Coal | India

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BUY

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COMPANY QUICK COMMENT

India's Power Secretary has stated that Coal Ministry would allocate/divert some coal earmarked for e-auction to the power sector; offtake would be the onus of IPPs. Channel checks suggest: 1] A diktat is likely, but it would be effective for a short period, 2] Pricing of such 'diverted' coal is undecided, ie, it may be at notified prices. Our views: 1] the Coal Minister hinted this sale would fetch e-auction prices; arguably, the statement is a bit ambiguous, 2] Specifics awaited; 1% lower e-auction volume (as % of total sales) would lower CIL's FY12F normalised EPS by ~2.5%. Maintain BUY.

Price target: 433.0 INR | **Price (12 Oct 2011): 337.95 INR**

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Proposed diversion of e-auction coal – prima facie negative, quantum uncertain

EVENT

Press reports (Press Trust of India, Business Line, CNBC-TV18) cite the Power Secretary (Mr. P. Uma Shankar) stating that: [1] in the current year, given the shortage of coal, e-auction of coal should be resorted to after coal producers meet the requirement of the power sector, [2] the Coal Secretary has confirmed that the Coal Ministry will be able to spare some of the coal that would be sold through e-auctions, provided the developer picks up the coal from the pithead, and [3] modalities regarding the same will be worked out with the Coal Ministry in upcoming meetings.

Separately, in an interview with CNBC TV-18, the Minister of Coal (Mr. Sriprakash Jaiswal) has stated that: [1] Discussions with power ministry on the proposal will take place, [2] NTPC's request to get preference in securing coal via the e-auction is welcome and merited, and [3] preferential/earmarked supply of e-auction coal would continue to be at e-auction prices.

INPUTS from our CHANNEL-CHECKS

- Power Ministry's request to get access to part of the coal earmarked for e-auction (typically ~10% of coal dispatches during a year) is under deliberation; no formal notification has been issued yet.
- Any arrangement on diversion of e-auction coal would likely be for a short period (1-2 months) to make up the depletion in stockpiles and disruption in coal supply across the country in September due to excessive monsoon and workers' strike in Singareni Collieries (SCCL).
- Importantly, pricing of such additional coal to the power sector has not been decided ie, it could be at the notified price or a price discovered via the e-auction process.
- Offtake of such 'earmarked' coal would be the onus of the IPP – such coal will not be loaded in 'normal' dispatches under FSAs.

ANALYSIS

- In our view, a diktat on diversion of part of e-auction coal to the power sector is likely to be issued. However, the *quantum, tenure and pricing of such 'preferred' supply is ambiguous*, at this stage.
- We note that previous attempt (in May/June 2011) by the power sector lobbyists to halt/curb e-auction of coal by CIL was *more to 'gain access' to the coal, rather than to 'pay notified price and not e-auction price'* for the coal
- We understand that in the normal course as well, substantial offtake of e-auction coal is directed towards the power sector. Lobbying by non-regulated sectors (cement, steel, sponge iron & others) which necessarily have to procure coal via e-auction would oppose any long-term move to earmark more e-auction coal for the power sector.
- Typically, 80% of coal sold via e-auction is evacuated via road, which rules out transportation over long distances. Logistics constraint, specifically relating to offtake via railways, would remain the critical bottleneck for the power sector to access the incremental earmarked e-auction coal.

IMPLICATIONS

Prima facie, diktat to divert/allocate part of e-auction coal likely to be negative for CIL…

Based on inputs from our channel checks, there is a reasonable probability that Coal Ministry's move to divert/allocate part of e-auction coal will dent CIL's earnings – the magnitude would vary depending upon the quantum, tenure and pricing of such preferential supply arrangement.

…unless offtake continues to fetch e-auction determined prices

On close examination, the Coal Minister's statement is a bit ambiguous i.e. it is not clear if it pertains only to NTPC's proposed preferential status in e-auction sales or to the overall 'preferential sale of e-auction coal to the power sector'. We do note that there would still be a risk of e-auction based prices for this 'earmarked' coal being lower than currently envisaged by the Street on the premise that the number of bidders would be lower. On the flip side, the quantum of coal available to be sold via e-auction to non-power sectors may well fetch higher realisations.

e-auction realisation/offtake for CIL – What we assume? What was reported in 1QFY12?
We expect revenues from e-auction sales to comprise 16.7%/17.5% of CIL's total revenues in FY12F/FY13F. Our FY12/FY13 earnings forecast for CIL assumes [1] e-auction sales as a %age of total raw coal sales at 11.5%, and [2] e-auction realisation at Rs2090/ton (66% premium over blended notified price of Rs1261/ton) for FY12 and Rs2260/ton (75% premium over blended notified price) for FY13. In this context, CIL reported e-auction realisation at Rs2246/ton (89% premium over the blended notified price of Rs1188/ton) for 1QFY12; quantity sold via e-auction was 12.7% of raw coal sales.

