

Equities

7 March 2011 | 9 pages

Coal India (COAL.BO)

Buy: Value Over Volume

- Company Update
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■ **Coal prices hiked** — Coal India (CIL)'s coal price hike announced in end-Feb 2011 should impact ~32% of its total volumes (excluding e-auction and washed coal). We now expect an overall yoy realisation increase of 20% in FY12 (vs 10% earlier). While CIL had been in discussions with the government to hike notified coal prices (to account for wage revisions expected in Jul 11) and had proposed market-linked prices for consumers with unregulated end-product prices, the timing and the quantum have surpassed market expectations.

■ **New pricing structure** — 1) 30% hike for all sectors except power/defense/fertilizers (~5% of CIL's volumes); 2) Increase in the price (~18% for power, ~56% for non-power) of Mahanadi coal (~22% of CIL's volumes) to bring it at par with South Eastern Coalfields; 3) Higher prices (+85-90%) for high quality A and B grade (~6% of volumes) in tandem with global prices (but at a discount). The new structure implies ~14% hike (constant volumes) in overall realizations – while we incorporate 20% assuming higher e-auction/washed coal prices (on global trends).

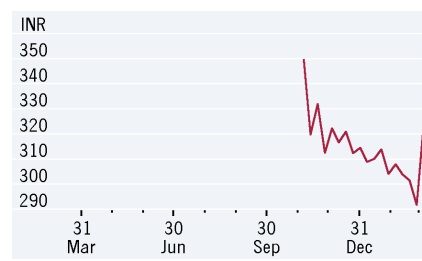
■ **Volume growth: a challenge** — While relaxed pollution norms/project approvals are likely, benefits should come only by FY13 – with a lag effect for subsequent approvals. Besides production, evacuation of coal is an issue. Production volumes are expected to be 431mt in FY11 (flat yoy) and 447mt in FY12 (+4% yoy).

■ **Raise earnings; TP** — We raise FY12 PAT by 20% to incorporate higher prices and higher wage expenses (+22% yoy vs +13%). We hike TP to Rs395 from Rs350 and continue to value CIL using: 1) DCF+30% (Rs469 vs Rs425) and 2) 12x FY12 PE (Rs284 vs Rs236), weighted 60:40. At our TP, CIL would trade at 14.5x FY12 PE (adjusted for overburden removal adjustment).

■ **Risks** — Forest/environmental/pollution clearances, 26% profit sharing, transport constraints, auction for future reserves, restricted ability to raise prices.

Buy/Low Risk	1L
Price (07 Mar 11)	Rs332.60
Target price	Rs395.00
	<i>from Rs350.00</i>
Expected share price return	18.8%
Expected dividend yield	1.5%
Expected total return	20.3%
Market Cap	Rs2,100,823M
	US\$46,779M

Price Performance (RIC: COAL.BO, BB: COAL IN)



Statistical Abstract

Year to	Net Profit	Diluted EPS	EPS growth	P/E	P/B	ROE	Yield
31 Mar	(RsM)	(Rs)	(%)	(x)	(x)	(%)	(%)
2009A	40,626	6.43	-5.2	51.7	11.1	22.4	0.8
2010A	98,337	15.57	142.1	21.4	8.1	43.8	1.1
2011E	102,813	16.28	4.6	20.4	6.4	35.0	1.5
2012E	149,660	23.69	45.6	14.0	4.8	39.0	2.0
2013E	149,282	23.63	-0.3	14.1	3.8	30.3	2.0

