

Business India

THE MAGAZINE OF THE CORPORATE WORLD

January 28-February 10, 2019

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WHERE TO INVEST 2019



Equity

A challenging year ahead

Equities may not be the best bet in uncertain times

Craving for consolidation

Vedanta Aluminium has an open field in terms of opportunity



Going by a market perception, even the staunchest critic of Anil Agarwal-led Vedanta group would probably desist from accusing it for lacking aggression. The metal and mining giant, in the last one decade, has made definitive aggressive moves in the metal businesses of the future, through staggering capex and capacity-building, with an eye on leadership position. Getting ready with all ammunition to respond quickly to a matured demand cycle in a foreseeable future has been a hallmark of the \$15 billion revenue group. Its aluminium unit, contributing more than one-fifth of the group's total revenue testifies the basic operational grain of the group.

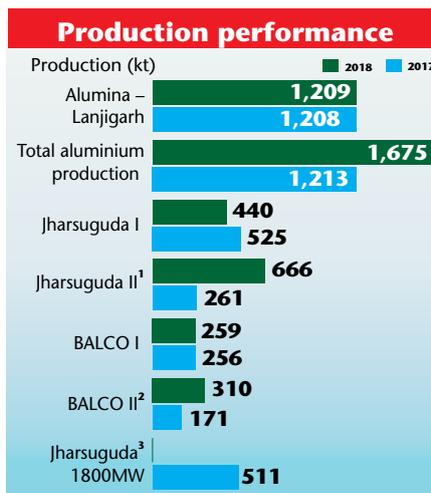
If the words of Ajay Dixit, CEO, Vedanta Alumina & Power are to be believed, then, with a commendable base built with a staggering investment of over ₹50,000 crore in the last one decade (a significant portion of it has been pumped in the last 3-4 years), the company is now at the cusp of a massive growth trajectory. The results of its Odisha- and Chhattisgarh-based facilities ramping up in the recent years probably reflected in its 2017-18 performance, when the key growth

indices steeply moved northward. It is no secret that the still evolving Indian aluminium sector is dominated by the triumvirate of Nalco, Hindalco and Vedanta. And the high-end technological backing, as the company claims, is turning out to be a huge asset, though experts point out that, in terms of captive linkages, particularly the availability of bauxite, the other two big names of the game are more firmly positioned

than Vedanta.

Dixit admits that this is the gap the company is keen to expeditiously fill; and so, it is looking forward to some progressive initiatives from the government (auctioning of bauxite blocks in particular). But the biggest cushion is the huge demand growth proposition in the domestic consumption of aluminium. "The level of aluminium consumption in India is too low, even lower than many developing countries. The real growth story is yet to begin," says K.K.S. Murthy, professor & former secretary general, Aluminium Association of India (AAI) and a renowned metal expert. That probably explains why Vedanta has chosen to bet big on aluminium, popularly billed as the metal of the 21st century. "We have chalked out an investment plan of \$8 billion in the next five years across our businesses," informed Anil Agarwal, chairman, Vedanta group, during his interaction with the press on the sidelines of a function in Kolkata recently. "After oil & gas, aluminium is our major priority."

The emergence of aluminium, with its light weight and recyclable attributes, as the apt substitute for steel



¹ Including trial run production of 61.8kt in FY18 vs. 95kt in FY17
² Including trial run production of 16.1kt in FY18 vs. 47kt in FY17
³ Jharsuguda 1,800MW and BALCO 270MW have been moved from the Power to the Aluminium segment since 1 April 2016.

(the metal which has spearheaded industrial growth since industrial revolution), is a well-established global phenomenon now. In the developed markets, its application across the board has significantly increased. And this is reflective in the growing per capita consumption of the metal in many countries, where it has begun to be used as a base or primary metal. For instance, the per capita consumption of aluminium is as high as 42 kg annually in Germany, whereas it is as low as 2.2 kg in India. China's dominance is visible in the global business, with the country accounting for over 50 per cent of the nearly 65 million tonnes of the annual global production market. "The world has already made decisive moves in the direction of embracing aluminium as the base metal. In many European countries, the average consumption of aluminium is 15-20 kg per person. The global average is close to 10 kg. While, in India, we are still debating if it should be used as a prime material, the rest of the world has recognised this," Dixit underlines.