1% lower e-auction volume (as % of total sales) would lower normalised EPS by 2.5-3%
Ceteris paribus, if quantum of coal sold via e-auction (as a % of raw coal sales) drops by 1% for the year, our FY12F/13F EPS for CIL would be lower by 2.5-3%; if realisation via e-auction is lower by 10% for the year, our FY12F/13F EPS would be lower by ~5%. Put another way, if 10mt of coal (~80% of the implied FY12F average e-auction sales volume for a quarter) is sold at notified price rather than via e-auction, our FY12F normalised EPS forecast would be lower by 6-7%.

Exhibit 1: CIL – EPS sensitivity to 1% variation in key variables

	FY12F	FY13F	FY14F
Volumes	1.6%	1.7%	1.7%
Offtake	2.9%	2.5%	2.5%
Blended ASP	3.3%	2.8%	2.8%
E-auction coal (as % of raw coal sold)	2.4%	2.3%	2.4%
Employee cost	-1.1%	-1.0%	-1.0%
Realisation of e-auction coal	0.5%	0.5%	0.5%
Realisation of washed coal	0.2%	0.2%	0.2%

Source: Nomura estimates

Structural growth story remains intact; maintain BUY
We remain focused on CIL's capacity to make-up for the shortfall in 1HFY12 production/offtake (following the sharper-than-expected monsoon-related slowdown in production / dispatches) and potential magnitude of wage revision – key risks to our FY12F/13F earnings forecast for the company. Maintain BUY; stock trades at 12.5x FY13F P/E.

Valuation Methodology and Investment Risks: Please see below.

Note: Ratings and Price Targets are as of the date of the most recently published report (http://go.nomuranow.com/research/globalresearchportal) rather than the date of this email.

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Issuer Specific Regulatory Disclosures

Mentioned companies

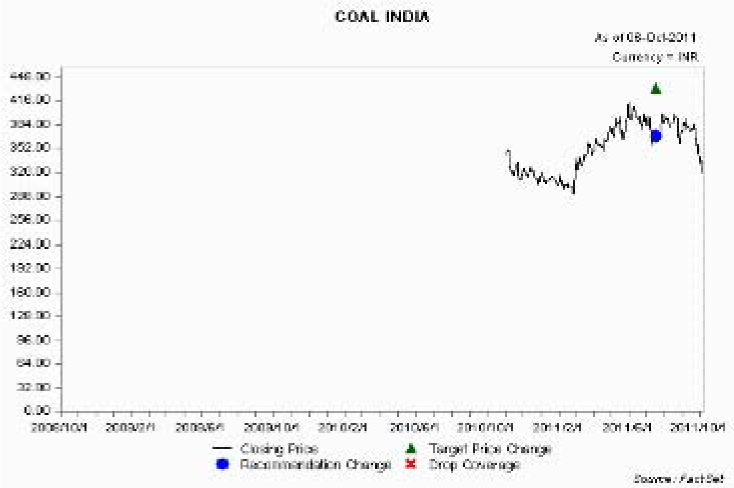
Issuer name	Ticker	Price	Price date	Stock rating	Disclosures
Coal India	COAL IN	337.95 INR	12 Oct 2011	Buy	

Previous Rating

Issuer name	Previous Rating	Date of change
Coal India	Not Rated	18 Jul 2011

Coal India (COAL IN) **337.95 INR (12 Oct 2011)** Buy

Rating and target price chart (three year history)



Date	Rating	Target price	Closing price
18-Jul-2011		433.00	368.85
18-Jul-2011	Buy		368.85

For explanation of ratings refer to the stock rating keys located after chart(s)

Valuation Methodology We arrive at our Rs433/share 12-mth target price for CIL using a sum-of-the-parts of [1] FCFF-based methodology to value the cash flows from its 10.6bn tons of proven reserves, and [2] EV/ton based value of CIL's probable reserves (8.3bn tons) and remaining resources (45.5bn tons) as per the JORC Code.

Risks that may impede the achievement of the target price Key risks: 1) Regulatory uncertainty particularly around pricing flexibility, environmental/forest clearance and restriction on e-auction coal sales; 2) lower-than-expected coal despatch due to lower rake availability; 3)delays in land acquisition/possession; and 4) wage revision of non-executives is higher than our expectation of a 30% increase.

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Explanation of Nomura's equity research rating system for Asian companies under coverage ex Japan published prior to 30 October 2008

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