In focus

December 7, 2011

Power Distribution Losses Trip SEBs

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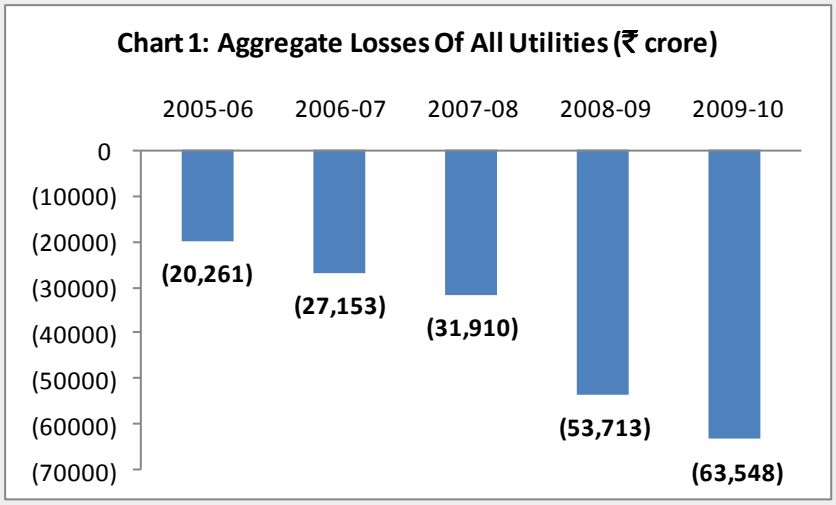
Power Distribution Losses Trip SEBs

Health of state electricity boards in India has been a major cause of worry for all its stakeholders. SEBs have been characterised by high operative inefficiencies, pressure from state governments, expensive imports, and consequently huge losses.

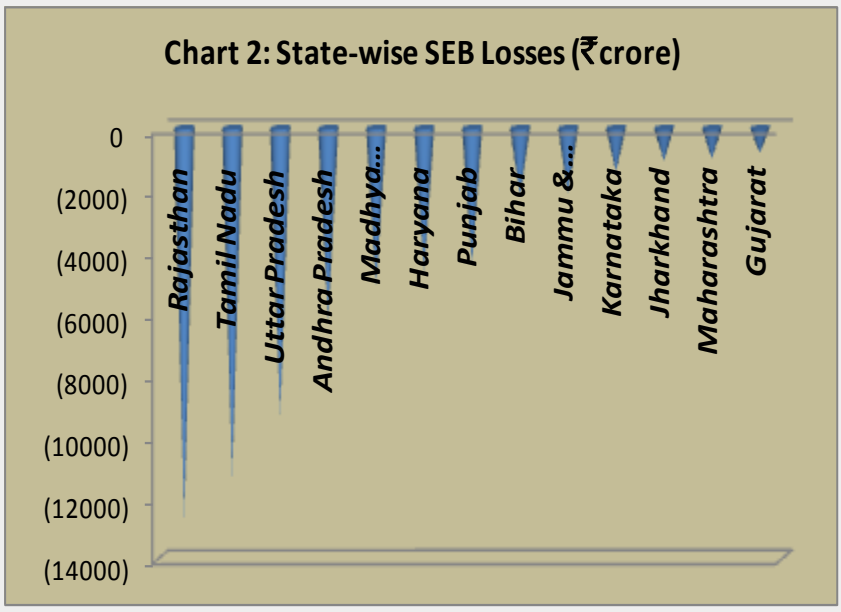
The power industry has managed to attract investments in the generation business, but transmission and distribution continue to be stricken because power distribution is mostly controlled by state electricity boards that are saddled with losses because of political compulsions, such as providing free power to farmers and inability to raise power tariffs.

The state power distribution sector suffers high aggregate technical and commercial loss, or AT&C losses, and is unable to recover costs of power supply, thereby resulting in financial losses. State electricity boards' financial health is in a distressed state also because of delayed payment of subsidies and problems related to fresh coal linkages.



According to the latest report released last month by government-owned Power Finance Corp Ltd, aggregate SEB losses in 2009-10 (April-March) was ₹63,548 crore (without accounting for subsidy). This is 18% higher from a year ago but better compared with 68% year-on-year increase in losses in 2008-09.

