

# COAL INDIA

## Play on energy shortage

India Equity Research | Metals and Mining

Coal India (CIL) has emerged as the strongest play on India's energy shortage. It enjoys tremendous pricing power, which offsets concerns on wage revision and implementation of mining tax. Moreover, production growth is likely to bounce back in FY14, as environmental issues get resolved. Also, structural positives of scale, cost and cash-rich balance sheet remain intact, and washeries are a long-term positive. We roll over our valuation from March 2012 to March 2013 thereby raising our target price from INR 424 to INR 460. Upgrade from 'HOLD' to 'BUY'.

### Best way to play India's energy deficit

With India remaining structurally short of crude, coal and increasingly gas as well, we see CIL as a preferred mode to play the country's energy deficit.

### Strong pricing power negates key issues

CIL has historically taken price hikes to offset wage revisions, albeit with timing mismatches. Our estimates incorporate annualised wage increase of INR 58 bn in FY12 against company guidance of INR 35 bn. We expect dilution of proposed mining tax of 26% of coal mining profits and believe CIL has the ability to take price hikes to negate the same (26% mining tax requires ~6% price hike).

### Coal washing, higher volume growth to boost EBITDA

We have not considered benefits of washed coal in our DCF which would commence in H2FY14 and by FY17 could account for 30% of volumes, providing over 50% boost to EBITDA. We see continuing resolution of the environment issues over next one year raising volume growth rates to 5-6% FY14 onwards (model assumption : 4.5%).

### Outlook and valuations: Solid value; upgrade to 'BUY'

We roll over our DCF valuation from March 2012 to March 2013, leading to increase in our target price from INR 424 to INR 460 share. We largely retain our forward estimates which imply an FY13 P/E of ~15x at our DCF valuation, in line with standard utility company multiples. We upgrade the stock to 'BUY/Sector Outperformer'.

#### Financials

Year to March	FY10	FY11	FY12E	FY13E
Revenues (INR mn)	466,843	502,336	634,277	668,632
Rev. growth (%)	14.4	7.6	26.3	5.4
EBITDA (INR mn)	102,632	134,791	209,265	240,098
Net profit (INR mn)	98,294	108,674	173,450	197,999
Share outstanding (mn)	6,316	6,316	6,316	6,316
EPS (INR)	15.3	17.3	27.5	31.3
EPS growth (%)	372.5	12.9	58.7	14.2
Diluted P/E (x)	24.1	21.3	13.4	11.8
EV/EBITDA (x)	18.8	13.8	8.3	6.7
ROAE (%)	43.8	36.7	43.7	37.2

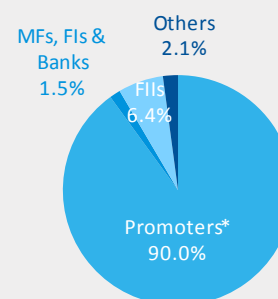
#### EDELWEISS 4D RATINGS

Absolute Rating	BUY
Rating Relative to Sector	Outperformer
Risk Rating Relative to Sector	Medium
Sector Relative to Market	Underweight

#### MARKET DATA (R: COAL.BO, B: COAL IN)

CMP	: INR 369
Target Price	: INR 460
52-week range (INR)	: 422 / 245
Share in issue (mn)	: 6,316.4
M cap (INR bn/USD mn)	: 2,272 / 49,538
Avg. Daily Vol.BSE/NSE('000)	: 9,480.7

#### SHARE HOLDING PATTERN (%)



\* Promoters pledged shares : NIL  
(% of share in issue)

#### PRICE PERFORMANCE (%)

	Stock	Nifty	EW Metals and Mining Index
1 month	(3.9)	(14.8)	(15.2)
3 months	(7.6)	(12.3)	(16.2)
12 months	NA	NA	NA

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August 29, 2011

**Table 1: Marginal change in estimates based on working capital changes and FY11 annual report**

	FY12			FY13		
	Current	Previous	% change	Current	Previous	% change
Sales volumes (mt)	465.0	465.0	0.0	467.6	467.6	0.0
Blended realisation (INR/t)	1,364.0	1,364.0	0.0	1,429.9	1,429.9	0.0
EBITDA/t (INR)	450.0	450.0	0.0	513.5	513.5	0.0
Revenue (INR mn)	634,277	634,277	0.0	668,632	668,632	0.0
EBITDA (INR mn)	209,265	209,265	0.0	240,098	240,098	0.0
Net profit (INR mn)	173,450	174,165	(0.4)	197,999	204,640	(3.2)
EPS (INR)	27.5	27.6	(0.4)	31.3	32.4	(3.2)

