Coal India Ltd

Best play on India's rising coal deficit

Coal India (CIL) commands a dominant 82% market share in India and hence offers the best play on the rising coal deficit in the country. Over the next three years, we expect CIL to register substantial expansion in operating margins from 22% in FY10 to 30% in FY13 led by improved labour efficiency, a focus on beneficiated coal and technology upgrades. This, in turn, would likely drive a PAT CAGR of 18% over FY11-FY13. We value CIL at between 7–9x FY12E EV/EBITDA, at which the stock would be priced in the range of Rs 265–315/sh (Rs 1,6165bn–1,993bn). Key upside risks to our estimates include cash deployment towards further improving operational efficiencies and for international acquisitions, better pricing parity with imports, and a faster turnaround in subsidiaries (ECL and BCCL). Key downside risks are delays in land acquisition, inability to meet minimum contracted quantity (MCQ), and transport infrastructure bottlenecks.

CIL to help alleviate coal deficit: We believe the supply-demand gap for coal in India could widen from 23mmt in FY10 to 79mmt by FY15. Our bottom-up analysis shows that India's overall demand could grow at a CAGR of 12.5% to 1,091mmt by FY15, and that the power sector alone could account for 80% of the incremental demand. Overall, the incremental demand for coal in India is estimated at 487mt by FY15. Of this, 161mmt or 32% is likely to come from CIL (for details refer to our report titled *Captive coal to partly bridge supply gap* dated 15Sep10).

Strong operational performance ahead: We expect CIL to deliver a robust operational performance over FY11-FY13, with sales likely to grow at a 12% CAGR (10.9% during FY06-FY10) and a significant improvement in EBITDA margin from 22.1% in FY10 to 30% in FY13. Margin expansion will be supported by improved labour efficiency, subsidiary turnaround, focus on beneficiated coal and upgrades to execution technology.

Robust balance sheet but volatile earnings: CIL's net profit has grown at a CAGR of 13% over FY06-FY10 while ROE, which decreased steadily from 42% in FY06 to 27% in FY09, has rebounded sharply to 44% in FY10. We expect the company to surpass its past growth rates and report a net profit CAGR of 18% over FY11-FY13, with ROE settling in the range of 31–39% (on account of non-utilisation of cash). CIL has cash of Rs 369bn on its books which could be used for future expansion plans and international acquisitions, thereby further bolstering ROE. In addition, a net worth of Rs 258bn would qualify the company for global project bids.

We value CIL in a range of 7–9x EV/EBITDA: Global coal companies are trading in the range of 5–13x EV/EBITDA and 9–14x P/E on CY11E. At 7–9x EV/EBITDA and 11–13x P/E on FY12 estimates, we arrive at a price band of Rs 265–315/sh for CIL. Triggers for a stock re-rating include any increase in raw coal price, international acquisitions, cash deployment and faster subsidiary turnaround.

BLOOMBERG

COAL IN

IPO fact sheet*

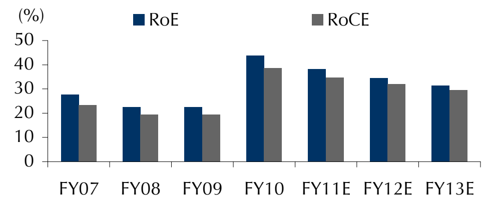
Issue opens	18 October 2010
Issue closes	20 October 2010

** Likely dates*

Issue details

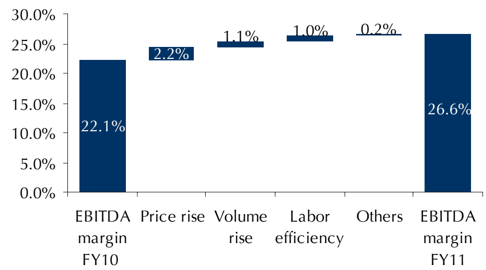
Particulars	No of shares (mn)
Total issue size	631.6
Net issue to public	198.9
QIB portion	284.2
HNI portion	85.3
Employees	63.1

ROE and ROCE



Source: CIL DRHP, RCML Research

Margin expansion in FY11E to be led by multiple factors



Source: CIL DRHP, RCML Research

Financial highlights

(Rs mn)	FY10	FY11E	FY12E	FY13E
Revenue	473,515	525,506	587,762	658,594
Growth (%)	*15.6*	*11.0*	*11.8*	*12.1*
Adj net income	98,293	114,948	137,076	163,069
Growth (%)	*141.9*	*16.9*	*19.2*	*19.0*
FDEPS (Rs)	15.6	18.2	21.7	25.8
Growth (%)	*141.9*	*16.9*	*19.2*	*19.0*

Profitability and return ratios

(%)	FY10	FY11E	FY12E	FY13E
EBITDA margin	22.1	26.6	27.9	30.0
EBIT margin	19.3	23.8	25.0	27.1
Adj PAT margin	20.8	21.9	23.3	24.8
ROE	43.8	38.2	34.5	31.5
ROIC	499.2	1,066.9	240.1	186.6
ROCE	38.6	34.7	32.0	29.6

Suhas Harinarayanan
(91-22) 6766 3404
suhas.hari@religare.in

Suman Memani
(91-22) 6766 3439
suman.memani@religare.in

Investment rationale

Largest producer and reserve holder of coal

World's largest coal producer, catering to 42% of India's energy requirements

CIL, a state-owned company, was established in 1973 and is the largest coal producer in the world (based on raw coal output), with a dominant 82% market share. CIL also holds the world's largest coal reserves with proven resources of 52,545mn tonnes (mt) and meets as much as 42% of India's primary commercial energy requirements.

Leveraging on strong exploration capabilities to expand resource base

We expect CIL to continue to leverage its strong exploration capabilities and technical mining expertise to augment its reserve base. The company achieved ~0.47mn metres of drilling operations in FY10 and has introduced new technology as well as advanced equipment to achieve a higher targeted drilling capacity. It has made significant investments to augment its resource base, with exploration and drilling capex rising from Rs 1bn to Rs 2.5bn over FY08-FY10.