Marketmen confirm that the ambit of aluminium-driven applications is expanding at a fast pace, with transportation, power, construction, consumer durables, packaging, etc, becoming its main consumers globally. "Forget about transportation, power and other businesses," Murthy points out. "In some European countries where plastic has been banned, aluminium is emerging as the vital solution for packaging." But, in a general sense, the mainstays of industrial aluminium usage are well-defined.

"The transportation sector takes the bulk of aluminium globally," points



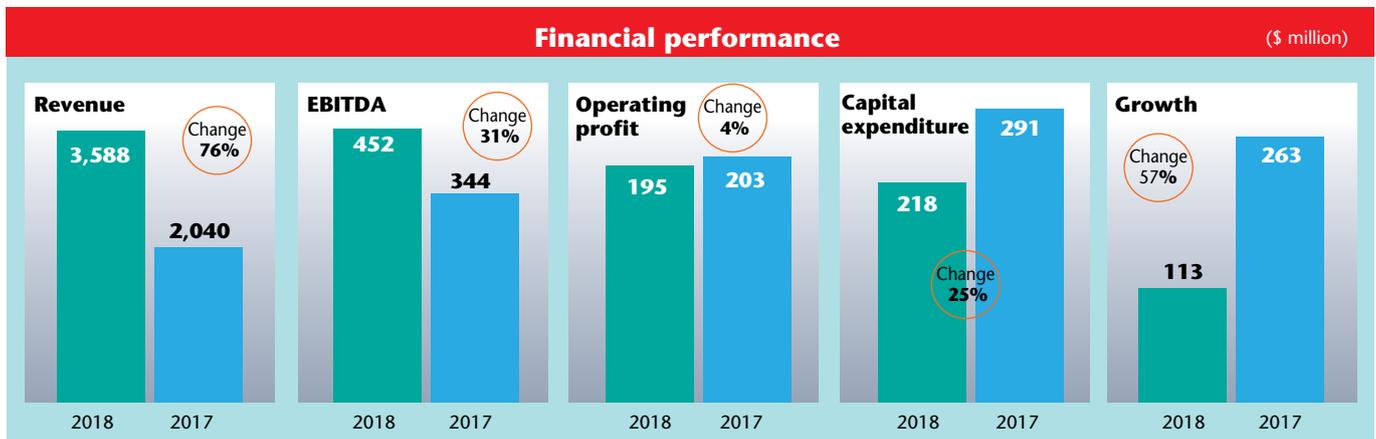
Dixit: keen to fill the gap

out Soumyajyoti Basu, assistant vice-president (corporate sector ratings), ICRA. "In India, it is driven more by the power sector – especially, the transmission lines. But it has also started making inroads in automobile production now," The credit rating agency had recently come out with a report, which testified the increasing use of the light metal in domestic automobile production. "Aluminium is gradually finding greater usage in the automobile industry, fuelled by demand growth," the report had said. "At the end of June 2018, aluminium usage per unit of passenger and commercial vehicles stood at 29.21 kg, exceeding 29.04 kg at the end of 2017-18". Presenting a long-term

analysis, the report had further gone on to point out the steady growth of the automobile industry in domestic aluminium production – from 16 per cent in 2008-09 to 25 per cent in 2017-18. The increased focus of the OEMs for vehicular weight reduction for better fuel efficiency has been cited as the reason for the growing demand.

The domestic market dynamics, however, presents a curious equation. While the cumulative manufacturing capacity of the major players far exceeds the domestic demand, a significant portion of domestic consumption is met through imports. And, the big three are exporting more than half of their produce. "The total consumption in the country is close to 3.9-4 million tonnes," Dixit points out. "Out of this, about 1.9 million tonnes are imported in the form of scrap and other variants. We are also exporting somewhat similar volume. It doesn't make any sense". Marketmen feel that the aluminium imports coming in scrap forms, especially from China and Russia, are resulting in this imbalance in market dynamics. "Low import duty (2.5 per cent) has led to an increase in the import of aluminium scarp," a report released last year by CARE Ratings said. "Producers find this an issue as it impedes with the production of primary aluminium. Imports of aluminium scrap are eating into the market share of domestic producers".

Import of aluminium scraps were pegged at 1,121 tonnes in 2017-18, which marked an annual increase of 20.4 per cent over the previous year. Scrap imports are primarily used by secondary producers and they are also heavily used in the automobile



industry. The ICRA report had underlined that “the alloying capacity of the domestic primary manufacturers remains limited because historically the primary manufacturers had set up capacities focusing on the T&D (transmission & distribution) sector, which do not require alloyed metal.” And the trend is expected to continue in the near run.