Source: Edelweiss research

**Table 2: Revised fair value of INR 460/share**

Assumptions for DCF valuation	FY13E	FY14E onwards
Volume growth (%)	4.0	4.5
Blended realisation growth (%)	4.8	4.5
Risk free rate (%)	8.0	
Stock beta	1.0	
Risk premium (%)	5.0	
Cost of equity (%)	13.0	
Firm value (INR mn)	2,204,330	
Total debt (INR mn)	19,272	
Total cash (INR mn)	718,143	
Net Debt (INR mn)	(698,871)	
Equity Value (INR mn)	2,903,201	
No. of shares (mn)	6,316	
Value per share (INR)	460	

Source: Edelweiss research

## Company Description

Coal India (CIL) is the world's largest coal reserve holder and producer and also controls ~80% of the Indian coal market. It is going to be the primary beneficiary of the structural deficit of coal in India. Moreover, it is one of the least cost producers of coal in the world.

CIL, a Maharatna company, is one of the largest public sector companies in India in terms of turnover. Its product portfolio consists largely of thermal coal (90%) with the balance being coking coal. The company enjoys a near-monopoly position in the lucrative coal market and is more of a utility player due to assured volume off-take, pseudo regulated environment and minimal chance of a product price cut, as prices already remain at ~50% discount to internal benchmark prices.

It currently operates ~471 mines in India and is also scouting for international mines to increase global presence and assure its resources. It sells ~10% of its production based on the e-auction route and ~3.5% beneficiated coal (2x realisations of raw coal). Beneficiated coal volumes are expected to rise significantly to ~150 mtpa by FY17 (25% of total volumes).

## Investment Theme

India's largest coal miner with a near monopoly position

Significant headroom to increase product prices

Expansion to increase mining capacity as well as beneficiated coal volumes

Strong balance sheet with low leverage and significant cash reserves

## Key Risks

Proposal to share 26% of profits with local inhabitants/for local development

Inability to obtain environmental clearances and/or acquire land

MoEF's proposal to segregate mining locations into 'Go' and 'No-go' zones

Increase in wages without immediate increase in prices

## Financial Statements

Income statement					(INR mn)
Year to March	FY09	FY10	FY11	FY12E	FY13E
Net revenue	408,108	466,843	502,336	634,277	668,632
Accretion to stock	(1,336)	(6,672)	(12,533)	-	-
Production expenses	67,898	68,605	52,314	76,965	78,436
Employee expenses	197,421	166,555	182,110	225,660	238,268
Power & fuel	15,951	17,396	17,546	20,692	21,848
SGA & other expenses	103,564	118,327	128,107	101,695	89,982
Total operating expenses	383,497	364,211	367,545	425,012	428,534
EBITDA	24,611	102,632	134,791	209,265	240,098
Depreciation and amortisation	16,909	13,295	16,729	18,824	20,894
EBIT	7,702	89,337	118,062	190,442	219,204
Interest expenses	1,789	1,560	791	999	981
Other income	51,196	52,408	47,963	58,343	64,633
Profit before tax	57,110	140,186	165,234	247,786	282,856
Provision for tax	36,632	43,425	55,959	74,336	84,857
Core profit	20,477	96,761	109,275	173,450	197,999
Extraordinary income/(loss)	(20,151)	(1,533)	(602)	-	-
Profit after tax	40,628	98,294	108,674	173,450	197,999
Profit after minority interest	40,628	98,294	108,674	173,450	197,999
Basic shares outstanding (mn)	6,316	6,316	6,316	6,316	6,316
Basic EPS	3.2	15.3	17.3	27.5	31.3
Diluted shares (mn)	6,316	6,316	6,316	6,316	6,316
Diluted EPS	3.2	15.3	17.3	27.5	31.3
Dividend per share (INR)	2.7	3.5	3.9	5.5	6.3
Dividend payout (%)	42.0	22.5	22.7	20.0	20.0
Tax rate	64.1	31.0	33.9	30.0	30.0

## Common size metrics- as % of net revenues

Year to March	FY09	FY10	FY11	FY12E	FY13E
Operating expenses	94.0	78.0	73.2	67.0	64.1
Depreciation	4.1	2.8	3.3	3.0	3.1
Interest expenditure	0.4	0.3	0.2	0.2	0.1
EBITDA margins	6.0	22.0	26.8	33.0	35.9
Net profit margins	5.0	20.7	21.6	27.3	29.6

