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Power producers stare at uncertain future

Recent decisions by the Cabinet, including raising gas prices, will raise production costs steeply. Will discoms, given their poor health, purchase expensive power?



The march to power for the Congress-led United Progressive Alliance government in the 2014 general elections is sure to be short-circuited, thanks to a series of policy decisions in recent months. In less than a year, the government has created the ground for an unprecedented jump in power tariffs, something that is not going to go down well with many voters.

The decisions include doubling the price of natural gas to \$8.4 per million metric British thermal units (mmBtu), allowing the additional cost incurred by companies on imported coal to be passed on to consumers and increasing domestic coal prices by an average 11 per cent. And all of this has happened amid an ongoing drive to revise tariff in order to restore the health of financially-ill distribution companies. What could be the combined cost of this sudden spate of moves to burden the consumer with a historic rise in power bills in the name of "energy pricing reforms"? A Business Standard analysis shows this cost runs into thousands of crore annually.

Gas price and consumers

India generates 912 billion units (BUs) of power annually. Of this, around 7.5 per cent or 65 BUs come from gas-based plants. Gas-based Independent Power Producers (IPPs) currently produce power at a cost of Rs 4.20 per unit (a fixed cost of Rs 2 per unit and a variable cost of Rs 2.20 per unit). With the gas price having been doubled, this cost of generation will rise by as much as 48 per cent to Rs 6.20 per unit. As fuel cost is allowed as a pass-through in levelised tariff (the average fixed and variable tariff over the entire term of the power purchase agreement) in India, the entire additional cost will be loaded on to tariffs to be paid by the consumer. Spreading this higher cost to the entire generation portfolio, the decision will raise power tariffs by 15 paise per unit. This means an additional cost of Rs 13,680 crore for the consumers.

The impact would also be seen on power companies, most of which are highly burdened with debt and are battling delayed payments by discoms. Take, for example, Gurgaon-based infrastructure major Lanco Infratech which is urging the government to roll back the price increase. The company, India's second largest gas-based IPP, operates 1,600 megawatt (Mw) of gas-based capacity in two states-Kondapalli in Andhra Pradesh and Tanjore in Tamil Nadu. The increased price of gas, coupled with a weak rupee, would push up variable cost for Lanco by up to Rs 3 per unit, Chief Operating Officer (finance) T Adibabu told Business Standard. "The gas price increase is a major negative for our business. It may not help unless discoms are financially enabled to buy costly power. The government should look at rolling back this price increase if the financial health of discoms is not improved," he says. But why should higher input cost be a problem for companies if fuel cost is a pass-through? "Where are the consumers of costly power? These days, consumers are refusing to buy power even at Rs 2 per unit," Adibabu explains.

Spillover effect

Other companies likely to be impacted by the decision include big names in the infrastructure space like GMR Infrastructure, GVK Power and Infrastructure, Reliance Power and state-owned NTPC. A major cause of concern for these companies is the fall of gas-based power in merit-order dispatch which dictates that low cost power be supplied first into the grid. The revised generation cost of Rs 6.20 per unit for these companies is in stark contrast to the average cost of generation for coal-based power plants at Rs 3.50 per unit. However, even this is likely to go up soon.

Interestingly, the average cost of production of public sector oil explorers like ONGC and Oil India stands at \$ 3.7 per mmBtu and \$3.2 per mmBtu, respectively. According to A K Banerjee, director (finance) of ONGC, even at \$ 4.2 per mmBtu, the company is getting a minor margin, though it would not be enough for further exploration and investments. At a price of \$8.4 per mmBtu, ONGC's net profit may zoom by another Rs 8,500 crore, while it would add Rs 1,050 crore to the bottom line of Oil India. The major private sector gainers due to the decision are Reliance Industries and Cairn India.

The ministry's logic behind increasing gas prices is that it would boost further investments in the oil and gas sector. Oil India has noted that it would review its Rs 19,000-crore capex plans for the next four years and has also asked its team to come up with a new exploration strategy. On the other hand, Reliance Industries and British Petroleum had already lined up plans to invest \$5 billion to exploit 4 trillion cubic feet of discovered reserves in the eastern coast in the next three to four years. A petroleum ministry calculation itself says that every dollar price increase would lead to a loss of Rs 10,040 crore per annum for the power sector, at 70 per cent plant load factor for 28,000 MW capacity.