Fig 1 - CIL's coal assets

Coal Fields (mt)	Proven reserve	Indicated Reserve	Inferred Reserve	Total Reserve	Extractable Reserve
Korba	3,896	1,605	51	5,552	2,670
Singrauli	3,270	212	0	3,482	1,891
Talcher	7,568	1,721	640	9,929	5,893
IB Valley	3,242	161	0	3,403	2,119
Wardha-Valley	2,249	614	58	2,921	795
Jharia	5,983	1,009	51	7,043	1,145
North Karanpura	4,458	35	0	4,493	2,072
Central India Coalfields4	2,665	892	123	3,681	774
Raniganj	7,556	1,242	379	9,177	662
Rajmahal/Deogarh	1,378	382	579	2,339	546
East Bokaro	2,116	1,110	0	3,227	692
West Bokaro	1,516	236	10	1,762	462
Kamptee	817	121	0	938	214
Mand Raigarh	1,957	114	0	2,070	659
Umrer Nand Bander	558	1	0	558	215
South Karanpura	1,550	196	7	1,753	308
Pench-Kanhan	693	199	44	936	148
Pathakhera	190	28	0	218	87
Makum	362	0	0	362	239
Ramgarh	386	19	0	405	138
Giridh	18	0	0	18	15
Daltonganj	16	0	0	16	0
Tatapani-Ramkola	97	387		484	0
Dilli-Jeypore	4	14		18	10
Total	**52,545**	**10,298**	**1,942**	**64,785**	**21,754**

Source: CIL DRHP

Fig 2 - Grade-wise dispatch

(mt)	2007		2008		2009		2010	
Non-coking Coal	**Raw Coal**	**%**	**Raw Coal**	**%**	**Raw Coal**	**%**	**Raw Coal**	**%**
A1	4.82	1.40	4.65	1.20	4.02	1.00	4.24	1.00
B	23.09	6.60	24.07	6.40	25.03	6.30	25.61	6.20
C	39.29	11.20	37.59	10.00	35.11	8.80	38.93	9.40
D	30.16	8.60	34.05	9.10	36.26	9.10	30.882	7.40
E	84.15	24.00	91.84	24.50	103.61	25.90	105.742	25.50
F	144.69	41.30	157.1	41.90	169.06	42.20	175.68	42.30
G	0.003	0.04	0.02	0.04	0.15	0.03	0.01	0.04
Total Non-coking	**326.2**	**93.10**	**349.32**	**93.30**	**373.24**	**93.10**	**381.09**	**91.80**
Coal								
Coking Coal								
Steel Grade I	0.13	0.04	0.09	0.04	0.06	0.04	0.09	0.04
Steel Grade II	0.51	0.20	0.28	0.10	0.87	0.20	1.06	0.30
Washery Grade I	0.28	0.10	0.46	0.10	0.31	0.10	0.29	0.10
Washery Grade II	2.12	0.60	2.00	0.50	1.65	0.40	1.48	0.40
Washery Grade III	6.17	1.80	5.64	1.50	6.62	1.70	7.07	1.70
Washery Grade IV	14.62	4.20	16.40	4.40	17.78	4.40	23.982	5.80
Others(SCI/	0.27	0.10	0.38	0.10	0.22	0.10	0.16	0.04
Total Coking Coal	**24.1**	**6.80**	**25.25**	**6.60**	**27.51**	**6.80**	**34.13**	**8.20**
Total Raw Coal	**350.3**	**100.00**	**374.57**	**100.00**	**400.75**	**100.00**	**415.22**	**100.00**

Source: CIL DRHP

Capacity expansion drive

45 expansion projects in various stages of planning and development

CIL has chalked out 45 expansion and new projects which are in various stages of planning and development: (1) 25 projects, with an aggregate estimated capacity of 47.51mtpa, were at various stages of implementation as on March '10, and are expected to become operational by the end of FY12; and (2) 20 projects, with an aggregate estimated capacity of 33.27mtpa, involve longer gestation periods and are expected to become operational during the 12th Five Year Plan (FY13-FY18). We believe this expansion drive would help CIL step up production significantly over the longer term.

Higher dispatches and coal prices to boost sales

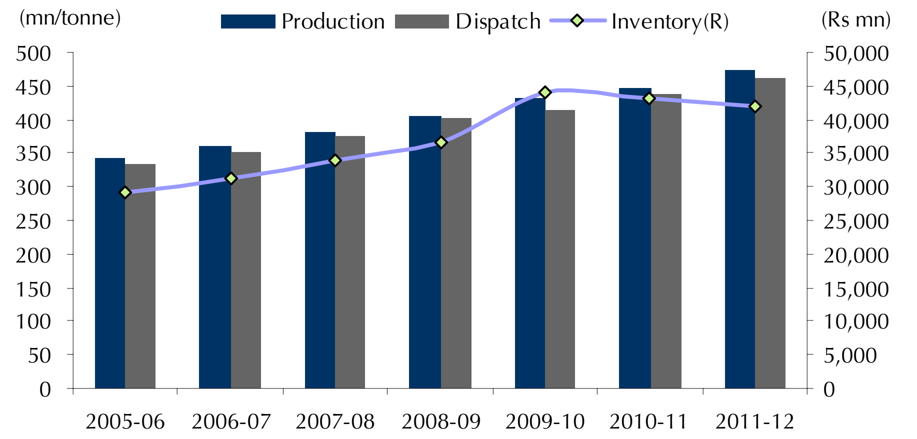
Sales likely to grow at a stronger CAGR of 12% over FY11-FY13

CIL has recorded a 10.9% CAGR in sales over FY06-FY10. We expect a stronger 12% CAGR over FY11-FY13 driven by the management's focus on dispatch growth and the likely increase in coal prices in line with inflation.

Focus on increasing dispatches

CIL aims to increase its dispatch-to-production ratio to 98% from the current 96%. However, the lack of adequate transportation facilities (road and rail) is proving a hurdle to this goal. We assume a 5.7% CAGR in dispatches over FY11-FY13. CIL is also working to clear its inventory before focusing on dispatch growth; we therefore assume that production will be 2% lower than CIL's projections as the company looks to first run down inventory.

Fig 3 - Production-dispatch ratio and inventory



Source: CIL DRHP

We expect raw coal prices to firm up by 6% during FY11-FY13

Higher coal prices

Over January '00 (when the price of coal was fully deregulated) to March '10, raw coal prices have increased at an annualised rate of 4.9%—lower than the average inflation rate in India during this period. We have assumed a 6% increase in prices of raw coal during FY11-FY13.