## Growth metrics (%)

Year to March	FY09	FY10	FY11	FY12E	FY13E
Revenues	17.9	14.4	7.6	26.3	5.4
EBITDA.	(59.3)	317.0	31.3	55.3	14.7
PBT	(29.3)	145.5	17.9	50.0	14.2
Net profit	(5.2)	141.9	10.6	59.6	14.2
EPS	(55.5)	372.5	12.9	58.7	14.2

<b>Balance sheet</b>					
(INR mn)					
<b>As on 31st March</b>	<b>FY09</b>	<b>FY10</b>	<b>FY11</b>	<b>FY12E</b>	<b>FY13E</b>
Equity capital	63,164	63,164	63,164	63,164	63,164
Reserves & surplus	126,918	195,274	270,008	396,126	540,094
Shareholders funds	190,081	258,437	333,172	459,290	603,257
Secured loans	1,805	4,669	326	2,475	2,304
Unsecured loans	19,680	16,199	15,210	17,159	16,968
Minority interest	19	236	326	326	326
Deferred tax liability	(9,548)	(9,658)	(8,732)	(8,732)	(8,732)
<b>Sources of funds</b>	<b>202,037</b>	<b>269,884</b>	<b>340,302</b>	<b>470,517</b>	<b>614,123</b>
Gross block	332,550	349,453	367,211	409,211	454,211
Depreciation	218,032	224,915	234,317	252,732	273,171
Impairment	4,430	4,228	4,465	4,874	5,328
Net block	110,088	120,310	128,429	151,605	175,712
CWIP	19,195	22,107	22,181	22,181	22,181
Total fixed assets	129,283	142,416	150,610	173,786	197,892
Investments	15,052	12,823	10,637	10,637	10,637
Loans and advances	117,271	86,762	99,225	99,225	99,225
Inventories	36,669	44,018	55,856	52,399	52,833
Sundry debtors	18,475	21,686	30,256	33,017	32,974
Cash and equivalents	296,950	390,778	458,623	583,433	718,143
Total current assets	469,364	543,244	643,960	768,074	903,175
Sundry creditors and others	399,423	413,825	448,692	465,766	481,367
Provisions	12,238	14,774	16,214	16,214	16,214
Total CL & provisions	411,662	428,599	464,905	481,980	497,581
Net current assets	57,702	114,645	179,055	286,094	405,594
<b>Uses of funds</b>	<b>202,037</b>	<b>269,884</b>	<b>340,302</b>	<b>470,517</b>	<b>614,123</b>
Book value per share (BV) (INR)	30.1	40.9	52.7	72.7	95.5

**Free cash flow metrics**

<b>Year to March</b>	<b>FY09</b>	<b>FY10</b>	<b>FY11</b>	<b>FY12E</b>	<b>FY13E</b>
Net profit	40,628	98,294	108,674	173,450	197,999
Add: Non cash charge	15,877	12,958	16,626	18,824	20,894
Depreciation	16,909	13,295	16,729	18,824	20,894
Deferred tax	(1,032)	(336)	(103)	-	-
Gross cash flow	56,505	111,252	125,299	192,274	218,893
Less: Changes in W. C.	(77,152)	(36,885)	(3,435)	(17,771)	(15,210)
Operating cash flow	133,657	148,138	128,734	210,045	234,103
Less: Capex	13,957	16,903	17,758	42,000	45,000
<b>Free cash flow</b>	<b>119,700</b>	<b>131,234</b>	<b>110,976</b>	<b>168,045</b>	<b>189,103</b>

**Cash flow statement**

<b>Year to March</b>	<b>FY09</b>	<b>FY10</b>	<b>FY11</b>	<b>FY12E</b>	<b>FY13E</b>
Operating cash flow	133,657	148,138	128,734	210,045	234,103
Financing cash flow	(16,619)	(17,573)	6,975	(42,000)	(45,000)
Investing cash flow	(13,239)	(21,625)	(29,108)	(44,234)	(55,373)
Net cash flow	103,799	108,939	106,601	123,811	133,729
Capex	(13,957)	(16,903)	(17,758)	(42,000)	(45,000)
Dividends paid	(17,054)	(22,100)	(25,832)	(47,332)	(54,032)

### Ratios

Year to March	FY09	FY10	FY11	FY12E	FY13E
ROAE (%)	22.4	43.8	36.7	43.7	37.2
ROACE (%)	4.0	37.9	38.7	47.0	40.4
Inventory (days)	16	16	19	19	18
Debtors (days)	34	40	47	45	45
Payable (days)	336	408	402	400	410
Cash conversion cycle (days)	(286)	(351)	(263)	(219)	(216)
Debt/EBITDA	0.9	0.2	0.1	0.1	0.1
Current ratio	1.1	1.3	1.4	1.6	1.8
Debt/ Equity	0.1	0.1	0.0	0.0	0.0
Adjusted Debt/Equity	0.1	0.1	0.0	0.0	0.0

