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IPO Note
October 15, 2010

Coal India Ltd. (CIL)

KING OF MINES

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ISSUE DETAILS

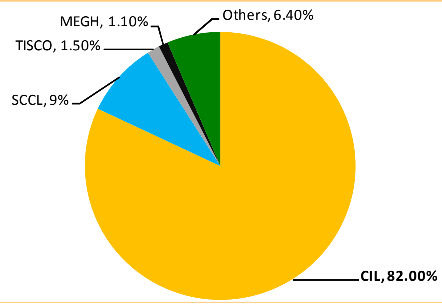
Offer Price Band (Rs.)	225/245
Face Value (Rs.)	10
Shares offered (No. Mn)	631.6
Mcap (Rs. Mn)	Lower 1421180/Upper 1547510
Grading (by CRISIL)	5/5
Lead Managers	Citi/Enam/Deutsche Equities/Kotak/ BofAML/Morgan Stanley
Market Lot	25 Shares
Listing	NSE, BSE
Offer Open Date	18th Oct 2010
Offer Close Date	21st Oct 2010

SHAREHOLDING PATTERN

	Pre Issue	Post Issue
Promotors & Promoter group	99.99%	89.9%
Others	0.01%	0.0%
Public	0.00%	10.0%

Source: RHP, IndiaNivesh Research

India % Share of coal production 2008-09

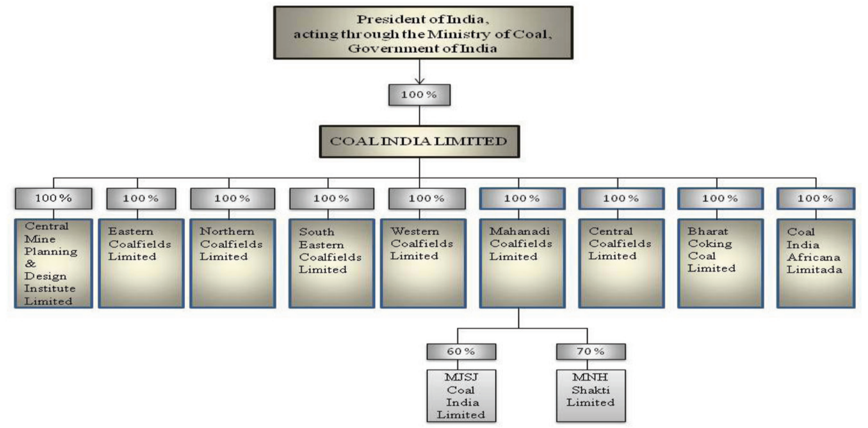


Source: RHP, SCCL - Singareni Collieries Co. Ltd.

Company Details

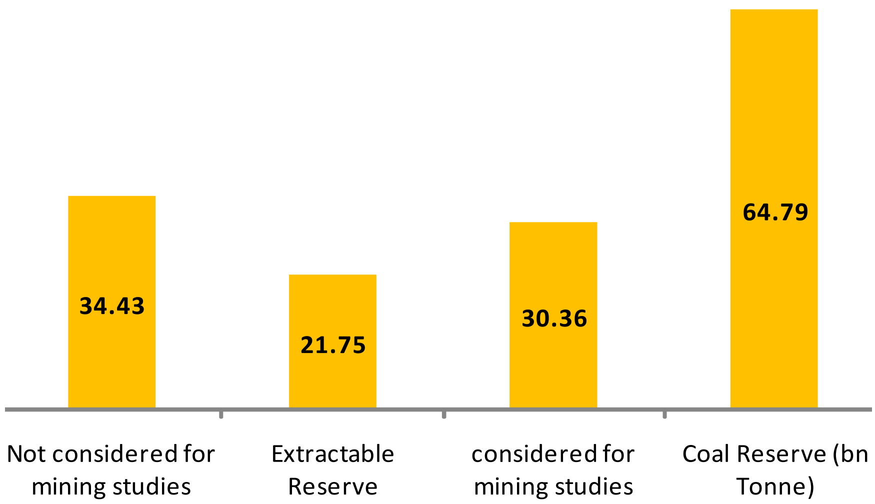
CIL is the largest coal producing company in the world *(Source: CRISIL Research)*, based on its raw coal production of 431.26 million tonnes in fiscal 2010. CIL is also the largest coal reserve holder in the world *(Source: CRISIL Research)* based on its reserve base as of April 1, 2010.