Government has appointed a committee under former comptroller and auditor general V.K. Shunglu to suggest reforms in power distribution sector. The draft report of the committee has pegged SEB losses at around ₹1 trillion.



Average AT&C loss for utilities selling directly to consumers was at 27.2% in 2009-10, and there was no improvement over the previous year.

While high losses affect revenue, insufficient or no revision in tariff is another major factor that affected performance.

Distribution companies file petitions for tariff revisions by November each year for the forthcoming financial year. The petitions, based on annual revenue requirement of distribution companies, are then submitted to regulators.

But the distribution arms of SEBs succumb to political pressure from governments and do not file for revisions and take a big hit on their books.

While units of electricity sold by utilities grew 8.8% in 2009-10 from the previous year, total income rose by a higher 11.3% to ₹1,90,948 crore. This indicates that revision in tariff enabled improvement in realisations.

Improvement in realisations would have been higher if the subsidy on power supplied to agricultural consumers not been as high as it is

Table 1: Cross-subsidisation in Power				
	Agriculture		Industrial	
	Share in units sold	*Share in Revenues*	*Share in units sold*	*Share in Revenues*
Haryana	38%	3%	26%	31%
Karnataka	35%	10%	22%	32%
Rajasthan	39%	18%	26%	39%
Punjab	32%	-	34%	57%
Andhra Pradesh	31%	2%	31%	44%
Maharashtra	22%	10%	45%	51%
Gujarat	32%	14%	43%	58%
Tamil Nadu	22%	-	35%	54%
Madhya Pradesh	30%	12%	31%	39%

Table 2: Top 10 States with Highest AT&C Losses (%)	
Jammu & Kashmir	70.4
Arunachal Pradesh	52.9
Sikkim	51.4
Meghalaya	48.8
Manipur	48.1
Nagaland	46.2
Bihar	43.9
Madhya Pradesh	41.0
Orissa	39.7
Uttar Pradesh	39.7

currently. Sales to agriculture account for close to 31% of total units sold, out of which revenues of only about 10% are garnered. Industrial consumers, on the other hand, consume nearly one-third power and contribute nearly 45% to total revenue in value terms.

Despite rise in income, losses of SEBs have risen. A look at their expenses shows that it is not high interest cost but excessively high power purchase cost that is hurting them. Power purchase cost was 61.3% of total expenses in FY10. Interest cost was as low as 6.8%.

The SEBs' bargaining power is low because of their high payables and weak financials. Expense statements of SEBs highlight their inability to purchase power at reasonable prices and lack of bargaining power pushes them to purchase from spot markets at high rates.

Weak financials also make it difficult for utilities to service their debt. So much so that the Union finance ministry has advised public sector banks not to increase their exposure to power utilities**,** particularly state electricity boards. This is because such lending could potentially lead to a rise in bad loans.

According to data released by the Reserve Bank of India, power sector accounts for nearly half of banks' lending to infrastructure. Outstanding bank loans to the power sector stood at ₹2.9 trillion as on August 26. Growth in April-August stood at 10.8%, slower from 16.9% last year. It must be noted that these loans include bank loans to the entire power sector, including private entitites.

The finance ministry's directive to not lend to distribution companies unless they pare losses and raise tariffs, has led to tariff hikes across states. In the past 18 months, 22 states have raised tariffs, including loss-making states like Rajasthan, Maharashtra and Tamil Nadu.

With measures like increase in tariffs, scrapping of policy related to go and no-go areas for coal mining activities, granting environment clearances for several delayed projects, and the Appellate Tribunal for Electricity facilitating tariff increase by the regulator on its own, we could see an overall improvement in performance in power sector (not only on the generation side).

According to a judgment by the Appellate Tribunal for Electricity, the apex regulatory body in the power sector, state regulators have the power to initiate proceedings on revision in electricity tariffs even if state governments have not filed the annual revenue requirement within the required timeline. This will help improve the financial health of SEBs to some extent.

However, a strong political will to decontrol SEBs from state governments is the crying need of the hour.

Weak Infrastructure Growth Points To Further Industrial Slowdown

India's infrastructure output plunged to its lowest in six years in October. The eight industries that constitute the infrastructure index grew a marginal 0.1% in October on a year-on-year basis, sharply lower from 7.2% growth a year ago and 2.3% growth in September, government data showed last week.