Fig 4 - Coal pricing trend

Time	Rise in coal price (%)
January 2001	8.5
June 2004	16.2
December 2007	10.0
October 2009	11.0

Source: CIL DRHP

Strong margin outlook

Margins likely to improve sharply over the next three years

CIL has delivered operating margins in the range of 6.4–23.9% during FY06-FY10. We expect an expansion in margins to 27–30% levels over FY11-FY13 on the back of lower employee costs (led by manpower reduction and higher labour productivity), a focus on coal beneficiation, and efficiencies arising out of technological upgrades.

Reduction in employee cost

At the end of FY10, CIL's employee base stood at ~397,000, a 7% decline from FY08. Its subsidiaries, ECL (Eastern Coal Field) and BCCL (Bharat Coking Coal), which accounted for 22.3% and 18.8% of total employees in FY08 now form a lower share of 21.5% and 18.5% respectively. Similarly, employee cost for these two subsidiaries combined has declined from 39.4% of sales in FY08 to 36.3% in FY10. We believe CIL is working to improve labour efficiency by both, downsizing its workforce and introducing technological upgrades. Led by these initiatives, output per man-shift has risen to 4.48tonnes in FY10 as against 3.79t in FY08 and we see room for further improvement.

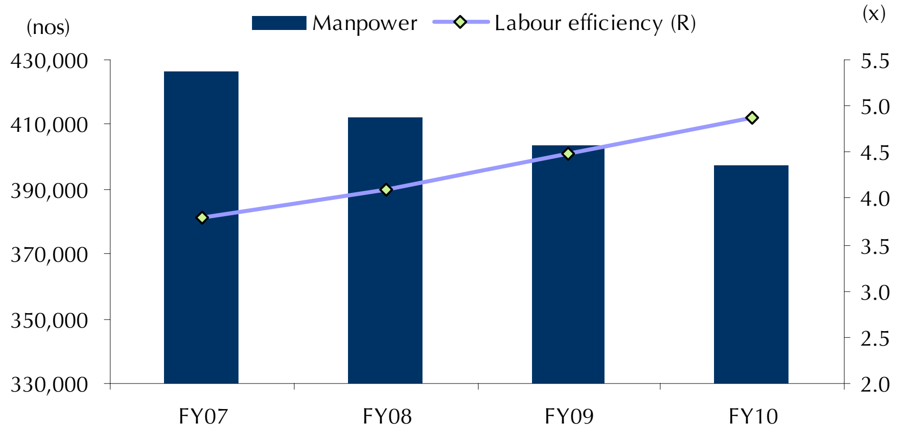
Shedding of excess manpower has helped lower employee costs

Fig 5 - Decline in CIL's employee base

Year	CIL	ECL share	BCCL share
FY07	439,343	22.5%	19.0%
FY08	426,077	22.3%	18.8%
FY09	412,350	21.9%	18.5%
FY10	397,138	21.5%	18.5%

Source: CIL, Annual Report

Fig 6 - Improving labour efficiency



Source: RCML Research

Beneficiation improves the quality and hence sale value of coal

Focus on coal beneficiation

CIL currently has 17 coal beneficiation facilities with a total capacity of 39.4mt. The management expects to add 20 new facilities in the 12th plan, raising its capacity to 111mt at a total expenditure of Rs 23bn. Further, the company intends to equip all new open-cast mining projects with coal production capacities greater than 2.5mtpa (not linked to pithead customers) with dedicated coal beneficiation facilities. Beneficiation increases the quality and gross calorific value (GCV) of coal so that it is comparable with imports, thereby enabling margin improvement.

Fig 7 - Beneficiated coal

(mt)	FY07	FY08	FY09	FY10
Beneficiated Non-coking Coal	10.31	10.46	11.28	11.62
Beneficiated Coking Coal	3.81	3.83	3.68	2.97

Source: Company

Turnaround in key subsidiaries

ECL and BCCL have turned around at the PAT level in FY10

CIL has 11 direct and indirect subsidiaries of which 9 are associated with coal production. ECL and BCCL, two key direct subsidiaries of the company, were making losses and had been referred to the BIFR (Board for Industrial & Financial Reconstruction). The BIFR has approved their revival plans and we note that both companies have turned around at the net profit level in FY10. We expect a stronger operating performance from these subsidiaries considering that employee costs have been reined in and labour productivity ramped up. ECL and BCCL together accounted for 13.5% of CIL's total production in FY10.

We note that both companies reported a significant increase in employee cost in FY09, largely on account of higher provisions made towards an expected retrospective increase in employee remuneration and benefits. These subsidiaries are now focused on improving cost efficiency. The ECL management expects to turn net worth positive in FY15 (and we expect the same from BCCL as well), which will strengthen CIL's financial potential.

Fig 8 - Financial performance of ECL and BCCL

(Rs mn)	Accumulated losses		Net worth		PAT		Employees cost as % of sales	
Subsidiary	March '10	March '09	March '10	March '09	March '10	March '09	March '10	March '09
ECL	-82,340.00	-86,331.60	-60,155.50	-64,147.10	3,333.90	-21,029.10	65%	112%
BCCL	-75,208.80	-83,560.70	-54,028.80	-62,380.70	7,941.90	-13,804.60	74%	43%

Source: Annual Report

Eyeing overseas acquisitions

Considering the coal supply shortage in India, CIL is exploring the acquisition of overseas coal assets. In this regard it has taken three key initiatives:

Potential acquisition of overseas coal assets to drive long-term growth

1) Acquired prospecting licences for two coal blocks in Mozambique in 2009 with plans to enter into strategic JVs for development of the same over a period of five years (CIAL set up to carry on mining activities).

2) Begun scouting for strategic partnerships for the acquisition of coal assets in Australia, the US, and Indonesia with a sum of Rs 60bn earmarked for the same.

3) Formed a JV called ICVL (international coal venture private ltd) (28.7% stake) with SAIL, NTPC, NMDC and RINL (Rashtriya ISpat Nigam ltd) for acquiring coal assets outside India.