Company Hierarchy



Source: RHP

CIL Coal Status (bn tonnes)



Source: RHP. SRK Mining Services (India) Private Limited and SRK Consulting (UK) Limited, JORC Code.

Coal demand: Sector-wise (2006-07 to 2011-12)

Sector	10th Five-Year Plan	11th Five-Year Plan				
	(2006-07) Actual Supply	2007-08 Actual Supply	2008-09 Actual Supply	2009-10 Actual Supply (Provisional)	2010-11 BE	2011-12 MTA revised
Steel/Coke Ovens & Cokeries	17.3	16.99	16.58	17.23	17.92	26.02
Steel (Import)	17.88	22.03	21.08	23.47	32.59	42.48
Sub-Total Coking	**35.17**	**39.02**	**37.66**	**40.69**	**50.51**	**68.5**
Power Utilities (Gen.Req.)	307.92 (1.61)*	332.40 1.45)*	362.93 (1.23)*	371.66 (0.80)*	442.00 (1.03)*	473
Captive Power	28.13 (1.64)*	29.31 (1.55)*	32.74 (1.38)*	39.08 (1.53)*	44.00 (1.70)*	47
Cement	19.67	21.27	18.85	18.98	30	33.35
Steel DR	17.47	20.92	19.78	23.09	28.8	28.96
BRK & Others	55.51	61.37	77.07	88.82	61	62.43
Sub-Total Non-Coking	428.70 (3.25)*	465.27 (3.00)*	511.37 (2.61)*	541.63 (2.33)*	605.80 (2.73)*	644.74
Grand Total (I+II)	463.87 (3.25)*	504.29 (3.00)*	549.02 (2.61)*	582.32 (2.33)*	656.31 (2.73)*	713.24

*Source: *Denotes middlings; Annual Plan 2010-11, MoC; RHP*

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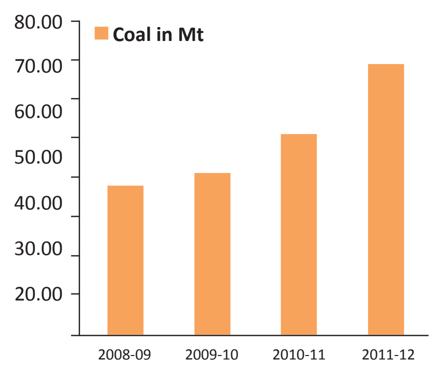
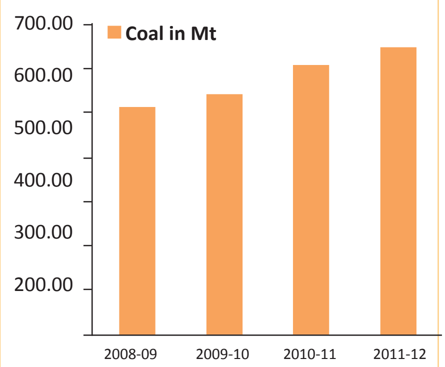
Demand estimate for Coking and Non-Coking coal in India b/w 2008-12

Demand of Coking coal (2008-09 to 2011-12)



