

Indian iron ore auctions - Part 1

Iron ore auctions are increasing the cost curve of eastern India iron ore mining. The premiums have ranged from 90% to 135% for the seven mines bid for till date. Expectantly, JSW Steel has played the role of an aggressor winning 4 mines (2 captive + 2 merchant). And its refreshing to see Tata steel/SAIL/JSPL not bidding aggressively in the ensuing auctions. Even Arcelor Mittal has been relatively measured in its response to lap up mines. Both state and especially centre has been proactive in changing the norms of the auction wherever necessary and few last roadblocks need to be cleared. Yet, we see the distinct possibility of Odisha ceasing to transmit deflation within states, post the auction. The environment we see playing out will i) reduce the margin profile of the unintegrated steel players and ii) will be beneficial for merchant miners of the other states. Maintain BUY on NMDC, Tata, JSPL.

► **Cost curve increasing for a sizeable chunk of Eastern India iron ore production.**

This is particularly true as the merchant miners are going to co-exist along with captive miners (as Serajuddin has won ~15mnte in the auction). The coexistence of merchant mining on such a scale post the auctions will i) not allow Odisha to virtually export deflation in iron ore prices across states -- one of the main reason that India has for long seen domestic prices at ~40-50% discount to import parity is Odisha playing truant and ii) correspondingly we expect Indian iron ore prices to move up relative to import parity i.e. the 40-50% discount existing till date will narrow. Key takeaway -- Odisha merchant ore can no longer transmit deflation to other states like Chattisgarh, Karnataka, and Maharashtra.

► **Yes, as Odisha merchant ore exists and stop playing truant in terms of pricing, other merchant miners will benefit!** No longer does NMDC need to supply ore to Chattisgarh sponge iron players at the Odisha Chattisgarh border keeping in mind the pricing differential that Odisha brings. Over a period of time, as these auctions take shape, there will be more localisation of Odisha ore (merchant) in terms of consumption. Interestingly, while cost curves in Eastern India is moving up, NMDC Chattisgarh mines just got renewed at no premium. We see, eventually, a similar predicament for NMDC Karnataka ore as well.

► **Increase in costs for JSWS; still better-off compared to an unintegrated steelplayer post auctions.** With ~30mnte of EC won, JSWS has decided to secure major part of their existing steel portfolio with Odisha ore and thereby inadvertently add to the existing cost structure. But, still given the scenario that we see unfolding, JSWS will be better off compared to an unintegrated steelplayer in India.

► **Despite bidding 118% as premium, Serajuddin can still make money.** We place this claim with following underlying assertions i) premium that miners will pay, won't form a part of IBM base price. It's a regulatory payment and will be handled separately and passed onto the buyers ii) iron ore price still has to be commercial and hence Odisha's ability to export deflation to other states goes out and Indian discount to import parity price narrows and iii) Odisha/Indian iron ore production will meander down from here on and scrap becomes more and more prevalent as forms of sponge iron making in India. Serajuddin has definitely shown the way for many more merchant miners to follow.

► **No, the advalorem premiums bid don't alter the base price of ore for Indian bureau of mines in the region! The high premiums bid for the mines don't make way to the base price** which miners will supply to IBM (which is taken to calculate royalty and the premiums). However, there is an element of Mineral concession rules (MCR 2016) that needs revision in our view. MCR 2016 has introduced a cascading impact of royalty for the miners, by including royalty in the base price which goes back to IBM and which IBM publishes as base price and on which miners pay royalty. This particular provision has created unnecessary confusion and needs to be amended (and we append the FAQs where miners have raised this question prior to auction). Having said that, this doesn't entail that the premiums currently bid by the players also get added in the base price.