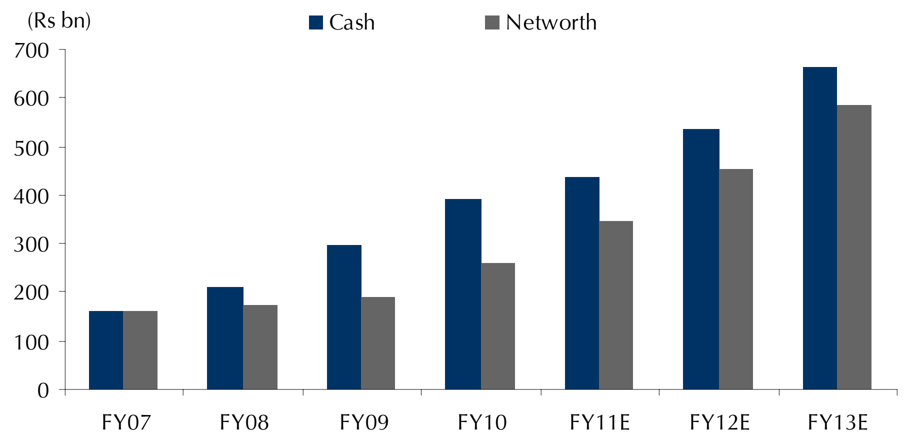
These initiatives would open up access to additional coal resources and enhance CIL's value, in our view.

Strong balance sheet

Capex of Rs 36bn–46bn over the next two years can be comfortably funded

CIL has a net worth of Rs 258bn and a net cash balance of Rs 369bn which will more than suffice to finance its growth plans. In the past, the company has incurred capex of less than Rs 20bn per annum. For FY11 and FY12, it has outlined an expenditure of Rs 36bn and Rs 46bn respectively. Considering the cash-rich balance sheet and the fact that CIL generates strong operating cash flows, we believe the company would comfortably finance its capex and overseas acquisition plans without recourse to external funding.

Fig 9 - Cash and Net worth



Source: CIL DRHP, RCML Research

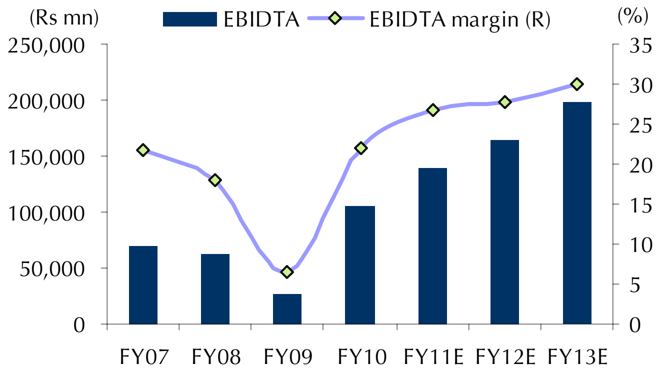
Financial performance

Wage provisions in FY09 dented otherwise consistent margin uptick

Steady increase in EBITDA margins barring FY09

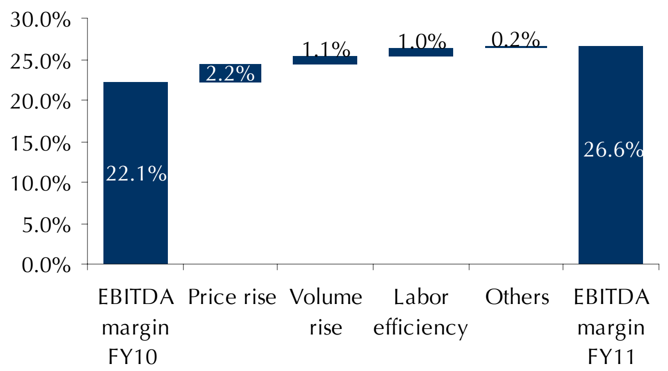
With the exception of FY09, CIL's EBITDA margins have inched up steadily from 21.8% in FY07 to 22.1% in FY10. In FY09, however, a significant increase in employee costs due to implementation of the National Coal Wage Agreement (NCWA VIII) led to a steep drop in margin to 6.4%. In January '09, as per the NCWA VIII, employee remuneration and benefits were hiked with retrospective effect for a period of five years from July '06. Accordingly, CIL made additional provisions in FY09 of Rs 41.2bn relating to salaries and wages and of ~Rs 40bn on increased liability towards gratuity and other employee benefits.

Fig 10 - EBITDA margin trend



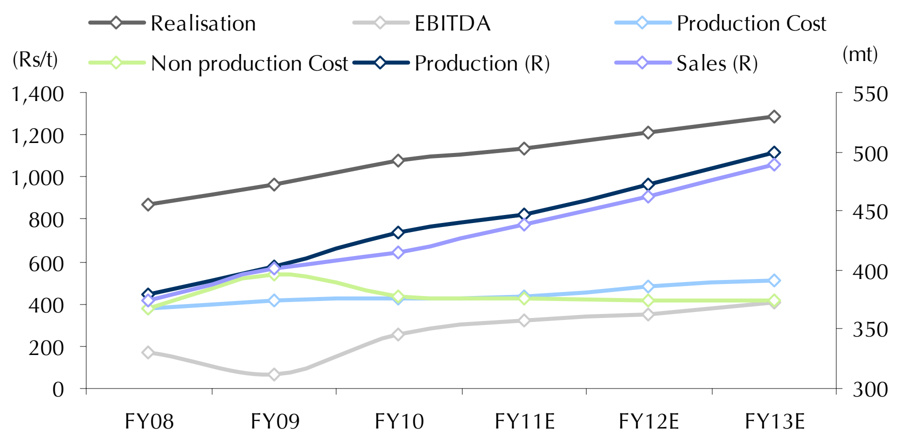
Source: CIL DRHP, RCML Research

Fig 11 - Margin expansion in FY11E to be led by multiple factors



Source: CIL DRHP, RCML Research

Fig 12 - Realisation and Cost variables



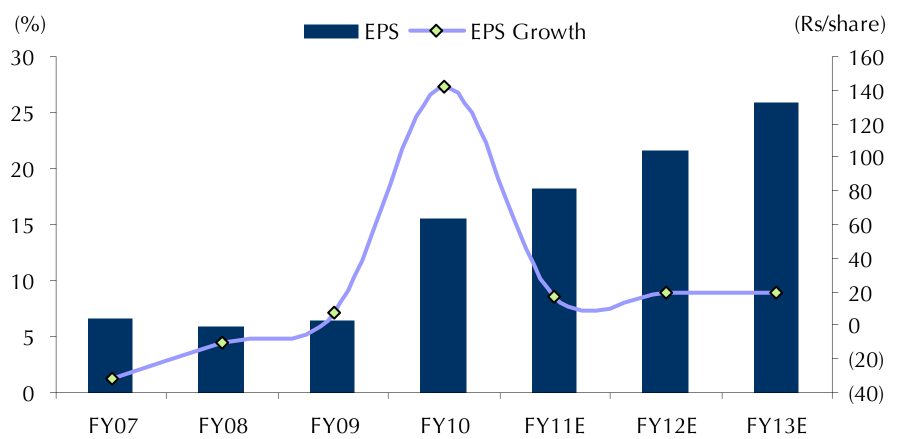
Source: RCML Research

Consistent EPS growth ex-FY09

EPS dropped marginally in FY09 on account of the employee cost provisions mentioned above. However, the drop wasn't as pronounced as the margin slippage largely because the company has restated accounts with respect to arrears in salary and wages as well as the tax impact.