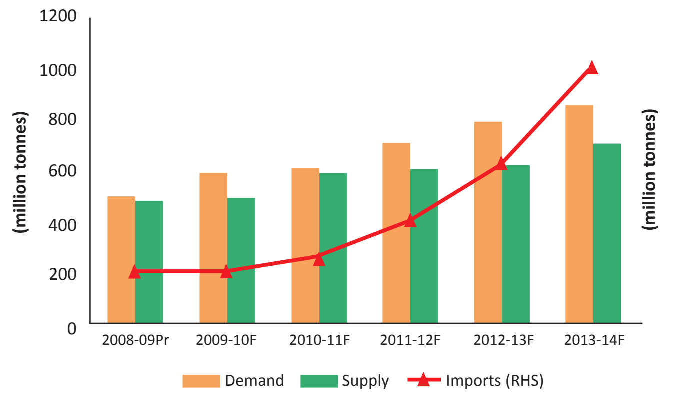
Demand of Non-Coking Coal (2008-09 to 2012)



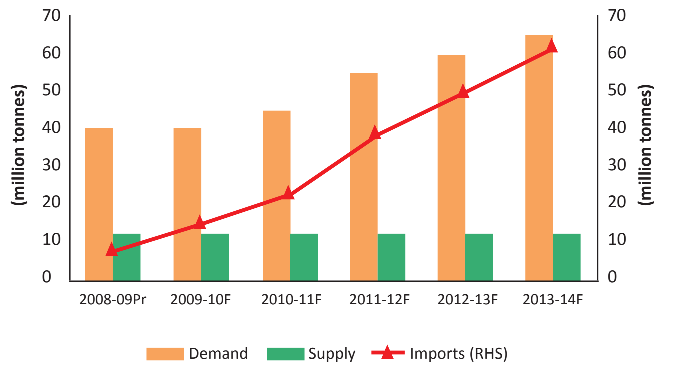
Source: RHP

The graphs below give an estimate of the demand-supply gap for coking and non-coking coal in India between 2008 and 2014

(2008-09-2013-14)

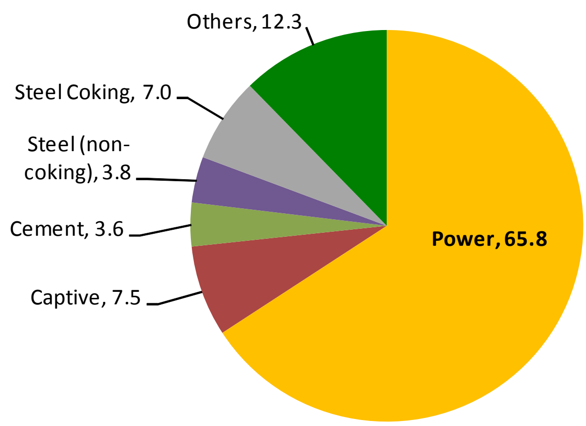


(2008-09-2013-14)



Source: RHP

Share of sectors in total coal demand (2013-14 Forecast)



Source: RHP

Domination from open cast mines:

CIL has 90% production from open cast mines and non-coking coal, around 10% of the production is from the underground mines while 90% comes from the open cast operations. CIL's 65% coal output comes from the top five coalfields viz, Korba, Singrauli, Talcher, IB Valley & Wardha Valley. 80% of output is sold to the power

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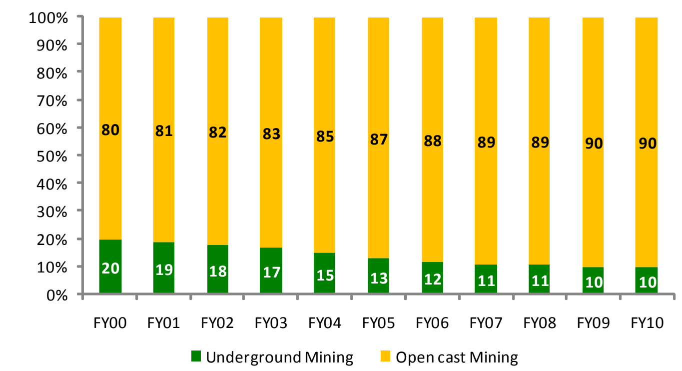
sector with steel and cement sectors accounting for 5% and 2% respectively. 90% of coal output is non-coking coal *(thermal coal)* while the balance 10% is coking coal. Most of CIL's coal is in E and F grade with low calorific value *(3600 – 4800 kcal/kg)*.

