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End of Monopoly, or is it?

Coal India's 43-year stranglehold on coal mining has loosened now, with high expectations of much-needed investments. However, it is yet to be seen if private miners will get access to the mines that really matter

Debjoy Sengupta

Recently in Davos, an exasperated GM Rao, chairman of the eponymous infrastructure conglomerate, was seen telling his old friend, Anil Agarwal of Vedanta, that after putting in $7 billion to build a sizeable power portfolio, he has learnt life's lesson the hard way.

Most of his coal-fired plants generate meagre returns, far lower than what was originally envisaged a decade ago when private developers — both first generation entrepreneurs like GMR, GVK or Lanco and pedigree groups like Tata, Reliance and Lanco — were swayed by the India infrastructure story and chased megawatts.

Therein lies the irony. India has one of the largest reserves of coal but annual production from monopoly miner Coal India (CIL) has not been enough to feed the guzzling needs of an industry as diverse as power plants, steel mills, cement and fertiliser units.

The 43-year old stranglehold is finally coming to an end. In line with the Modi government's stated policy of auctioning natural resources, the government opened up the sector to commercial miners.

From Gautam Adani to Agarwal, some of our biggest conglomerates have been jostling for this much-needed reform to meet their own needs and start mining for others. Key users such as Kumar Mangalam Birla's Hindalco, Tata Steel or Sajjan Jindal's JSW Group have been hankering for security of supplies, hamstrung by Supreme Court's cancellation of mines and volatile commodity prices.

"This is bold reform," said Anil Agarwal, chairman, Vedanta. "Opening up the sector will increase domestic and FDI as well help in stabilising irregularities in coal supplies and linkages. Some of the most evident benefits of this measure would be enhanced energy sufficiency for India and availability of power at lower costs for the end consumer. Also, thousands of jobs will be created in the process."

CIL ex-chairman Partha Bhattacharyya compares these reforms with those in life insurance, where private insurers compete with behemoth LIC of India.

The multiplier effect will also be immediate. "Power generators can source commercial coal to improve margins and availability. Further, as merchant power prices fall, utilities and manufacturing industry too benefit from lower energy costs," argues Kameswara Rao, partner and leader, energy, utilities and mining at PwC.

Stalled or stranded power projects account for nearly 50 gigawatts (GW) of electricity production capacity, or roughly 15% of India's total of more than 300 GW. Close to 10,000 MW of coal-fired plants have been mothballed due to lack of coal supply and that made power the second largest contributor to the ballooning bad debt situation in the country. Finally, developers can hope for a revival.

"Owners of distressed assets will no longer worry about uncertain fuel supplies and can contract with commercial coal suppliers to revive projects. On a broader note, we will see industry consolidation, rise of large vertically-integrated energy companies with interests in coal mining, generation, transmission and distribution to retail supply," Rao adds.

Non-regulated sectors such as cement and steel have a greater dependence and ability to pay and could dominate initial auctions. Captive power producers too can corner a lion's share, especially in states with high cross-subsidies in retail tariffs.

Even in the middle of the prevalent narrative of renewable and clean energy, it is estimated that fossil fuel power generation will grow at a 7% compound annual rate in 2016-20, raising overall coal demand to about 985 million metric tonnes.

Fuelling The Economy

COAL RESERVES

Proven 1,25,909 MT
Indicated 1,42,506 MT
Inferred 33,149 MT
Total 3,01,564 MT

Around **20%** of coal is imported

DEMAND ESTIMATES

900–1,000 MTPA by 2020

1,300 MTPA and 1,900 MTPA by 2030

Coal meets **55%** of India's primary commercial energy requirement

70% of the power generated uses coal as fuel

Coal India contributes **82%** of coal produced in India

THE COST MATHEMATICS...

For Coal India, salaries constitute **55%** of cost of production

For others, salaries constitute about **22%** of cost of production

There are **4** major coal mines:

PRIVATE SECTOR

Moher, Moher Amlori extension: Production **17 MTPA**

COAL INDIA

Gevra in Chhattisgarh **40+ MTPA**
Kushmunda in Chhattisgarh **29 MTPA**
Bhubaneswari in Odisha **28 MTPA**

USER INDUSTRIES

Largest user: Thermal power generators
Others include cement, steel, fertilisers and sponge iron units

DEVIL IN THE DETAILS

Nonetheless, a lot will still depend on the fine print. The nature of blocks that are auctioned, their reserves and methodology of the auction process all matter.

"This will be contingent upon the nature of blocks that will be offered to merchant miners, and risks inherent in large mining projects including issues in land acquisition. Therefore, coal production from commercial mining in the next two to three years is unlikely to be significant relative to India's current coal production levels," says Jayanta Roy, senior vice-president and group head, corporate sector ratings, ICRA.

The government has not identified which blocks will go under the hammer; auction will be held on the basis of rupees per tonne of coal produced.

Commercial coal production was nationalised in 1975, when coal mining was taken over by the Centre and monopoly CIL was formed. It remained the Centre's prerogative till February 20, 2018.

CIL's mandate has been to meet the nation's demand for coal. In fact, coal meets 55% of India's primary commercial energy requirement. **(See, Fueling The Economy).** At least 70% of power generated takes coal as fuel while Coal India contributes 82% of coal produced in India. Rest is from Singareni Collieries — a relatively smaller public sector coal producing company — and captive coal mines.