Scaling up

Structural oddities in the domestic market notwithstanding, Vedanta Aluminium has made swift moves in the recent past in ramping up its units, considering the long-term scenario, wherein the low aluminium consumption pattern will give way to its increased acceptability in the country too. “We are producing over 2 million tonnes and this is the largest in the country,” says Dixit. “Our target is to enhance it to 3 mt in two years. In a broader sense, we are looking at 5 mt capacity. We want to drive the business based on our R&D and innovation capabilities converting to applications”.

The year 2017-18 was critical, as it witnessed the ramping up of facilities centred in Odisha and Chhattisgarh, showing the preliminary signs of the big leap Vedanta Aluminium is aiming at. In 2017-18, the company had produced a record 1.7 million tonnes of the metal, with the ramping up of Balco and Jharsuguda completed. While the performance of its alumina refinery was somewhat flat, the production at its recently ramped-up Jharsuguda Smelter II shot up significantly from 261,000 tonnes to 666,000 tonnes. Balco II smelter also delivered major gains with the actual production going up by 81 per cent – from 171,000 tonnes to 310,000 tonnes (*see chart on production performance*). As a result, at the end of 2017-18, the company had seen its total aluminium production going up by a commendable 38 per cent vis-à-vis the previous fiscal. With 60 per cent of its produce being routed to the international markets, the company benefitted from the spike in prices globally – as much as 21 per cent, clocking an average of \$2,046 per tonne as determined by London Metal Exchange (LME). In its annual report, the company attributed price increase



Pati: no looking back

to anti-pollution supply reforms in China, increases in raw material prices and trade tariff announcements by the US. Meanwhile, the company had ended the year with a revenue of about \$3.5 billion and an EBITDA of \$452 million, even as the company had to bear with marginal to modest hike in the production cost across various categories.

The units at Jharsuguda and Balco in Korba, Chhattisgarh, are clearly the mainstays of Vedanta Aluminium, with the former dubbed as the fulcrum. “We tapped our first metal in March 2008 and we haven’t looked back since,” says Abhijit Pati, CEO, Aluminium, Jharsuguda. “Within the short span of a decade, we’ve established Jharsuguda on the world map as the home to India’s only aluminium smelter, which is a part of the exclusive global ‘single location 1 million tonne club’ of aluminium producers. The global industry is moving on an accelerated path towards smart-technology enabled production, value-added products & services and minimal environmental footprint. Vedanta Ltd, Jharsuguda, and its peers are on the same path”. And the company has plans to further harness this facility, which is nestled in the midst of the hottest aluminium production hub in the country

– Odisha, which is also the mainstay of much of Hindalco and Nalco’s operations. “Our immediate plans are to ramp up operations to the full potential of our existing facility in Jharsuguda, which is 1.75 million tpa,” adds Pati. “Following that, we have plans for expanding our smelting operations to 2 million tpa capacity. We have also collaborated with IDCO and the state government to build an Aluminium Park near the mother smelter, which would attract additional investment to the tune of ₹1,200-1,400 crore and nearly 200-300 industries to set up shop in the region”.

Balco, the public sector unit acquired by Vedanta way back in 2001 as part of the government’s disinvestment programme then, has also seen swift addition in capacity – as much as six times. “When Vedanta had acquired Balco, its production capacity was close to 100,000 tonnes,” informs Dixit. “But now it has scaled to 600,000 tonnes. We firmly believe that it has the potential to grow much more and it will continue to remain a vital cog in our production base”.

Captive linkages challenge

Though the recent report card of Vedanta Aluminium undoubtedly has brownie points, the lack of captive linkages for vital raw materials – coal, power and most importantly bauxite – appear to be major challenges, which it will have to surmount for the future expansion and reaching to 4-5 mt production base. “Hindalco and Nalco have better captive linkages in terms of availability of raw materials than Vedanta Aluminium,” comments an industry observer. “And it is imperative for them to fill this gap as expeditiously as possible for the big ticket expansion they are pursuing”. Hindalco, for instance, has captive bauxite mines in Jharkhand, Chhattisgarh, Maharashtra and Odisha, which provide raw material to its alumina refineries located at Muri in Jharkhand, Renukoot in Uttar Pradesh, and Belagavi in Karnataka. Public sector aluminium major Nalco similarly has a large-scale bauxite mine on Panchpatmali hills of Koraput district in Odisha. The mine is estimated to have a potential reserve of 310 million tonnes. Vedanta’s Balco unit is supported by

two captive units in Chhattisgarh – at Manipat and Bodai Daldali – but they are not producing enough to support the expanding operational ambit of its entire aluminium business. “We are importing 2.5 million tonnes of bauxite, which is 50 per cent of our requirement,” acknowledges Dixit. “This is a major challenge”.