Production break-up (% of total production)



Source: RHP

Investment Thesis

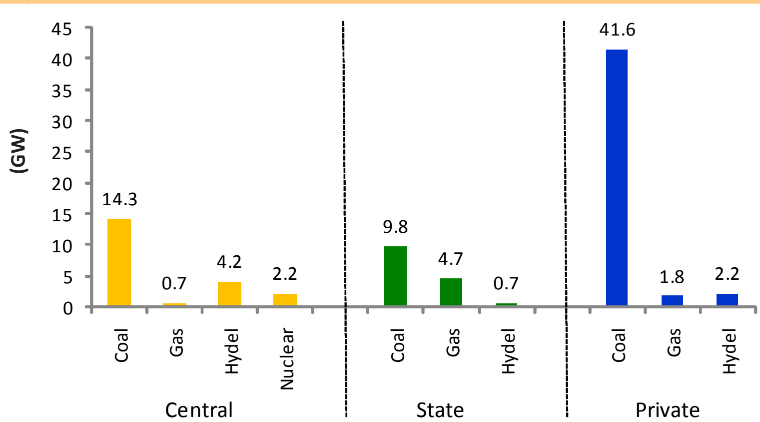
Demand driven by power sector

India's growing economy need support from power sector in this regard government of India has put more thrust on power development and increasing capacity. 70% of power capacity under construction of FY10 coal supply India had 84 GW of coal-based power generation capacity as at end-FY10. Additional work of 90 GW of plants is underway. Of this upcoming capacity, 39 GW is scheduled to be completed during the 11th Five-Year Plan period *(ending FY12)* and 51 GW for the 12th Plan ending FY17. The under construction capacity implies 396m tonnes of additional coal requirement, or 70% of India's FY10 coal production.

Installed Capacity as on March, 2010 (Figures in MW)								
		Thermal					R.E.S	
Sector	**Hydro**	**Coal**	**Gas**	**Diesel**	**Total**	**Nuclear**	**(MNRE)**	**Total**
State	27,065.00	44,977.00	4,046.12	602.61	49,625.73	0	2,701.12	79,391.85
Private	1,233.00	8,056.38	6,307.50	597.14	14,961.02	0	12,819.99	29,014.01
Central	8,565.40	31,165.00	6,702.23	0	37,867.23	4,560.00	0	50,992.63
Total	**36,863.40**	**84,198.38**	**17,055.85**	**1199.75**	**102,453.98**	**4,560.00**	**15,521.11**	**159,398.49**
% Total of production	23.10%	52.80%	10.70%	0.80%	64.30%	2.90%	9.70%	100.00%

Source: CEA, "Power Scenario at a Glance," April 2010)

Fuel-wise capacity additions (2011-2015)



Source: RHP

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Coal demand from steel sector

Coal consumption in the steel sector has increased over the years, however a substantial portion of coking coal comes from imports due to the low quality of coking coal in India. It is expected that the steel sector's total coal requirement add up to 60.5 m tones by 12th five year ending FY12-17 and translates to incremental demand of 20 m tonnes of coal by FY17.