But Coal India has always been accused of sloth and inefficiency. The unions, aware that they may not be able to compete when private companies move in, are predictably up in arms, fearing salary cuts or worse — job losses.

"We will go on an indefinite nation-wide strike if necessary," thunders SQ Zama, secretary general, Indian National Mineworkers' Federation, under INTUC, one of the central sector unions at Coal India.

"A Coal India workman receives an average salary of ₹40,000 per month, while their counterparts in the private sector, who work under contractors, receive between ₹10,000 and ₹12,000 as salary per month. Coal India pays adequate attention to the safety of workers and offers their wards free schooling and medical facilities," says Zama.

> **Tender conditions for selecting the winner should be on the basis of core competence and expertise. Auctioning blocks solely on the basis of price may not lead to desirable results. We need to learn from our experiences**
> **PARTHA BHATTACHARYYA** Former chairman, Coal India

In fact, at the open cast mines of Coal India subsidiary Mahanadi Coalfields, cost of extraction by its CIL workmen is around ₹600 per tonne while the same — when outsourced — comes to around ₹400 per tonne. "The difference is basically labour cost," says a senior Coal India executive, who did not wish to be identified.

Large companies that are into mining coal in India as operators or have their own captive mining include the Adani's, Reliance and GMR — all of these companies operate at costs that are less than CIL's cost of production.

"We use large equipment and latest technologies. Labour cost is less than 10% and comes to around ₹50 per tonne," points out an executive from a private mining company that operates as a contractor for CIL. His firm has been a key mining development operator (MDO), brought in to boost Coal India's production.

An executive from another large private company, on condition of anonymity, broke it down further, saying their labour cost varies between 5% and 22% of total outgo, depending on thickness of the layer of topsoil needing to be removed to extract coal.

"As an MDO, we need to quote costs that our customers find attractive. This we achieve through multi-tasking. An individual who is a mining engineer can double up as a supervisor and a technical guide. Use of better technology also keeps costs low. Average cost of production for mines that need heavy overburden removal is between ₹600 and ₹650 per tonne — way lower than CIL," says a senior executive from the company.

"The difference between a private operator's cost and Coal India's cost is basically labour cost, efficiency, higher productivity and offering lower margin for having one contractor for all activities on turnkey basis," he adds.

> **This is bold reform. Opening up the sector will increase domestic and FDI as well help in stabilising irregularities in coal supplies and linkages. Benefits would be enhanced energy sufficiency and power at lower costs**
> **ANIL AGARWAL** Chairman, Vedanta

Coal India's management is aware of these legacy challenges and has been actively pursuing ways and means of bringing down costs. A majority of CIL's 2.98 lakh workmen employed in underground mines were inherited when the company was formed. It is now planning to close down some 100 such mines that are unviable. "We have successfully brought down cost of production by almost ₹54 a tonne in the third quarter of the current financial. This has been despite a rise in salaries of workmen and executives in 2017, which increased outgo by ₹400 crore a month," says Gopal Singh, Coal India chairman.

TOO LITTLE, TOO LATE?

For the end users, privatisation is expected to make coal sourcing easier. "Both prices and quality are expected to be reasonable due to competition being introduced in the sector," says Subhasri Chaudhuri, secretary general, Coal Consumers' Association of India.

She feels logistics may improve, resulting in lesser environmental impact and consumers would be able to procure coal suitable to their requirement.

Yet, doubts linger among some private players. "Blocks that would be on offer are likely to be the ones given away by Coal India because they had no plans of operating them. These are the ones likely to be auctioned for commercial coal mining. Most of these blocks are difficult ones — in that they are either in densely populated areas or have difficult terrain. Some have coal seams buried deep underground. Cost of operations on these blocks is likely to be high," cautions a senior executive from a large mining company.

Bhattacharyya echoes the view, saying that blocks' mineable reserves need to be at least 40 million tonne for production to be assured over a number of years.

He also did not agree with the auction model. "Tender conditions for selecting the winner should be on the basis of core competence and proven expertise. Auctioning blocks solely on the basis of price may not lead to desirable results. We need to learn from our experiences."

The reverse auction methodology for captive mines has not been successful, with most private players outbidding each other and then relinquishing licence.

"In the absence of a strong regulator, such auctions may bring back issues faced by the industry during the pre-nationalisation era, which saw major exploitation of reserves and workmen in unethical ways," warns Bhattacharyya.

According to Niladri Bhattacharjee, partner, strategy & operations, mining & metals, KPMG in India, private commercial miners may end up producing a maximum of 100 million tonne by 2025.

"Some 30 MTPA of capacity has been allocated to state mineral development corporations and that capacity too will come onstream in a few years. This will be approximately 8-10% of the size of coal PSUs, assuming there is no drastic change in market structure," he says.

"What remains to be seen is whether involvement of commercial coal miners will make the bids more reasonable. Bidding parameters too may need some finetuning for mines without a mine plan," says Bhattacharjee.

A senior executive from a Delhi-based coal mining outfit says, "For extracting 1 tonne of coal, 5 tonnes of top soil needs to be removed from a majority of these blocks. Producers may find it a tad difficult to match prices of the same quality of coal offered by Coal India from nearby mines after adding royalty and cess."

States too will seek their pound of flesh in royalties and bid conditions for value addition in the region, much like ferrous metals. After adding these, CIL's competitive edge may still remain.

Volumes growth and cost reduction from commercial coal development should also keep import prices in check.

However, the need is to auction out the larger and more lucrative blocks in sufficient numbers to meaningful new investment.