

## India Power Sector

Government permits 49% foreign investment in power exchanges - ALERT

- Among recent policy measures, the government has decided to permit foreign investment up to 49% in power trading exchanges.** As per the existing policy 100% foreign investment is permitted in power generation (except atomic energy), transmission and distribution; however, until now there was no stated policy on FDI in power exchanges. India has two operational power exchanges (IEX and PXIL) which trade less than 2% of the country's annual power generation (~850billion kWh) primarily in the day-ahead market. IEX is the dominant exchange (daily turnover of 45MU vs. ~2MU for PXIL) and is promoted by Financial Technologies and PTS India Financial Services (PFS). Other equity holders include a range of sector participants – (Jindal Power Ltd., Lanco Infratech, Reliance Energy, IDFC, REC, Tata Power – and 3 foreign investors – Multiples Private Equity Fund, Lightspeed Venture Partners and Bessemer Venture Partners – who came via the government approval route. In Mar-12, an equity sale transaction by PFS pegged IEX's value at Rs5bn. Even with two new exchanges planned in the country, the capital requirement is too small in context of sector capex requirements, in our view. The benefit could flow from alliance(s) of Indian power exchanges with foreign bourses to share global best practices.
- Merchant volumes have suffered of late.** The share of power exchanges in the short term market dominated by bilateral and UI transactions has remained dormant at ~16-17% over the last few quarters. To drive growth, the exchanges require regulatory approvals to introduce longer tenure products. Since Oct-11, share of merchant volumes in total generation has fallen to average 10.4% vs. 13.3% in the preceding 12-month period. Loss making SEBs have curtailed the purchase of relatively expensive merchant power, driving the slow down.
- In the context of core power sector issues, FDI in power exchanges is a non-event.** Despite the absence of restrictions on foreign investment in generation, transmission and distribution since 1991, the country has not been able to encourage and retain large scale FDI. China Light & Power (CLP) and AES Corp., large foreign players in India, have also been impacted by delayed sector reforms. Actionable steps to improve domestic coal and gas availability, time bound approvals on forest/environmental clearances, renegotiation of unremunerative PPAs and structural reform of SEBs/faster reduction of AT&C losses are a few measures where favorable policy push is required.

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