Flip through the annual report of the company for 2017-18 and you will come across several instances of disruption or low performance, owing to lack of captive strength. For instance, its Lanjigarh alumina refinery grew flat during the course of the fiscal because of low availability of bauxite from Chhattisgarh mines and there was temporary disruption in the coal supply from India, though the year saw the company adding 4 million tpa of coal linkages, ending the year with a total coal linkage of 10 million tpa.

Betting big

The company claims filling up the gap particularly on the bauxite availability front is the top priority. It has joined hands with Emirates Global Aluminium (EGA) for supply of bauxite from Guinea (expected to begin later this year) and a long-term supply contract with Odisha Mining Corporation (OMC) to draw 250,000 tonnes from their Kodingamali mine. These deals are expected to bring down the bauxite import quantum by nearly 500,000 tonnes by next year. But, more than anything else, the company is betting big, when the new bauxite mines are auctioned later this year. There have been indications from the ministry of mines that it would put as many as 19 bauxite mines for auction. “The government has put up a transparent auctioning process,” agrees Dixit. “We are hopeful that these auctions would happen soon. We are ready to participate in them,”

Though the group has courted controversies in the past and faced resistance from local communities (the Niyamagiri bauxite mine controversy in Odisha) it is difficult to disbelieve Dixit’s claim of aggressive participation to grab new blocks. Last year, Vedanta-controlled Cairn Oil & Gas had surprised everyone by participating in all 55 oil and natural gas blocks, when they were auctioned



The ambit of aluminium-driven applications is expanding at a fast pace

under Open Acreage Licensing (OAL), and eventually ended up bagging 41 of them. Also, marketmen seem to be convinced that, given its growth appetite, Vedanta Aluminium too will not miss such an opportunity as and when it comes its way. “If new bauxite blocks are put for auctioning, it could be a huge shot in the arm for non-integrated manufacturers looking to strengthen their captive linkages,” observes Basu of ICRA. Bagging new blocks, points out another analyst, is the most vital element for Vedanta’s future growth, as it would help it to achieve cost-competitiveness. The company has set a medium term target of bringing down its CoP (cost of production) to \$1,500 (about ₹1,05,000)/tonne, as against the present level of slightly under \$2,000 (about ₹1,40,000) tonnes. Dixit claims that the capex made in the past is sufficient to further expand the base in the coming years. However, it will not be a challenge, if the fresh capital is required. For instance, it has recently committed to invest \$250-300 million in the next fiscal to expand the capacity of its Lanjigarh alumina refinery in Odisha.

“One of our major objectives is to sell more in the domestic market,” says Dixit. “We are exporting 60 per cent of our produce and remaining in the domestic market and we are keen to reverse this ratio in a medium-term scenario”. And the time has come for the government to give it a serious push, with policy interventions,

he adds. The market, meanwhile, is abuzz with the theory that the primary producers are pressing hard for hike in import duty on scraps, which will give them larger penetration in the domestic market. “It would be easier said than done,” argues Murthy. “You can’t do something which would directly impact smaller players in the game. In a long-term sense, the government should facilitate a balanced regime where there is growth opportunity for everybody, considering the potential of this metal in a market like India”.

Marketmen, meanwhile, also believe that, even if the country improves on its 2.2 kg aluminium consumption per person, the scene is not expected to get too competitive, with the kind of penetration the big three, including Vedanta Aluminium, have made in the high-stake game. “The capex for setting up a greenfield integrated aluminium manufacturing facility with a matching captive power plant is huge – almost five times of a steel plant of similar capacity,” informs Basu. “I don’t foresee new players jumping in the fray in the near to medium run”. So, while Vedanta Aluminium, with its current definitive positioning, would probably have an open field in terms of opportunity, experts would be keenly watching how efficiently it brings into the place the supporting elements.

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