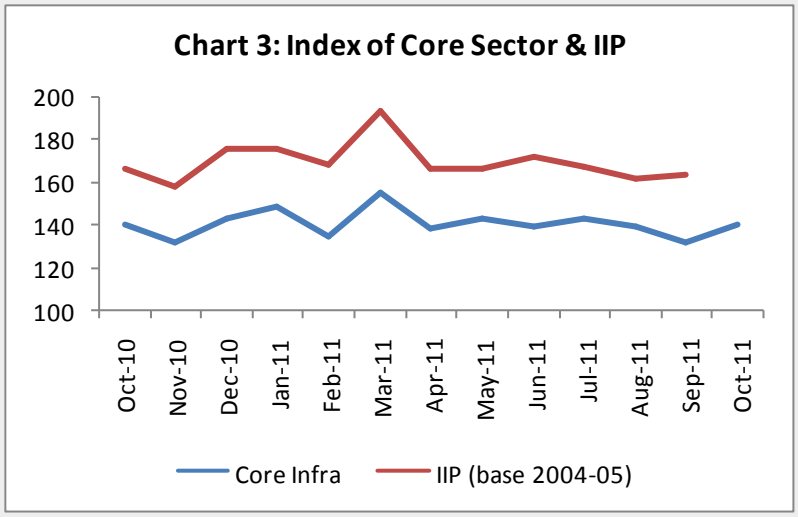
Output Affected

The infrastructure sector has a 37.9% weighting in overall Index of Industrial Production. With five out of the eight industries in the index registering a drop in output in October, there are increased fears industrial output growth could slow down further.

In October, there was contraction in output of industries such as coal (9%), natural gas (7.4%), fertiliser (2.1%) and petroleum refinery (2.8%) compared with a year ago.

Crude oil production fell marginally (0.9%) and cement output stagnated.

Electricity (4.9%) and steel (3.8%) were the only two sectors to have recorded a year-on-year growth during the month.



Source: PIB, Dhanbank PRU

April-October Growth 4.3%

During April-October, the cumulative growth rate of the infrastructure industries slowed to 4.3% from 5.9% a year ago. The slowing growth is mainly because of a fall in coal and natural gas output.

Coal output fell 5.5% in the seven months to October because of poor output by Coal India Ltd — the largest coal producer in the country. In October 2010, coal output was up 0.3% from the previous year. A strike by workers, heavy monsoon rains and muted output from existing coalfields have resulted in this decline. Since the sector has a high weighting of 4.4% in IIP, it dragged down growth.

Poor output from Reliance Industries Ltd's KG-D6 basin led to a 8.3% fall in natural gas output in the seven months to October against 22.2% growth in the year-ago period.

Weak demand from construction and real estate sectors resulted in a slow 2.8% growth in cement production in April-October.

Higher production by private and joint venture participants enabled the crude oil industry to record 4.4% year-on-year growth in output.

Capacity in the previous year and better utilisation resulted in 3.6% rise in petroleum refinery production compared with 1.4% growth in the year-ago period.

While regulations in the fertiliser industry have resulted in stagnating output over the past few years, falling fertiliser imports into the country have been a serious cause of concern. In fact, high cost of imported fertilisers is expected to result in a sharp fall in imports in the current financial year.

A double-digit growth in hydro (14%) and nuclear power (42.1%) generation led to 8.7% year-on-year rise in electricity output. Thermal power which accounts for nearly 75% of the total power generated in the country registered a 5.2% growth.

Steel production growth accelerated to 8.7% in April-October compared with 8.3% in the year-ago period.

- **PRU View**

High interest rates, rising raw material costs and uncertainty have taken a toll on growth in investments in the first half of the current financial year. The latest gross domestic product numbers show a slower growth in investments. According to a survey of India's CEOs, conducted by industry association Confederation of Indian Industry, shows that they are not planning any major investments for 2012.

While slower investment growth may not have an impact in the short term, the impact on growth may be felt in the medium to long term if this situation continues.

Weak growth in core industries strongly hints at slower industrial output in October.

