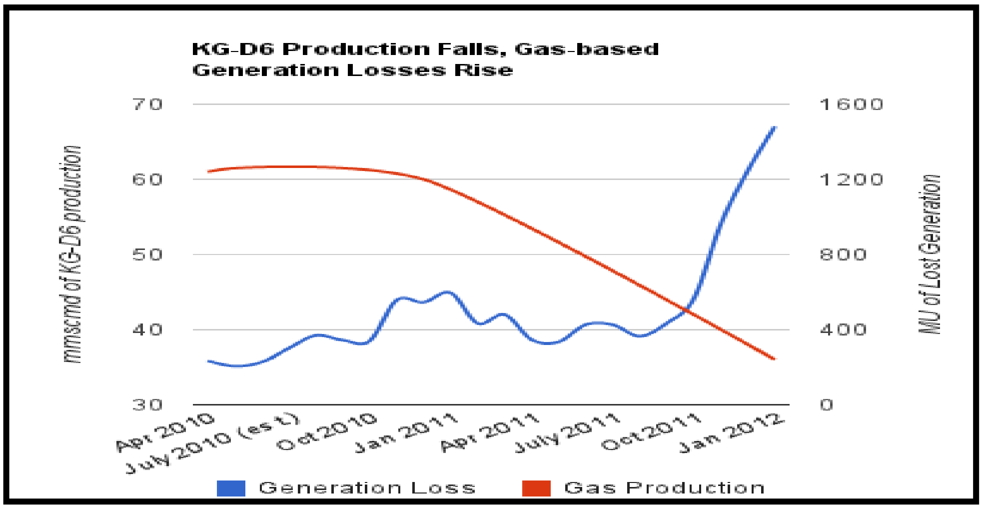
Fuel supply issues dampening future outlook

As on April 30, 2012, India has the fifth-largest power generation capacity in the world with an installed capacity of 201.6 GW (Thermal 66% and Hydro 19%). The XII five year plan envisages capacity addition of 90 GW (majority being thermal-based), which is essential for attaining desired economic growth in the next few years. But currently, the domestic power sector is plagued with multidimensional issues, with fuel availability (coal & gas) emerging as the biggest challenge for both operating and upcoming power projects.

In 2011-12, India's energy deficit was 8.5% with peak energy deficit being 10.6%. The All India thermal Plant Load Factor (PLF) has fallen from 77.5% in FY10 to 73.3% in FY12, mainly due to acute shortage of coal in the domestic market. This was further aggravated by steep increase in international coal prices and imposition of mining tax on major coal-export oriented countries (Australia & Indonesia), which the power companies were unable to pass on, due to inadequate/non revision in tariff. In 2011-12, the gap in domestic demand-supply of coal was 161.5 million tonnes (mt), an increase from 132.8 MT in 2010-11. For 2012-13, Government of India (GoI) has taken various steps to increase coal supply including expediting environment & forestry clearances, pursuing railways for higher availability of rakes and assistance in resolving land acquisition issues. In addition, in April 2012, GoI also issued a Presidential directive to Coal India Limited (CIL) to sign Fuel Supply Agreements (FSAs) with the power producers and supply at least 80% of the committed coal delivery. A power purchase agreement (PPA) with the distribution companies was stated as a necessary pre-condition for signing of FSAs. A few weeks later, CIL declared that it can supply only around 65% of the power sector's coal requirement, and the balance 15% of its promised supplies to the generation plants needs to be imported. Furthermore, it also fixed the penalty, for failing to supply any amount less than 80%, at a meager 0.01% of the shortfall. Various public & private power companies including NTPC and DVC refused to sign the new FSA with CIL, stating that the new FSA has been diluted to such an extent that CIL cannot be held accountable in the event of non-supply of coal. Even banks and FIs raised similar concerns. This has resulted in a deadlock over fuel supply.

While coal-based power companies are grappling with the above issues, power generation by gas-based power companies (accounting for 9.11% of total installed power capacity) has been affected by sudden dip in gas supply. This is mainly due to steep fall in gas supply from KG-D6 basin (major gas supplier to domestic power supplier), from 60 million metric standard cubic metre per day (mmscmd) in April 2010 to 35 mmscmd in January 2012. The following graph depicts increase in gas based generation loss with decline in gas production during the last two years:



The gas production from KG-D6 basin has further declined to 27.4 mmscmd in May 2012. Going forward, this trend is expected to continue leading to further widening of demand-supply gap. According to Ministry of Power, demand for gas to fire gas-based power plants, will rise to 102.25 mmscmd by 2013-14 vis-à-vis the estimated supply of merely 24.23 mmscmd. This translates into higher dependence on import of expensive gas, which is likely to affect the margins of power producers. The existing gas-based power producers in the central, state and private sector are on the verge of facing penalties from state utilities due to non-conformance with minimum power supply levels as per PPA.

The current price for KG-D6 gas is US$4.2 per million British thermal unit (mmBtu; one mmscmd of KG-D6 gas yields about 35,000 mmBtu). This price was set in 2009 and is due for review in 2014. Natural gas, trading from US$3 per mmBtu in America to US$8 per mmBtu in Malaysia, is expected to get expensive in future, as China and India's reliance on gas for energy requirement is on the rise.

Future outlook

Coal - Overall coal demand is expected to reach around 710 mt in 2012-13, while production may reach 560 mt. CIL has been given a target of 460 mt for 2012-13, while the captive blocks and Singareni Collieries would contribute another 100 mt. Accordingly, coal import in India is expected to be around 150 mt, as against 117.46 mt in 2011-12. In order to augment future coal supply, GoI is also looking at the possibility of allocating 16 coal mines to the power sector in the upcoming auction of 54 mines. The same will be allocated to new projects on the basis of tariff-based bidding. However, timely commencement of operation in such mines (corresponding to commissioning of link projects) depends on timely receipt of all regulatory clearances.

Gas - In order to address the gas availability issue, GoI is considering a proposal for allocation of all domestic gas, besides imported gas intended for supply to power producers, to public sector GAIL (India) for the purpose of price pooling. However, major power producers (Tata Power, NTPC, Torrent Power and Mahagenco, etc), have opposed the proposal on the ground that this would lead to higher tariffs. As such, it may take some time to iron out the modalities of the proposal. In the interim, Power ministry has advised the prospective gas-based power developers to refrain from setting up new gas-based projects till 2015-16, as no additional domestic gas is likely to be available for new projects.

Credit perspective - Going forward ongoing thermal capacity addition, continued coal/gas shortage and inadequate/non revision in tariff are expected to weaken the credit profiles of the companies operating in the power sector.

Contact:
Saurav Chatterjee
Asst General Manager
saurav.chatterjee@careratings.com
+91- 9830714920