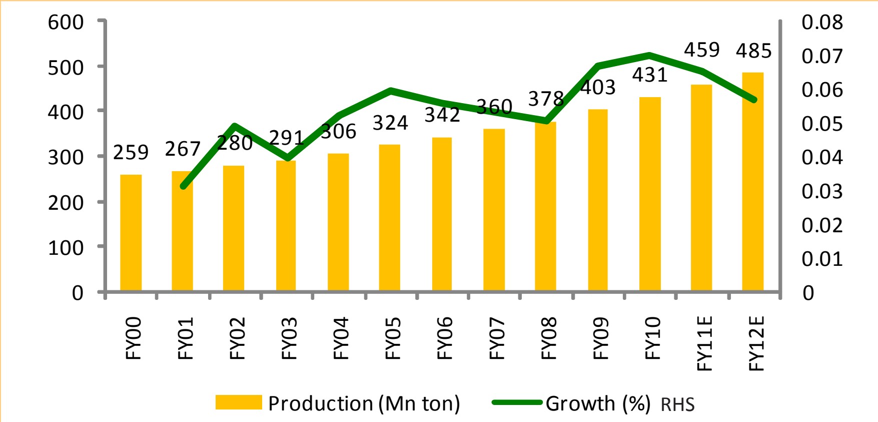
Demand from cement sector is increasing

Coal offtake in the cement industry increased from 13.6 million tonnes in fiscal 2004 to 15.3 million tonnes in fiscal 2009, which represented a growth of 3.1%. The offtake from the chemical, bricks and textiles industries during fiscal 2009 was 83.3 million tonnes, approximately 17% of the total offtake of coal. It is expected that India's annual cement production will register a CAGR of 7.8% over FY11-17, from 199 m tonnes in FY10 to 337m tonnes in FY17. At average specific consumption of coal at 0.125 mt, annual coal consumption for cement production will increase from 15m tonnes in FY10 to 32.4m tonnes in FY17.

Increasing production

As per the Annual Plan 2011 of the Ministry of Coal, CIL intends to increase production from 431m tonnes in FY10 to 461m tonnes in FY11 and further to 487m tonnes in FY12. The target is revised from 521m tonnes in FY12 to 487m tonnes, due to environmental issue and naxalite movement. CIL's production has grown at 5-8% over the last 15 years, despite the challenges relating to environment, land acquisition, naxalite movements, etc.

Production Growth



Source: RHP

Increasing Beneficiated-coal sales

The company is in process to increase the sales of beneficiated (commonly known as washeries) coal which has higher realization than the raw coal. Beneficiated coal prices over FY07-10 were 119–150% higher than raw-coal prices. Pricing of beneficiated non-coking coal is determined on cost-plus basis, whereas beneficiated coking coal is priced at import parity, with 15% discount to landed prices of comparative quality of imported coal.

Beneficiated-coal sales over FY07-10 have stagnated at 14-15mtpa. CIL plans to significantly ramp up production of beneficiated coal by setting up 20 facilities at a cost of Rs 23300 Mn, with raw feedstock capacity of 111mtpa by FY17, against current consumption of 20 mtpa of raw coal.

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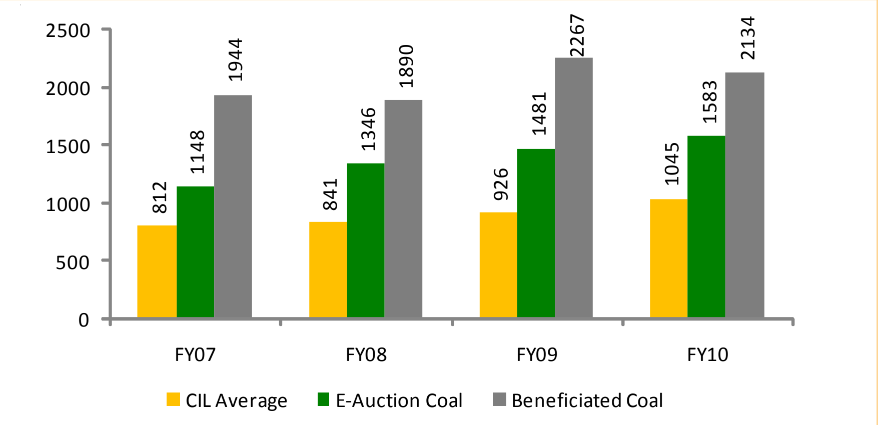
Realization (Rs./tonnes)