Gems, Jewellery Exports in April-October up 16% Vs Year Ago

Gems and jewellery exports in October grew 16% from a year ago to ₹17,508 crore, according to latest data from Gems and Jewellery Exports Promotion Council. In dollar terms, exports grew only 5.4% from a year ago because of depreciation of the rupee (refer Table 3).

Growth in October was driven mainly by 66.7% year-on-year rise in exports of gold medallions and coins. Exports were up in terms of realisation as well as volume. Realisation grew as price of gold in October rose 38.2% from a year ago. Exports of cut and polished diamonds registered a sluggish growth of 1.25% in October on a year-on-year basis, compared with 31.76% growth recorded in the previous year. Volumes fell almost 30% from a year ago to 39.47 lakh carat.

Table 3:Gems and Jewellery Exports (₹Crore)

	Oct-11	Oct-10	April-October-11	April-October-10	Y-o-Y %			
					Oct-11		April-October	
					₹ term	$ term	₹ term	$ term
Cut and Polished Diamond	9285.71	9170.7	69612.6	67906.6	1.25	8.72	2.51	2.62
Gold Jewellery	4075.6	3215.9	23746.8	18819.8	26.73	14.12	26.18	25.59
Gold Medallion and Coins	3084.7	1850.8	19116	12037.2	66.67	50.23	58.81	58.1
Gems and Jewellery(Total)	**17508.2**	**14975.8**	**120001.7**	**103640**	**16.91**	**5.4**	**15.79**	**15.67**

In April-October, gems and jewellery exports followed a similar trend. Total exports, in rupee terms, grew only 15.79% against 34.48% rise in the corresponding period in the previous year. Cut and polished diamond exports increased only 2.51% from a year ago during the same period.

Exports of gold medallions and coins grew 58.81% in April-October, which pushed up overall gems and jewellery exports. This segment is also the only one to have recorded healthy volumes growth in the seven months under consideration. The segment's realisations grew around 30% and the remaining growth came from growth in volumes.

Gold jewellery exports rose only 26.18% in rupee terms in April-October, despite a 30% rise in gold prices from a year ago. This indicates export volumes of gold jewellery fell during the period.

A sharp rise in exports of gold medallions and coins indicates consumer preference for gold was more for investment purpose rather than consumption. The ongoing economic uncertainties in the US and Europe have prompted people to buy gold medallions and coins as they are considered to be a safe-haven investment .

Demand for cut and polished diamond appeared to have slowed down because of economic uncertainty and high prices of gold, one of the key constituents for diamond jewellery.

Diamond is not regarded as an investment option like gold. This is because there is no universal pricing system for diamonds. Polished and rough diamonds lack some of the desirable attributes of investment vehicles, including liquidity and homogeneity.

According to International Diamond Manufacturers' Association, global demand for rough diamonds is estimated at $1.2 billion in October-December, much lower from $4.6 billion sold in each of the first three quarters of 2011. According to newspaper reports, diamond jewellery exporters felt that overseas orders have declined on expectations that prices could fall.

Depreciation of rupee has made import of rough diamonds expensive as India imports almost its entire requirement for eventual re-exports. Since, gems and jewellery exports are heavily dependent on import of precious metals like gold and rough diamonds, the advantage to export because of rupee depreciation is being offset by expensive imports.

The Indian currency has lost about 6% of its value against the US dollar since beginning of November.

According to Gems and Jewellery Export Promotion Council, short supply of dollars from Indian banks also has affected overseas sourcing of raw material. On the other hand, high interest rates for working capital are adding to cost of production.

Tea Prices Likely to Remain Up On Firm Demand, Fall In Output

Winter demand heats up retail tea prices: Retail price of tea has appreciated by 5% and is set to go up as demand is increasing with the onset of winter. The two leading packeteers, HUL and Tata Global, are also buying heavily at auctions along with western India buyers like Wagh Bakhri, Jivraj and Society. *(The Economic Times, December 2)*