Restating of accounts mitigated impact of wage provisions on EPS

Fig 13 - EPS growth trend



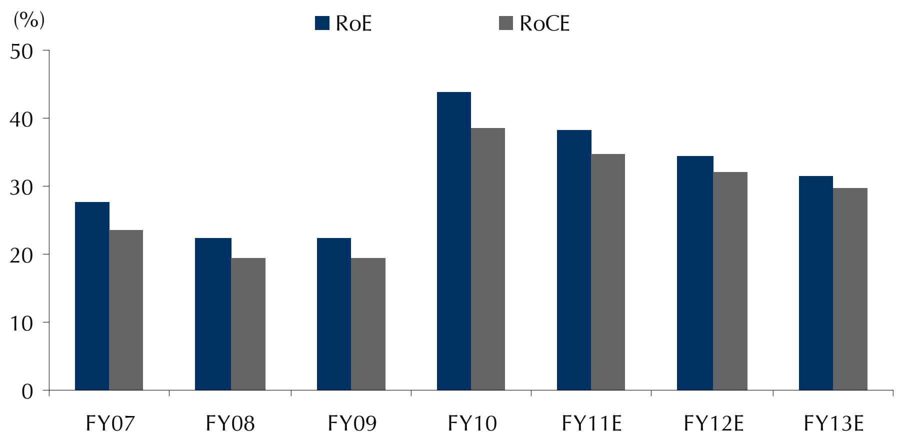
Source: CIL DRHP, RCML Research

ROE and ROCE likely to remain strong

We expect ROE and ROCE to remain strong over FY11-FY13, in the range of 31–39% and 30–35% respectively, albeit lower than FY10 mainly on account of excess cash lying in the balance sheet. Utilisation of cash for capex or for international acquisitions will further bolster return ratios.

Effective cash deployment could further boost return ratios

Fig 14 - ROE and ROCE



Source: CIL DRHP, RCML Research

Valuation

We value CIL at an EV/EBITDA of 7–9x on FY12E

EV/EBITDA a preferred valuation tool

In our view, EV/EBITDA is the best valuation methodology for coal companies rather than EV/Reserve or EV/Tonne. We believe it is difficult to accurately compare companies on an EV/Reserve or EV/Tonne basis on the account of (a) differing grades of produced coal which warrants a different price point for each grade, (b) divergence in the timelines for exploiting coal reserves due to disparate technologies and mine categories (open-cast or underground).

CIL merits valuation of 7–9x on FY12E EV/EBITDA

Overseas coal players are trading in the range of 5–13x EV/EBITDA on CY11E. We believe CIL merits an EV/EBITDA multiple in the range of 7–9x on FY12E, translating to a price band of Rs 265–315/sh (including cash).

Fig 15 - Global valuation summary

Company	CMP LC	MCap	P/E (x)			EV/EBITDA (x)		
		($ mn)	CY10E	CY11E	CY12E	CY10E	CY11E	CY12E
Yanzhou Coal Mining Co-H	21	13,348	21.9	12.6	10.8	12.6	7.4	6.2
China Coal Energy Co-H	13	20,681	13.0	11.1	9.6	6.1	5.1	4.4
China Shenhua Energy Co - H	35	73,444	12.5	11.1	10.0	6.3	5.5	4.9
Peabody Energy Corp	51	13,647	16.0	10.9	9.2	8.0	6.2	5.5
Macarthur Coal Ltd	13	3,831	13.6	11.0	9.3	8.3	6.8	5.9
Whitehaven Coal Ltd	6	3,171	32.9	17.2	11.5	18.5	10.5	7.4
Adaro Energy Tbk Pt	2,050	7,349	14.9	19.2	12.3	7.0	8.1	5.9
Tambang Batubara Bukit Asam	20,250	5,229	16.3	19.4	13.6	10.6	13.1	8.9
Bumi Resources Tbk Pt	2,225	5,180	11.9	14.1	9.3	8.2	7.1	5.2
Indo Tambangraya Megah Pt	43,200	5,470	16.3	16.5	11.0	10.1	9.9	6.8
United Tractors Tbk Pt	21,000	7,830	19.0	16.7	14.3	10.2	8.8	7.6

Source: Bloomberg

Fig 16 - Sensitivity to Coal Price and Volumes at 8x EV/EBITDA (Rs 290/sh)

		Volume sensitivity				
		2%	3%	4%	6%	8%
Price	2%	230	238	246	262	278
	4%	253	262	270	286	302
	6%	274	282	**290**	306	322
	8%	294	302	310	326	343
	10%	315	323	331	347	364

Source: RCML

Fig 17 - Sensitivity to Cash deployment at FY12E EV/EBITDA (Rs 290/sh)

		EV/EBITDA				
		1x	2x	3x	4x	5x
Deployment rate	5%	293	296	299	302	306
	10%	296	302	309	315	321
	15%	299	309	318	328	337
	20%	302	315	328	340	353
	25%	306	321	337	353	369

Source: RCML

Key risks

Inability to exploit existing reserves and acquire additional reserves

Hurdles to mine development could affect growth prospects

An inability to conduct successful exploration and development activities at its existing mines may lead to a decline in CIL's coal reserve. If the company encounters geophysical or geological conditions different from that predicted by past exploration activities, then its reserve estimates may have to be adjusted downward. In the event that the coal mined is of a lower quality than expected, the demand for, and realisable price of coal may decrease, thereby affecting profitability.

Hurdles to land acquisition

CIL is required to acquire the land and associated surface rights overlying its coal reserves prior to commencing mining activities. It typically faces difficulties in the acquisition of land in a timely manner, particularly with respect to land owned by private parties and forest land, resulting in delays in some of its projects. Inability to acquire land and associated surface rights could materially affect business operations.

Inadequate transportation facilities

CIL depends primarily on a combination of rail and road transportation to deliver coal to customers. It also relies on third-party road transportation providers, including truckers, for the movement of coal from the mine to beneficiation facilities and further for the supply of coal to customers. Non-availability of adequate road transportation could have an adverse effect on receipt of materials and offtake arrangements for coal produced.