Source: Powered by dataCentral

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Fiscal year end 31-Mar	2009	2010	2011E	2012E	2013E
Valuation Ratios					
P/E adjusted (x)	51.7	21.4	20.4	14.0	14.1
EV/EBITDA adjusted (x)	49.5	16.2	12.8	8.4	7.9
P/BV (x)	11.1	8.1	6.4	4.8	3.8
Dividend yield (%)	0.8	1.1	1.5	2.0	2.0
Per Share Data (Rs)					
EPS adjusted	6.43	15.57	16.28	23.69	23.63
EPS reported	6.43	15.57	16.28	23.69	23.63
BVPS	30.09	40.92	52.20	69.40	86.53
DPS	2.70	3.50	5.00	6.50	6.50
Profit & Loss (RsM)					
Net sales	408,108	466,843	514,936	645,542	674,936
Operating expenses	-385,708	-365,246	-393,545	-464,775	-497,389
EBIT	22,400	101,597	121,391	180,766	177,547
Net interest expense	-1,789	-1,560	-1,368	-1,457	-1,457
Non-operating/exceptionals	36,499	40,149	36,943	44,064	46,719
Pre-tax profit	57,110	140,186	156,966	223,373	222,809
Tax	-36,632	-43,425	-54,153	-73,713	-73,527
Extraord./Min.Int./Pref.div.	20,149	1,576	0	0	0
Reported net income	40,626	98,337	102,813	149,660	149,282
Adjusted earnings	40,626	98,337	102,813	149,660	149,282
Adjusted EBITDA	39,309	114,891	137,413	197,545	195,219
Growth Rates (%)					
Sales	17.9	14.4	10.3	25.4	4.6
EBIT adjusted	-58.5	353.6	19.5	48.9	-1.8
EBITDA adjusted	-43.5	192.3	19.6	43.8	-1.2
EPS adjusted	-5.2	142.1	4.6	45.6	-0.3
Cash Flow (RsM)					
Operating cash flow	117,194	133,199	124,591	215,246	202,520
Depreciation/amortization	16,909	13,295	16,022	16,778	17,672
Net working capital	56,198	62,727	-16,029	27,791	34,295
Investing cash flow	-16,619	-17,747	-28,500	-36,500	-37,000
Capital expenditure	-17,469	-19,988	-28,500	-36,500	-37,000
Acquisitions/disposals	2,127	2,228	0	0	0
Financing cash flow	-13,239	-21,625	-34,103	-41,014	-41,014
Borrowings	2,646	-616	-2,653	0	0
Dividends paid	-17,054	-22,100	-31,582	-41,056	-41,056
Change in cash	87,335	93,828	61,988	137,733	124,507
Balance Sheet (RsM)					
Total assets	623,244	708,220	802,476	980,750	1,135,553
Cash & cash equivalent	296,950	390,778	452,766	590,498	715,005
Accounts receivable	18,475	21,686	27,059	33,957	35,504
Net fixed assets	129,283	142,590	155,068	174,789	194,117
Total liabilities	433,146	449,490	472,515	542,186	588,763
Accounts payable	38,401	43,359	46,287	50,976	55,672
Total Debt	21,485	20,869	18,215	18,215	18,215
Shareholders' funds	190,099	258,730	329,961	438,564	546,790
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	9.6	24.6	26.7	30.6	28.9
ROE adjusted	22.4	43.8	35.0	39.0	30.3
ROIC adjusted	-36.3	nm	na	na	na
Net debt to equity	-144.9	-143.0	-131.7	-130.5	-127.4
Total debt to capital	10.2	7.5	5.2	4.0	3.2

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Estimate Changes

Figure 1. Estimate changes, FY11- 13E

	FY11E			FY12E			FY13E		
	Old	New	% change	Old	New	% change	Old	New	% change
Rs/US\$ rate	45.6	45.6	0%	43.9	43.9	0%	43.0	43.0	0%
Net sales (Rs bn)	511.2	514.9	1%	588.2	645.5	10%	624.7	674.9	8%
EBITDA (Rs bn)	134.3	137.4	2%	161.9	197.5	22%	165.3	195.2	18%
Net profit (Rs bn)	100.7	102.8	2%	124.4	149.7	20%	125.9	149.3	19%
EPS (Rs)	15.9	16.3	2%	19.7	23.7	20%	19.9	23.6	19%
Coal production volumes (mt)	431.0	431.0	0%	447.0	447.0	0%	467.0	467.0	0%
Coal dispatch volumes (mt)	427.1	427.1	0%	447.0	447.0	0%	467.0	467.0	0%
Raw coal sales excl e-auction (mt)	357.4	357.4	0%	375.2	375.2	0%	389.5	389.5	0%
E-auction sales (mt)	49.6	49.6	0%	49.2	49.2	0%	51.4	51.4	0%
Washed coal sales (mt)	15.3	15.3	0%	17.2	17.2	0%	19.9	19.9	0%
Average realisation (Rs/t)	1,161	1,166	0%	1,279	1,401	10%	1,302	1,405	8%
Raw coal realisation excl E-auction (Rs/t)	1,017	1,012	-1%	1,077	1,209	12%	1,124	1,221	9%
E-auction realisation (Rs/t)	1,734	1,771	2%	1,938	2,176	12%	1,967	2,165	10%
Washed coal realisation (Rs/t)	2,664	2,806	5%	3,797	3,379	-11%	3,062	3,062	0%

Source: Citi Investment Research and Analysis estimates

Valuation

We calculate our Rs395 target price based on two metrics:

- a valuation based on DCF + 30% premium (Rs469/sh)
- a 12x FY12 PE-based valuation (Rs284/sh)

which we then combine based on a 60/40 weighting.