- **PRU Analysis**

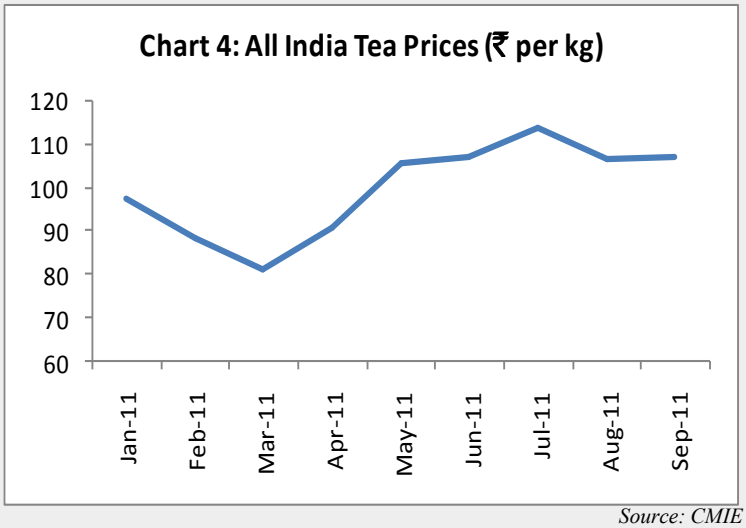
Onset of winter typically leads to a rise in tea demand globally in October-December. This year, global tea prices are rising because while demand has remained unchanged, output is expected to contract.

Adverse climatic conditions in Sri Lanka and Kenya have led to a fall in tea output in these regions. This resulted in a 1.9% decline in world tea production to 1,224.6 million kilogram in January-August compared with a year ago. Kenya's tea output is expected to be lower in September-December and that is likely to worsen the global supply situation.

In India too, unfavourable climatic conditions like poor rainfall in some areas and excessively dry weather in some others are likely to adversely impact output. While tea production until September has been higher when compared with a year ago, Tea Board of India officials suggest that output is estimated to be lower in October and November.

In January-September, north Indian (including Darjeeling, Terai, Dooars and Assam) production was up by 36.7 million kg compared with last year. South Indian (Kerala, Karnataka and Tamil Nadu) outout during the same period fell by 4.6 million kg.

All India demand for tea has risen by a healthy 10% until November, according to media reports. December and January are expected to register a further rise in domestic demand.



Source: CMIE

- **PRU View**

Given the expected fall in tea output and strong demand, tea prices are likely to remain firm in the coming months. Together with high CTC prices, other input costs like packaging and transportation costs are also adding to high retail prices.

Cheap Imports From China Hurt Ferro Alloy Industry

Capacity utilisation dips 62% compared with 65% last year. At a time when Indian ferro alloys producers have slowly expanded their installed capacity over the years to meet expected rising demand from steel industry, cheap import from China is steadily grabbing the domestic market share. *(Business Standard, December 6, 2011)*

- **PRU Analysis**

Despite a rise in domestic production of ferro alloys, a surge in cheap imports from China has resulted in lower capacity utilisation in the alloy industry. Capacity utilisation has declined to 62% for 2010-11 (April-March) from 65% in the previous year.

According to Indian Ferro Alloy Producers Association, overall imports of ferro alloys in FY11 jumped 21% from a year ago to 218,401 tonnes. In the past six years, overall imports have risen by a whopping 125%.

Ferro alloy refers to various alloys of iron with varying proportion of other elements, including manganese, silicon and nickel. They are primarily used for steel-making as a de-oxidant and the requirement for ferro-alloys varies depending on the process of steel-making and the product.

In FY11, overall installed capacity of the industry stood at 4.04 million tonnes, while production grew 9% from a year ago to 2.87 million tonnes.

Table: 4

	Import Duty	Imports (₹ Crore)
2005-06	10	591
2006-07	7.5	779.8
2007-08	5	1089.4
2008-09	0	1530
2009-10	5	1516
2010-11	5	N/A

Production costs in India are comparatively elevated due to high power tariff and input costs. Power tariff in India is three to five times higher than that of China. Import duties of 10% and 7.5% on key inputs — such as, metallurgical coke and ferro nickel, respectively — that are not available in the domestic market have pushed up production costs.

Government has been cutting import duty on ferro alloys over the years, which has resulted in surge in imports to the country. For instance, imports jumped 23% from a year ago to ₹591 crore in FY06 when duty was reduced to 10% from 15% By March 2010,, imports had touched ₹1516 crore (refer Table 4).