### Turnover

Year to March	FY09	FY10	FY11	FY12E	FY13E
Fixed assets t/o (x)	3.8	4.1	4.0	4.5	4.1
Total asset turnover (x)	2.1	2.0	0.7	0.7	0.6
Equity turnover (x)	2.1	2.0	1.7	1.6	1.3

### Valuation parameters

Year to March	FY09	FY10	FY11	FY12E	FY13E
EPS (INR)	3.2	15.3	17.3	27.5	31.3
Y-o-Y growth (%)	(55.5)	372.5	12.9	58.7	14.2
CEPS (INR)	5.8	17.4	19.9	30.4	34.7
P/E (x)	113.9	24.1	21.3	13.4	11.8
Price/BV(x)	12.3	9.0	7.0	5.1	3.9
Market cap/Sales (x)	5.7	5.0	4.6	3.7	3.5
EV/Sales (x)	5.0	4.1	3.7	2.7	2.4
EV/EBITDA (x)	82.2	18.8	13.8	8.3	6.7
Dividend yield (%)	0.7	0.9	1.1	1.5	1.7

Company	Absolute reco	Relative reco	Relative risk	Company	Absolute reco	Relative reco	Relative Risk
Bhushan Steel	HOLD	SP	M	Coal India	BUY	SO	M
Hindalco Industries	BUY	SO	M	Hindustan Zinc	BUY	SO	L
Jindal Steel & Power	HOLD	SP	M	JSW Steel	UNDER REVIEW	Under Review	Under Review
National Aluminium Company	HOLD	SU	M	Steel Authority of India	HOLD	SU	L
Sesa Goa	UNDER REVIEW	Under Review	Under Review	Tata Steel	BUY	SO	M
Sterlite Industries (India)	BUY	SP	M	Usha Martin	HOLD	SP	M

## ABSOLUTE RATING

Ratings	Expected absolute returns over 12 months
Buy	More than 15%
Hold	Between 15% and - 5%
Reduce	Less than -5%

## RELATIVE RETURNS RATING

Ratings	Criteria
Sector Outperformer (SO)	Stock return > 1.25 x Sector return
Sector Performer (SP)	Stock return > 0.75 x Sector return
	Stock return < 1.25 x Sector return
Sector Underperformer (SU)	Stock return < 0.75 x Sector return

Sector return is market cap weighted average return for the coverage universe within the sector

## RELATIVE RISK RATING

Ratings	Criteria
Low (L)	Bottom 1/3rd percentile in the sector
Medium (M)	Middle 1/3rd percentile in the sector
High (H)	Top 1/3rd percentile in the sector

Risk ratings are based on Edelweiss risk model

## SECTOR RATING

Ratings	Criteria
Overweight (OW)	Sector return > 1.25 x Nifty return
Equalweight (EW)	Sector return > 0.75 x Nifty return
	Sector return < 1.25 x Nifty return
Underweight (UW)	Sector return < 0.75 x Nifty return



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## Coverage group(s) of stocks by primary analyst(s): Metals and Mining

Bhushan Steel, Coal India, Hindalco Industries, Hindustan Zinc, Jindal Steel & Power, JSW Steel, National Aluminium Company, Prakash Industries, Steel Authority of India, Sesa Goa, Sterlite Industries (India), Tata Steel, Usha Martin

### Recent Research

Date	Company	Title	Price (INR)	Recos
22-Aug-11	Coal India	In pursuit of higher volume; Company Update	395	Hold
22-Aug-11	JSW Steel	Karnataka iron ore mining woes; EdelFlash	665	Under Review
22-Aug-11	Sesa Goa	Karnataka iron ore mining woes; EdelFlash	222	Under Review

### Distribution of Ratings / Market Cap

#### Edelweiss Research Coverage Universe

	Buy	Hold	Reduce	Total
Rating Distribution*	132	51	18	203
* 2 stocks under review				
	> 50bn	Between 10bn and 50 bn	< 10bn	
Market Cap (INR)	117	65	21	

### Rating Interpretation

Rating	Expected to
Buy	appreciate more than 15% over a 12-month period
Hold	appreciate up to 15% over a 12-month period
Reduce	depreciate more than 5% over a 12-month period

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