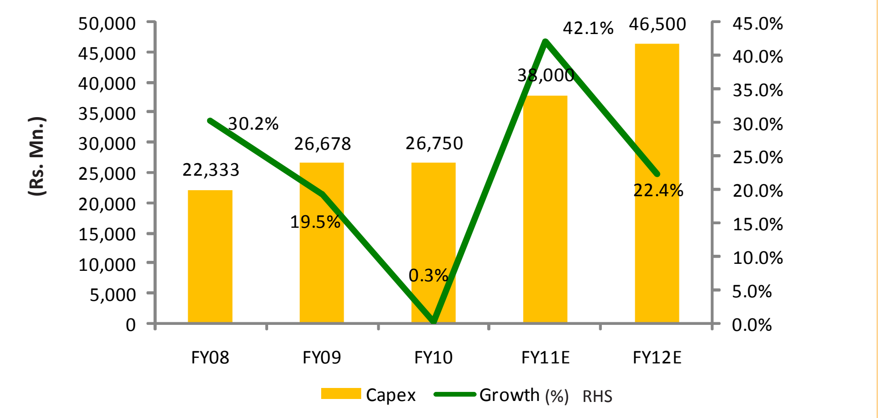


Source: RHP, Company

Capex to boost production

To increase its production CIL has outlined significant increase in planned capex for FY11 and FY12, after a flat growth in FY10. CIL's capex on exploration increased from Rs 988.8m in FY08 to Rs 1,738.6 m in FY09 and Rs 2,486.5 m in FY10.

Huge Capex Plan for next two years



Source: RHP

Price increase a sensitive issue

Going forward, we believe that, gap b/w the international and CIL coal price will narrow down

Coal prices in India have been deregulated and CIL became a nodal agency for any hike with consideration of GoI (Ministry of Coal) since 2000. Coal pricing is a sensitive issue especially given the monopoly situation, in the last 10 years, CIL has increased the prices of raw coal by just 5% CAGR. Thus, the impact has been far less than the movement in global coal prices. Also, most attempts to increase coal prices have been driven by cost push; price increases have merely passed on the cost increases to the consumers.

Risk

Operating in Naxalite area:

Large parts of India's coal reserves are located on the Eastern belt, which has seen significant increase in Naxalite movement. This can be a key challenge both in putting new mines into production by acquiring land and ramp-up in existing mines. 71% of CIL's extractable reserves are in three states, viz. Orissa, Jharkhand and Chattisgarh, which are affected by the Naxalite movement. The contribution of these states to FY10 production was 57%.

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Environment/forest clearances and land acquisition

CIL has been facing headwinds for its planned expansion, given delays in requisite environment/forest clearances. MoEF's classification of mining areas as "go" areas and "no-go" areas has impacted 619m tonnes of CIL's production potential and covers 44% of total mining area under CIL. While the MoEF has reviewed its classification of "no-go" areas, any subtle action on this front could delay CIL's ability to ramp-up production.

Valuation

International coal producers are trading at an average PE of 15.8x of annual earnings; Indian PSUs are trading at an average PE of 19.5x of annual earnings.

At the higher side of the price band i.e. Rs 245; the issue is available 15.7x its FY'10 EPS, indicating a discount of 19.5% and 36.7% to other Indian PSUs and international coal producers respectively.

	FY10		
Companies	**P/E**	**EV/EBITDA**	**RoE**
Consol Energy	15.9	8.74	20.29
China Shenhua Energy	16.4	8.40	19.9
China Coal Energy	15.73	8.50	15.17
Coal & Allied Industries	11.74	11.65	29.34
Coal India Ltd.	**15.7**	**10.30**	**38.04**

Source: Bloomberg, RHP

Alternative Methods

We assume terminal operating cash flow growth of 3% for both Total life of the mines and Life of extractable reserves of 50 and 150 years respectively. We have taken lower terminal growth rate considering all probable possibilities like increase staff cost and other expenses etc. We have assumed an equity discount rate of 11%-12%. On the basis of these elements, we estimate CIL's fair value between Rs 295 per share to Rs 300 per share.