Regulatory risk

CIL's exploration and mining activities depend on the grant, renewal or continuance of various exploration and mining related approvals, licences and permits. Bringing mines into operation and maintaining such mines requires the company to secure approval for a mining plan as well as applicable forest and environmental clearances. Mining leases are typically granted for a period of 20–30 years and there is no assurance that the company will be able to renew all its leases in a timely manner, which could significantly affect operations.

Appendix

Coal supply: Captive mines hold the key

India's overall supply-demand gap for coal could increase from 23mmt in FY10 to 79mmt by FY15. Our bottom-up analysis shows that the country's overall demand could grow at a CAGR of 12.5% to 1,091mmt by FY15, and that the power sector alone could account for 80% of the incremental demand.

Increase in captive mining could plug coal shortage post FY16-FY17

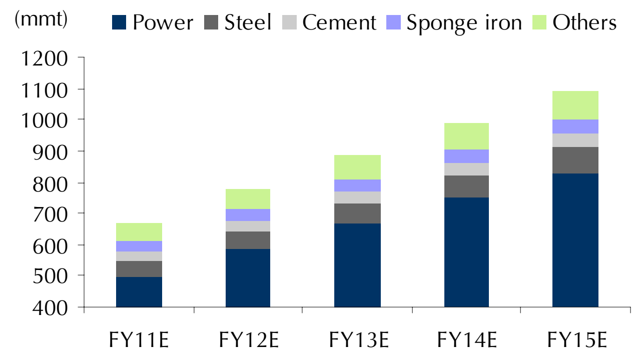
Ex-captive coal, India's deficit could rise to 284mmt by FY15

As per our analysis, coal supply from CIL is expected to meet only 32% of incremental demand by FY15. Based on our forecast of coal handling capacity expansion, and thus imports via major and non-major ports, we believe imports could grow at a CAGR of 19% till FY15. However, the biggest turnaround could come from captive coal supply, which is expected to increase from 34mmt to 205mmt. Excluding captive sources, India's supply-demand gap could increase to 284mmt by FY15.

Near-term constraints but captive mines offer longer-term solution

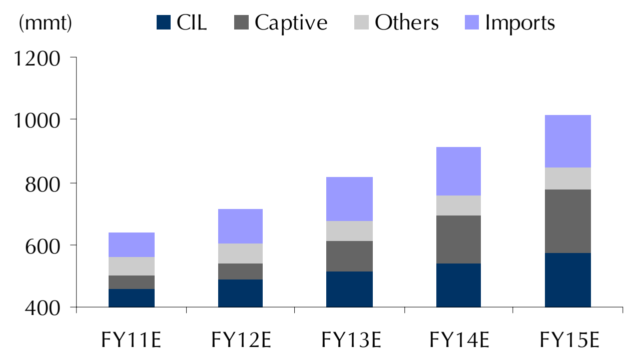
We believe India could face a coal deficit over the next couple of years as the growth in coal supply from CIL, captive and imported sources could come with a lag. However, post FY16-FY17 captive coal supply could fill the gap, in our view.

Fig 18 - Net coal demand in India from various sectors



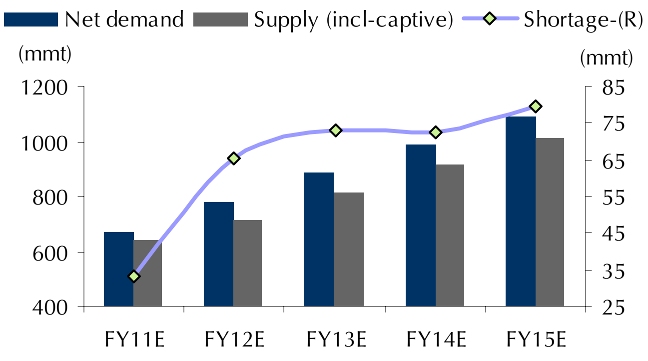
Source: RCML Research

Fig 19 - Net coal supply in India from various sources



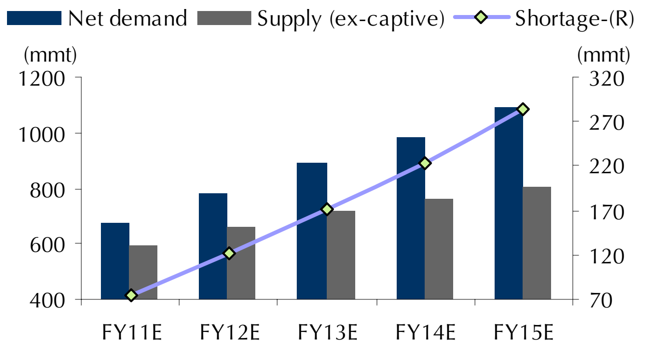
Source: : RCML Research

Fig 20 - Net coal demand versus supply (incl-captive)



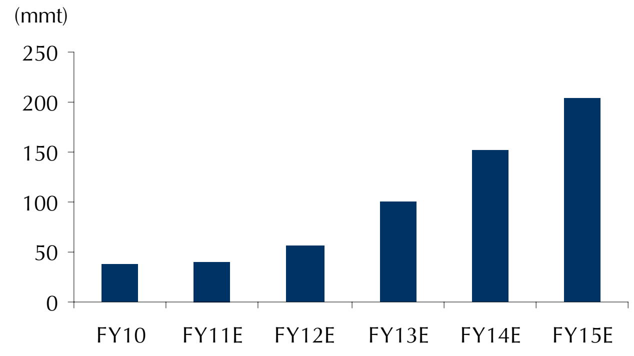
Source: RCML Research

Fig 21 - Net coal demand versus net supply (ex-captive)



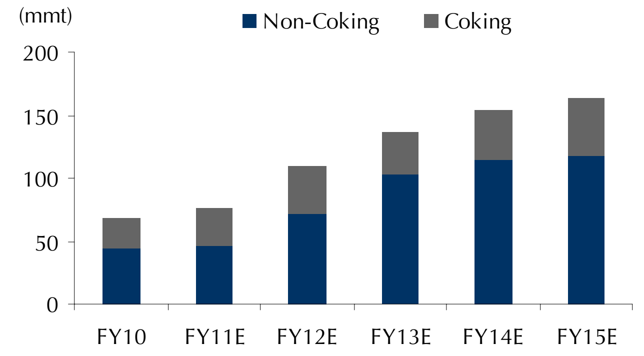
Source: RCML Research

Fig 22 - Captive coal supply



Source: RCML Research

Fig 23 - Net supply of imported coal



Source: RCML Research

Captive coal for power set to grow at 46% CAGR by FY15, containing the deficit to some extent