Figure 2. Target price based on DCF

WACC (%)	11.8%
EV (Rs m)	1,693,921
Net Debt (Rs m)	-585,105
Market cap (Rs m)	2,279,025
No. of shares (m)	6,316
Per share (Rs)	361
Value per share at 30% premium (Rs)	469

Source: Citi Investment Research and Analysis

Global Coal Comps

Figure 3. Global Comps

Company Name	RIC Code	Rating	YE	Mkt Cap		Share			P/E (x)		EV/EBITDA (x)		P/B (x)	
				\$m	Ccy	Price	Target	Upside	2011E	2012E	2011E	2012E	2011E	2012E
Australia														
Macarthur Coal Ltd	MCC.AU	3M	30-Jun	3,567	AUD	11.74	11.50	-2%	19.6	12.7	10.7	7.0	1.4	1.2
Whitehaven Coal	WHC.AU	2M	30-Jun	3,481	AUD	6.95	7.00	1%	40.3	15.8	20.1	9.2	3.2	2.6
Riversdale Mining	RIV.AU	2H	30-Jun	3,569	AUD	14.86	16.00	8%	638.1	54.6	(338.2)	38.1	3.3	3.1
Indonesia														
Bumi Resources	BUMI.ID	2H	31-Dec	7,030	IDR	2,975	3,400	14%	9.1	10.5	2.8	2.9	2.7	2.4
Adaro Energy	ADRO.ID	1M	31-Dec	8,642	IDR	2,375	3,650	54%	9.0	9.8	5.0	5.1	2.9	2.4
Indo Tambangraya	ITMG.ID	1L	31-Dec	5,540	IDR	43,100	61,200	42%	8.7	9.7	5.2	5.5	4.1	3.6
PT Bukit Asam	PTBA.ID	2L	31-Dec	5,242	IDR	20,000	22,000	10%	12.3	10.5	8.0	6.3	5.0	3.9
China														
China Coal Energy	1898.CN	2M	31-Dec	19,651	HKD	11.54	14.19	23%	10.0	7.9	6.4	5.2	1.6	1.3
China Shenhua	1088.CN	1M	31-Dec	86,851	HKD	34.00	43.71	29%	12.7	11.0	7.2	6.1	2.5	2.1
Yanzhou Coal	1171.CN	1H	31-Dec	15,539	HKD	24.60	32.22	31%	8.7	7.6	5.4	4.4	2.2	1.8
USA														
Arch Coal	ACI.US	2H	31-Dec	5,847	USD	35.99	34.00	-6%	14.1	10.7	7.4	6.0	2.3	1.9
Peabody Energy	BTU.US	1H	31-Dec	18,763	USD	69.35	76.00	10%	13.9	12.6	7.4	6.5	3.1	2.6
CONSOL Energy	CNX.US	2H	31-Dec	11,873	USD	52.48	52.00	-1%	18.4	12.5	11.0	8.6	3.4	2.7
Diversified Coal														
Anglo American	AAL.GB	2M	31-Dec	71,073	GBP	33.05	37.00	12%	9.6	7.9	5.3	4.3	1.6	1.3
BHP Billiton Ltd	BHP.AU	1M	30-Jun	246,047	AUD	46.32	56.00	21%	11.7	10.3	6.3	5.0	4.1	3.1
Rio Tinto Ltd	RIO.AU	1M	31-Dec	132,927	AUD	84.15	100.00	19%	8.8	9.2	3.4	3.1	2.0	1.7
Xstrata PLC	XTA.GB	1M	31-Dec	67,902	GBP	14.24	20.11	41%	8.9	9.6	5.6	5.8	1.6	1.4

Source: Citi Investment Research and Analysis estimates. Note 2012 valuations for Macarthur Coal, Whitehaven Coal, Riversdale Mining and BHP imply June 12 and for the remaining Dec12.

Coal India

Valuation

Our target price of Rs395 is arrived at using (1) a valuation based on DCF + 30% premium (Rs469/sh) and (2) a 12x FY12 PE based valuation (Rs284/sh), with a 60/40 weighting. This method incorporates both CIL's asset valuation and also its earnings potential. Our DCF valuation is enhanced by 30% to account for the probable reserves (8.3bn tonnes - an additional 78% over the proven reserves) that we have not incorporated in our valuation. We have not taken a terminal value and thus also use a PE-based valuation as it assumes new reserves replace the ones exhausted. The lower weightage to PE seems justified given CIL's limited exposure to international prices and that the benefits of beneficiation are likely to have a meaningful impact only after 3-4 years - thus PE alone cannot fully capture a fair valuation.

Risks

We rate Coal India shares Low Risk based on our quantitative risk rating system. We believe CIL's stable margins, mine life visibility, limited risk of coal price downside, low costs and net cash position warrant a Low Risk rating. Downside risks that could prevent the shares from reaching our target price include, but are not limited to: risks of restrictions imposed by regulators related to forest clearance and environmental safeguards; difficulties in obtaining reserves/resources; a proposed 26% profit-sharing requirement contained in the New Mining Bill; land acquisition; logistical constraints including rail transport bottlenecks; restricted ability to raise coal prices; disruption of operations in politically unstable areas; auction for future reserves; and non-availability of critical equipment.

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