To protect domestic industry and create a level playing field, the government has to reduce import duty on inputs and increase he import duty on final products of ferro alloys.

An analysis of 15 ferro alloys companies' aggregate earnings during July-September reveals a dismal picture. Aggregate net sales grew only 5.7% from a year ago to ₹1,638 crore mainly because of lower realisation due to softening of prices in the domestic market arising from low-priced imports (refer Table 5).

Aggregate operating profit fell 66.3% from a year ago due to a sharp rise in operating expenses — such as, raw material and power costs. Power costs account for 60-65% of cost of pro-

Table 5 : Aggregate Financial Result (₹ crore)

	Q2FY12	Q2FY11	Y-o-Y %
Net sales	1638.01	1550.4	5.7
Raw Material Costs	864.46	710.37	21.7
Power Costs	237.16	197.07	20.3
Operating Profit	85.86	254.64	66.3
Interest Expense	68.54	40.77	68.1
PBT	25.15	224.9	88.8
PAT	19.9	153.34	87

duction for ferro alloy manufacturers. Cost pressure due to high coking coal prices during the quarter took a toll on profitability of these companies. Although coking coal price fell to $285 a tonne in July-September, it was still 35% higher compared with last year.

Net profit fell by a steep 87% due to a sharp rise interest expenses. Aggregate interest expenses went up 68.1% from a year ago.

Net sales of Manganese Ore India Ltd, a key player in the sector, fell 12.6% in July-September period from a year ago to ₹248 crore mainly because of lower average realisation. The company's average realisation in July-September declined 26% from a year ago to ₹8,150 a tonne.

Domestic ore prices during the quarter softened 30% from January levels due to intense competition led by increased supplies from international markets.

Despite the company's other income surging 49.3% from year ago to ₹47 crore, quarterly net profit fell 31.9% on a year-on-year basis.

India May Opt For More Nuclear Power Plants On Increased Uranium Supply

Aussie Ruling Party Okays Uranium Export To India: With riders, however, on a safeguards treaty first; sales still in some doubt. The ruling Australian Labor Party's national conference on Sunday voted by a very narrow margin to overturn its long-standing policy banning uranium sales to India. *(Business Standard, December 5, 2011*)

- **PRU Analysis**

Australia's ruling labour party has voted in favour of uranium sales to India, marking the end of long-standing policy that banned the sale of the radioactive element to countries that are not a signatory to the Nuclear Non-Proliferation Treaty.

Australia, the second largest producer of uranium after Canada, expects to sell around 2,500 tonnes a year to India by 2030. Uranium sales to India will further boost nuclear power generation in the country. Currently, nuclear power output contributes to about 3.5% of overall generation.

In April-October, nuclear generation achieved a growth rate of over 40% from a year ago to 18,729 million kilowatt-hour due to increase in uranium imports.

India's nuclear power generation has been constrained over the years due to lack of indigenous uranium reserves that led to high dependence on imports. Since India was outside the NPT treaty, it was excluded from transfer of any nuclear material.

In December 2006, after United States Congress approved the United States-India Peaceful Atomic Energy Cooperation Act, India was granted transactions on the basis of its clean non-proliferation record. In August 2008, the International Atomic Energy Agency approved the India Safeguards Agreement and India was granted the waiver by the Nuclear Suppliers Group to procure fuel for nuclear power reactors.

After 2008, India signed uranium supply agreements with Russia, Kazakhstan, France and Argentina.

But high supply of uranium in last few years has resulted in sharp surge of nuclear power generation.

Currently, India has 20 operational nuclear power reactors with a generation capacity of 4,780 megawatt. Another seven reactors with

capacity of 5,300 MW are under construction. After completion, India's total nuclear power capacity is all set to increase to 10,080 MW by 2017.

India has been procuring uranium from countries like France and Kazakhstan but does not yet have a long-term supply contract with any country. In 2010, India imported 300 tonnes of uranium from France.

Currently, India has two functioning uranium mines, both in Jharkhand. Total uranium reserves in these two mines are estimated at around 1,70,000 tonnes. It can be highlighted here that recent discovery of 1.5 lakh tonnes of uranium in Andhra Pradesh is enough to feed a 10,000-MW nuclear power plant.

India continues to visualise nuclear energy as a possible solution for its energy needs.

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