Sector update

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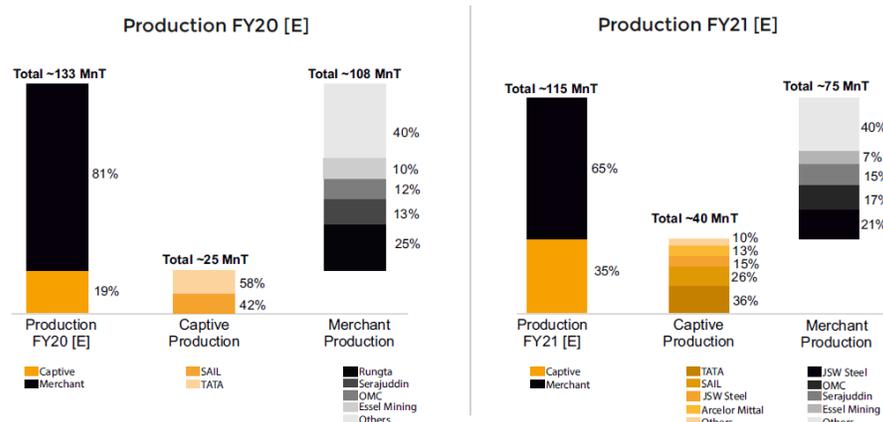
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Table 1: List of Odisha iron ore mines for auction and results till date

Name of the block	Mineral	Area in hecmts.	Recourses in mnte	(Name of the Existing lessee)	EC Capacity mnte	Production in 2018-19/ mnte	Successful Bidder	Premium
Nuagaon	Iron Ore	767.284	792.93	K.J.S. Ahluwalia	5.62	5.61	JSW Steel	95.20%
Narayanposhi	Iron & Mn Ore	349.254	190.6 (Iron) 0.486 (Mn)	M/s A.M.T.C. (P) Ltd	6	2.99	JSW Steel	98.55%
Thakurani	Iron Ore	228.04	180	M/s Kaypee Enterprises Co.	5.5	5.49	Arcelor Mital	107.55%
Balda Block	Iron Ore	335.594	210.17	M/s Serajuddin & Co.	15.15	9.36	Serajuddin	118.05%
Ganua	Iron Ore	86.886	119.203	P.K. Ahluwalia	1.2	0.349	JSW Steel	132.00%
Jilling-Langalota	Iron Ore	456.1	79.122	M/s Essel Mining & Industries Ltd.	6.28	6.27	Shyam (SEL)	135.00%
Jajang	Iron Ore	666.15	58.509	M/s Rungta Mines Ltd	16.5	11.71	JSW Steel	110.00%
Roida - II	Iron Ore	74.867	29.387	K.N Ram & Co.	3.5	2.2	Narbheram Power & Steel	90.90%
Mahulsukha Nadidihi (BICO)	Iron & Mn Ore	399.839	32.814 (Iron) 0.771 (Mn)	M/s A.M.T.C. (P) Ltd	0.04	0.04	Auction Schedule on 08.02.2020	
Gorumahisani Nadidihi, Rengalibeda & Nadikasira	Iron Ore	73.855	27.042	M/s B.I.Co. Ltd.	5.3	3.41	Auction Schedule on 09.02.2020	
	Iron ore	349.5	18.4	M/s G.S. Mishra & Sons	0.75	0.747	Auction Schedule on 10.02.2020	
	Iron & Mn Ore	121.405	23.69 (Iron) 0.059 (Mn)	M/s Feegrade & Co.	7.45	2.88	Auction Schedule on 11.02.2020	
Kolmong	Iron & Mn Ore	218.53	1.397 (Iron) 3.739 (Mn)	M/s Rungta Mines Ltd	0.04	0.014	Auction Schedule on 12.02.2020	
Siljora-Kalimati	Iron & Mn Ore	715.639	4.022 (Mn) 8.153	M/s M.L. Rungta	0.136		Auction Schedule on 13.02.2020	
Jaribahal	Iron Ore	106.533	11.527	M/s Patnaik Minerals	0.998	0.998	Auction Schedule on 14.02.2020	
Teherai	Iron & Mn Ore	137.46	0.074 (Mn)	M/s B.I.Co. Ltd.	2.496	0.387	Auction Schedule on 15.02.2020	
Jururi	Iron Ore	73.228	4.795	M/s Kalinga Mining Corpn.	2.1	0.43	Auction Schedule on 16.02.2020	
Badampahar	Iron ore	129.61	6.16	M/s Lal Traders & Agencies (P) Ltd.	1.5	0.72	-	