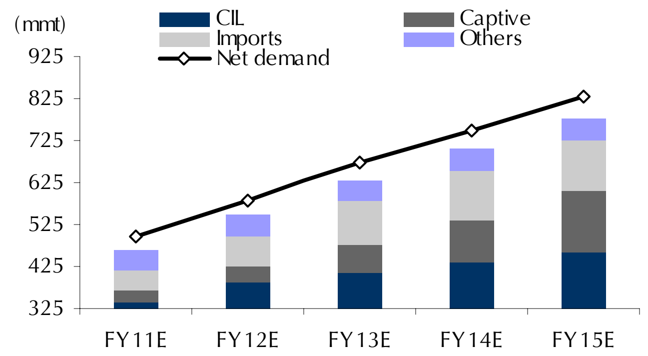
Power sector: Hardest hit by the deficit

We believe India's power sector could be worst hit by the coal shortage. *We have built a proprietary demand-supply model for power, based on a project-by-project analysis and discussions with industry players*. Accordingly, we estimate that India could add ~95GW of additional power capacity and needs incremental coal supply of ~390mmt over the next five years. Overall, we expect the deficit for the power sector to widen from 20mmt in FY10 to 52mmt in FY15. Captive coal is expected to constitute 19% of the overall supply for the sector, from the current share of 4%.

Captive supply to increase at 46% CAGR

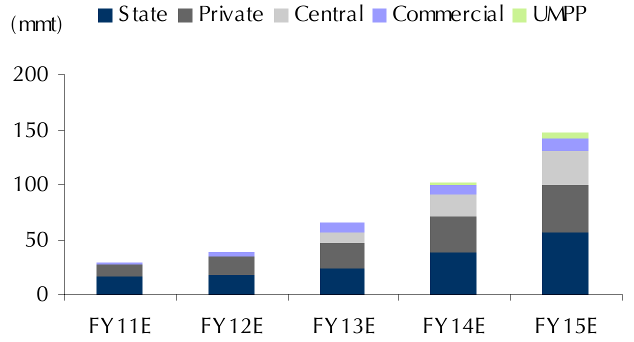
We believe that out of the 98 blocks currently allotted to the power sector, state-based utilities could have the highest share (46%), followed by the private sector (30%). However, we expect additional allocation to the sector from blocks currently categorised as 'commercial'. Based on our analysis, we project an increase in captive coal supply for the power sector at a 46% CAGR to 147mmt in FY15 (includes supply from commercial blocks).

Fig 24 - Demand-supply scenario for power sector



Source: RCML Research

Fig 25 - Captive coal supply for power sector



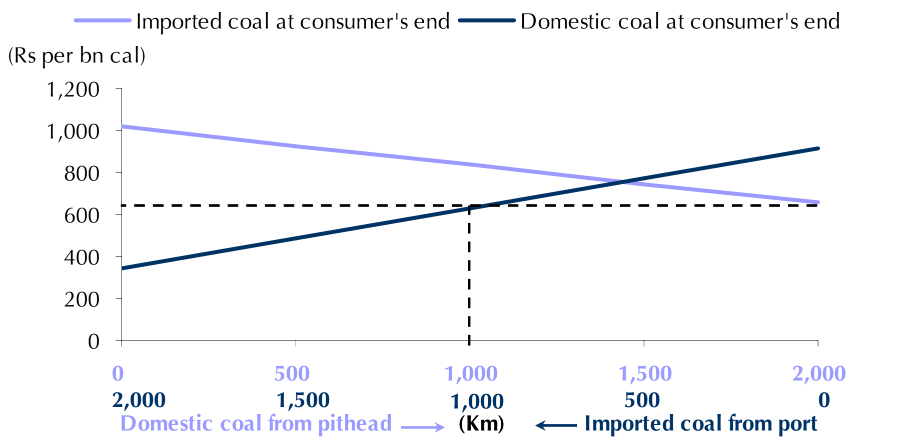
Source: RCML Research

Case study: Importance of domestic coal supply over imported coal

India's domestic coal supply to the power sector comprises predominantly of grades E and F with an average calorific value of 3500kg/kcal, as against 5500kg/kcal for imported coal. We have compared domestic and imported coal in terms of cost per billion calories of delivered heat value at the consumer end.

Indian coal cheaper than imported coal when delivered to a distance of <1,000km

Fig 26 - Delivered cost of domestic and imported thermal coal



Source: RCML research

We find that the delivered cost of power-grade domestic coal is less than the cost of imported coal at port when delivered to consumers within 1,000km. Moreover, Indian coal remains a cheaper option when imported coal has to cover more than 500km and domestic coal has to cover less than 1,400km.

Our case study compares domestic coal supply to imported coal; if we were to compare captive coal (which is cheaper than imports), the distance to which domestic coal can be delivered economically could be even higher.

Case study assumptions

- Domestic coal from mine to consumer and imported coal from port to consumer are being transported by rail.
- Landed CIF price of US$ 80/mmt for imported coal with a gross calorific value of 5500 kcal/kg.
- Exchange rate of Rs 45/US$.
- Domestic coal price includes weighted average notified price of coal for the respective grades, royalty, stowing, excise duty, transportation charges from mine to railway siding, central sales tax and rail freight.

Landed price of imported coal at port includes all applicable taxes and duties. However, the cost of handling imported coal at the Indian port and transporting it to the railway siding for inland transportation is not included. If included, the distance to which imported coal can be economically transported inland will reduce further.