Finance minister P Chidambaram had indicated that power and fertilizer sectors would be insulated from the price increase, either by tweaking it or by having a separate input price for the sectors. "The power and fertilizer sectors are asked to submit a proposal on how the industry can be protected from the gas price increase. It is likely that the government will pay an additional subsidy to the sectors," says a senior official close to the development. Still, there is no clarity on the quantum of sharing of the burden by the government in these sectors.

POWER REFORMS

- The government has doubled the price of natural gas to \$8.4 per million metric British thermal units
- It has allowed the additional cost incurred by companies on imported coal to be passed on to consumers
- The cost of power generation will rise by as much as 48 per cent to ~6.20 per unit as a result of the increase in gas prices
- Infrastructure companies fear gas-based power will fall in merit-order dispatch which dictates that low cost power be supplied first into the grid
- Oil and gas explorer, including Reliance Industries and Cairn India, will be among the major gainers from the move

Coal costs

The Union Cabinet, on 21 June, approved a proposal to allow power companies to pass on to consumers the higher cost of imported coal to be used in plants. This coal would either be shipped by state-owned Coal India to be supplied to power generators or IPPs would import it themselves. The idea is to fill the 15 per cent void in supply from Coal India to meet 80 per cent annual contracted quantity (ACQ) of power plants of 78,000 Mw capacity commissioned, or likely to be commissioned, between April 2009 and March 2015. Coal India says it would be able to meet the rest 65 per cent of the ACQ through domestic linkages.

Business Standard calculated the cost of implementing the Cabinet's decision to arrive at a likely estimate of the impact on consumers due to higher tariffs resulting from high-cost coal imports. The calculation is based on assessing the volume of coal imports to be undertaken to bridge the shortfall and deducting the cost of extra coal if it were to be supplied by Coal India under notified prices, from the total value of imports. The 78,000 Mw capacity would have to be supplied at least 214 MT, or 65 per cent of their coal requirement, by state-owned Coal India domestically.

The balance 15 per cent, or 32 MT, of coal demand would have to be met through imports. Companies would have to shell out upwards of Rs 14,080 crore for sourcing the costly imports at a price of \$80 per tonne (Rs 4,400 per tonne at a rupee-dollar conversion rate of 55). Indonesian coal from East Kalimantan, which represents a bulk of Indian thermal coal imports, with calorific value of 5,800 kilocalorie per kilogram that landed at Vizag port on 17 June was priced at \$76 per tonne. The same coal, if sourced from Coal India under the notified prices, would cost Rs 3,520 crore at an average cost of Rs 1,100 per tonne charged from power utilities currently. The balance of the two, Rs 10,560 crore, would be the cost to be borne by consumers on an annual basis. With power ministry set to advise the Central Electricity Regulatory Commission to allow this pass-through on a case-to-case basis, coupled with necessary amendments in the coal distribution policy and tariff guidelines, the stage is set for a nationwide tariff rise between 20 paise and 25 paise per unit.

Cost Impact

Coal India on May 28 increased prices of low-grade coal, used largely by power companies, by up to 11 per cent. This, the miner says, would add Rs 2,500 crore to its coffers annually. While coal prices are theoretically decontrolled in India, the government continues to wield significant control over prices. Coal India increased prices of lowest grade coal by 11.1 per cent from existing Rs 360 per tonne to Rs 400 per tonne. Prices of grade-6 coal were increased 10.3 per cent from Rs 1,450 per tonne to Rs 1,600 per tonne. This left the consumers severely miffed as the price revision meant a 10-12 paisa per unit increase in generation cost to be passed on in tariffs. Overall, this was the sixth time Coal India had increased prices since they were deregulated in 2000.

The high electricity rates driven by increasing cost of generation on fuel front is supplemented by the states' own tariff revisions. Two factors—a December 2011 order of the appellate tribunal of electricity and the Centre's financial restructuring package (FRP) of August 2012—have goaded the distribution utilities to take steps to revise tariffs. Almost every Indian state and Union Territory has raised tariffs over the past one-and-a-half year. The FRP is aimed at dissolving the over Rs 2 lakh crore accumulated losses of all the state utilities put together. Clearly, if tariff increase alone holds the key for transformation of the distribution sector, the power sector is on its way to reforms. Experts, however, disagree and point out that the twin issues of high line losses and huge agricultural subsidies have to be tackled for any meaningful transformation of the sector.