Source: Company data, I-Sec research

Chart 1: Odisha iron ore production before and after mines auction 2020

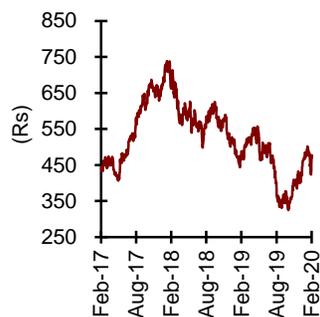
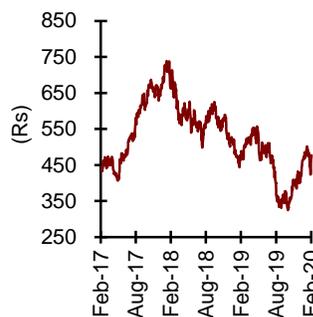
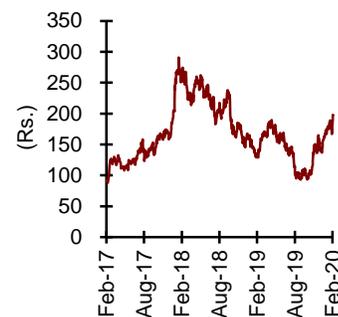


Source: Company data, I-Sec research

Table 2: Provision on calculation of royalty is creating unnecessary confusion.

Document	Clause No. and Existing Provision	Clarification Required	Suggested Text for Amendment, if any	Rationale for Clarification or Amendment	Response
Tender Document for Auction Of Jilling-Langalota Iron Ore Block	All information provided in this Tender Document should be read together with the Act and the rules framed thereunder. In the event of a conflict between this Tender Document and the Act or the rules, the Act or the rules (as amended from time to time), as the case may be, shall prevail. It is clarified that payment in accordance with the Final Price Offer shall be required to be paid monthly in addition to the payment of royalty or dead rent, as applicable.	As per tender condition, bidder has to follow MMDR Act and rules framed thereunder. All the miners have to submit monthly and annual return as per MCDR 2017, wherein miners have to provide sale price inclusive of Royalty, DMF, NMET excluding Taxes/GST. IBM is computing average sale price on the basis monthly return.			As per provisions of the applicable
	Royalty on Iron Ore as per MMDR Act:15% of Average sale price on ad valorem basis. As per MCDR 2017: CHAPTER VI Notices and Returns 45. Monthly and annual returns.(8) In case of mining of minerals by the holder of a mining lease, the– (a) sale value is the gross amount payable by the purchaser as indicated in the sale invoice, where the sale transaction is on an arms' length basis and the price is the sole consideration for the sale, excluding taxes, if any. Explanation.– For the purpose of computing sale value, no deduction from the gross amount shall be made in respect of royalty, payments to the District Mineral Foundation and payments to the National Mineral Exploration Trust.	Since Royalty is calculated on IBM published sale price, it seems that Royalty is calculated on Base price + Royalty + DMF+ NMET i.e. cascading effect is there on Royalty + DMF+ NMET resulting higher cash outflow by miners. To mitigate the above, it is requested to please consider Royalty on actual sale price. The same may be consider through additional condition. Precedence can be taken from Madhya Pradesh State government's Bunder Diamond Project, wherein royalty is to paid on actual sale price and not on IBM sale price.			

Source: Company data, I-Sec research

Price charts**Tata Steel****NMDC****JSPL**

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