Consolidated financials

Profit and Loss statement

Y/E March (Rs mn)	FY10	FY11E	FY12E	FY13E
Revenues	473,515	525,506	587,762	658,594
Growth (%)	*15.6*	*11.0*	*11.8*	*12.1*
EBITDA	104,724	139,989	163,725	197,373
Growth (%)	*297.1*	*33.7*	*17.0*	*20.6*
Depreciation & amortisation	13,295	15,030	16,790	18,726
EBIT	9,460	91,429	124,959	146,935
Growth (%)	-	*866.5*	*36.7*	*17.6*
Interest	1,560	1,120	1,120	1,120
Other income	50,315	47,726	58,776	65,859
EBT	139,648	171,565	204,591	243,386
Income taxes	43,425	56,616	67,515	80,317
Effective tax rate (%)	*31.1*	*33.0*	*33.0*	*33.0*
Extraordinary items	-	-	-	-
Min into / inc from associates	-	-	-	-
Reported net income	96,223	114,948	137,076	163,069
Adjustments	2,070	-	-	-
Adjusted net income	98,293	114,948	137,076	163,069
Growth (%)	*141.9*	*16.9*	*19.2*	*19.0*
Shares outstanding (mn)	6,316.4	6,316.4	6,316.4	6,316.4
FDEPS (Rs) (adj)	15.6	18.2	21.7	25.8
Growth (%)	*141.9*	*16.9*	*19.2*	*19.0*
DPS (Rs)	-	4	4	4

Cash flow statement

Y/E March (Rs mn)	FY10	FY11E	FY12E	FY13E
Net income + Depreciation	100,612	131,099	154,986	182,915
Non-cash adjustments	(11,869)	22,901	(18,662)	(16,758)
Changes in working capital	22,183	(61,316)	10,990	11,994
Cash flow from operations	110,926	92,684	147,315	178,151
Capital expenditure	(17,573)	(36,802)	(46,000)	(49,882)
Change in investments	-	-	-	-
Other investing cash flow	-	-	-	-
Cash flow from investing	(17,573)	(36,802)	(46,000)	(49,882)
Issue of equity	(616)	(4,869)	-	-
Issue/repay debt	1,091	(1,120)	(1,120)	(1,120)
Dividends paid	-	2	0	(0)
Other financing cash flow	-	(4,465)	-	-
Change in cash & cash eq	93,828	45,431	100,195	127,149
Closing cash & cash eq	390,778	436,209	536,403	663,552

Economic Value Added (EVA) analysis

Y/E March	FY10	FY11E	FY12E	FY13E
WACC (%)	13.7	13.7	13.7	13.7
ROIC (%)	499.2	1,066.9	240.1	186.6
Invested capital (Rs mn)	(14,022)	29,717	52,282	75,978
EVA (Rs mn)	(68,083)	312,975	118,368	131,387
EVA spread (%)	485.5	1,053.2	226.4	172.9

Balance sheet

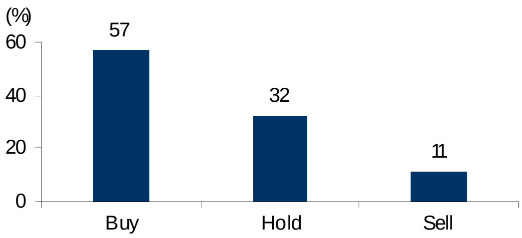
Y/E March (Rs mn)	FY10	FY11E	FY12E	FY13E
Cash and cash eq	390,778	436,209	536,403	663,552
Accounts receivable	21,686	24,476	27,375	30,674
Inventories	44,018	43,192	41,868	36,087
Other current assets	86,762	117,424	133,772	152,976
Investments	12,821	10,821	9,821	8,821
Gross fixed assets	349,453	370,362	408,362	454,362
Net fixed assets	120,313	130,420	151,630	178,903
CWIP	22,107	38,000	46,000	49,882
Intangible assets	-	-	-	-
Deferred tax assets, net	9,658		-	-
Other assets	-	-	-	-
Total assets	708,143	800,543	946,870	1,120,896
Accounts payable	7,725	8,000	8,000	8,000
Other current liabilities	323,704	331,561	357,996	384,302
Provisions	82,396	86,177	97,075	109,878
Debt funds	20,869	16,000	16,000	16,000
Other liabilities	14,997	14,962	16,441	17,850
Equity capital	63,164	63,164	63,164	63,164
Reserves & surplus	195,289	280,679	388,194	521,702
Shareholder's funds	258,453	343,843	451,358	584,866
Total liabilities	708,143	800,543	946,870	1,120,896
BVPS (Rs)	50.9	64.4	81.5	102.6

Financial ratios

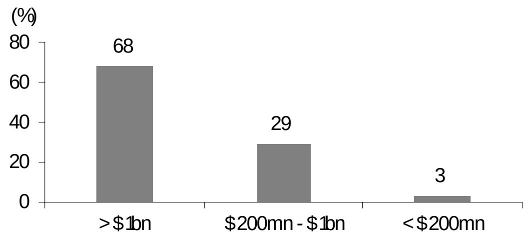
Y/E March	FY10	FY11E	FY12E	FY13E
Profitability & Return ratios (%)				
EBITDA margin	22.1	26.6	27.9	30.0
EBIT margin	19.3	23.8	25.0	27.1
Net profit margin	20.8	21.9	23.3	24.8
ROE	43.8	38.2	34.5	31.5
ROCE	38.6	34.7	32.0	29.6
Working Capital & Liquidity ratios				
Receivables (days)	15	16	16	16
Inventory (days)	170	168	149	121
Payables (days)	35	30	28	25
Current ratio (x)	1.6	1.8	2.0	2.3
Quick ratio (x)	1.2	0.1	0.1	0.1
Turnover & Leverage ratios (x)				
Gross asset turnover	1.4	1.5	1.5	1.5
Total asset turnover	0.7	0.7	0.7	0.6
Interest coverage ratio	58.6	111.6	131.2	159.5
Adjusted debt/equity	0.1	0.1	0.0	0.0
Valuation ratios (x)				
EV/Sales	2.8	2.5	2.2	2.0
EV/EBITDA	12.5	9.3	8.0	6.6
P/E	17.0	14.6	12.2	10.3
P/BV	5.2	4.1	3.3	2.6

Coverage Profile

By recommendation



By market cap (US$)



Recommendation interpretation

Recommendation	Expected absolute returns (%) over 12 months
Buy	More than 15%
Hold	Between 15% and –5%
Sell	Less than –5%

Recommendation structure changed with effect from March 1, 2009

Expected absolute returns are based on share price at market close unless otherwise stated. Stock recommendations are based on absolute upside (downside) and have a 12-month horizon. Our target price represents the fair value of the stock based upon the analyst's discretion. We note that future price fluctuations could lead to a temporary mismatch between upside/downside for a stock and our recommendation.

Religare Capital Markets Ltd

4th Floor, GYS Infinity, Paranjpe 'B' Scheme, Subhash Road, Vile Parle (E), Mumbai 400 057.

Disclaimer