	Value of Extractable Mines For 50 years	**Value of Total coal reserve For 150 years**
Total PV of FCFF Rs cr	148185	151564
Net Debt Rs cr	-38273	-38273.05
Net Value of equity (Rs cr)	186458	189837
Share Capital (nos cr)	632	632
Per Share Value (Rs)	**295**	**301**
Coal Reserve (cr Tonne)	6478.6	
considered for mining studies	3035.6	
not considered for mining studies	3443	
Extractable Reserve	2175.4	
Current Production	43.126	
Total Life of the mines (Yrs)	**150.2**	
Life of Extractable reserves (Yrs)	**50.4**	

Source: RHP; IndiaNivesh Research

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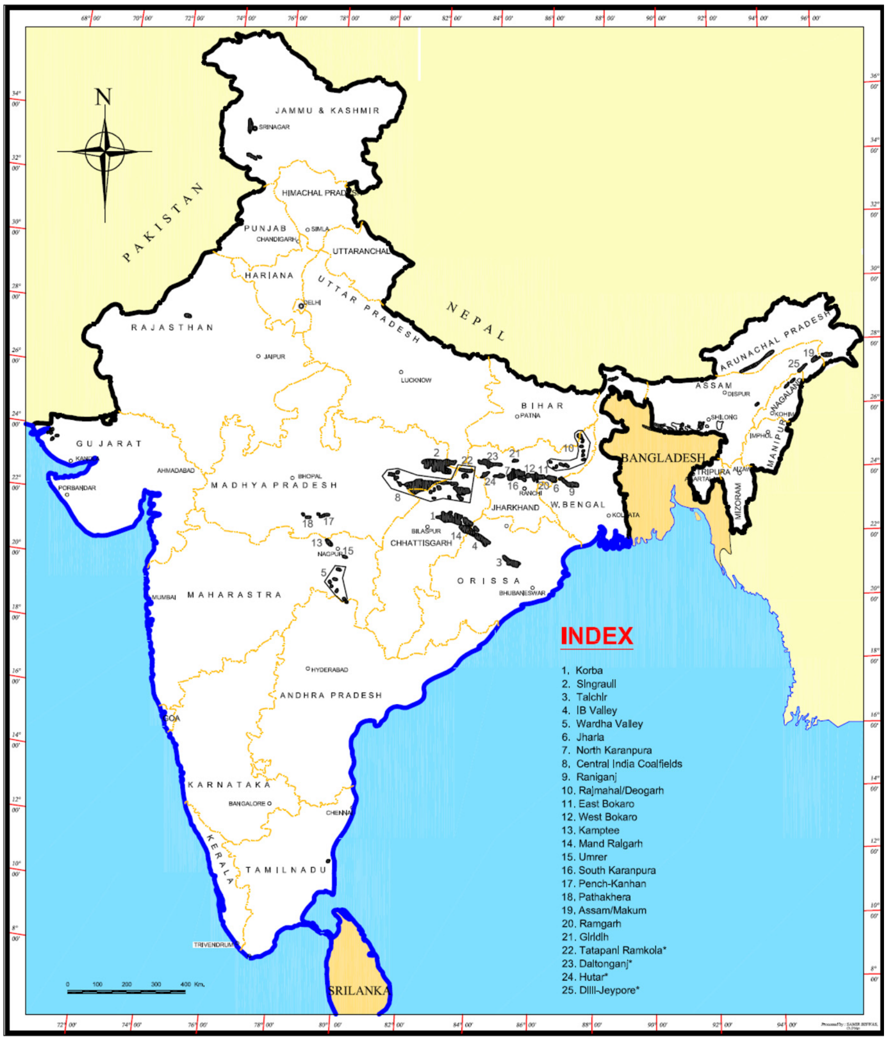
Coalfields and Mines



*Non-producing coalfields as of April 1, 2010

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