

31 May 2011

Produced by: The Royal Bank of Scotland N.V., (India) Office

Coal India

Monopolistic constraints

Sell

Target price
Rs315.00 (from Rs290.00)

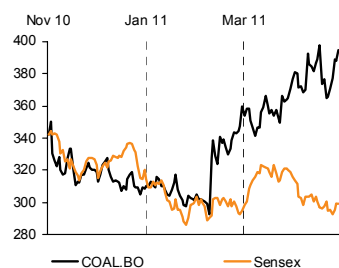
Price
Rs394.95

Short term (0-60 days)
n/a

Market view
Underweight

Price performance

	(1M)	(3M)	(12M)
Price (Rs)	380.5	327.7	n/a
Absolute (%)	3.8	20.5	n/a
Rel market (%)	8.9	17.8	n/a
Rel sector (%)	2.7	15.1	n/a



Market capitalisation
Rs2.49t (US\$55.24bn)

Average (12M) daily turnover
Rs3985.03m (US\$88.65m)

Sector: BBG AP Mining
RIC: COAL.BO, COAL.IN
Priced Rs394.95 at close 30 May 2011.
Source: Bloomberg

Analyst

Rahul Jain
India
+91 22 6715 5305
rahul.k.jain@rbs.com

83/84 Sakhar Bhawan, Nariman Point,
Mumbai 400 021, India

<http://research.rbsm.com>

Near-complete control over the domestic coal supply brings with it a strong sense of responsibility. Correctly pricing coal is a contentious issue and further price increases appear limited in the near term, even as evacuation issues and wage hikes take centre-stage. Maintain Sell with a new target price of Rs315.

Key forecasts

	FY09A	FY10A	FY11F	FY12F	FY13F
Revenue (Rsm)	387,888	446,153	502,336	604,358	668,832
EBITDA (Rsm)	69,094	137,450	166,755 ▲	191,604 ▲	217,650 ▲
Reported net profit (Rsm)	40,626	98,337	108,674	125,665	142,506
Normalised net profit (Rsm) ¹	41,086	96,436	109,275	125,665	142,506
Normalised EPS (Rs)	6.50	15.30	17.30	19.90	22.60
Dividend per share (Rs)	2.70	3.50	3.90 ▼	4.97	5.64
Dividend yield (%)	0.68	0.89	0.99	1.26	1.43
Normalised PE (x)	60.70	25.90	22.80	19.90	17.50
EV/EBITDA (x)	32.10	15.50	12.30	10.70	8.93
Price/book value (x)	13.10	9.65	7.49	5.91	4.77
ROIC (%)	-310	-145	-134	-158	-732

Use of ▲ ▼ indicates that the line item has changed by at least 5%.

year to Mar, fully diluted

1. Post-goodwill amortisation and pre-exceptional items

Accounting standard: Local GAAP

Source: Company data, RBS forecasts

Working backwards

Our recent interaction with Coal India indicated that the company works backwards. As long as a reasonable EBITDA margin is being generated, which also allows for a reasonable growth, we believe prices will not be disturbed. Owing to the near-monopolistic status of the domestic coal supply scenario, price increases happen after taking into account the concerns of the various stakeholders involved. According to the company, the price increase in February 2011 should ensure topline growth of US\$1.4bn and would be able to absorb a large part of the wage increase due in July 2011, and hence further increases may not be necessary. Besides, as a policy the company is not keen to tinker with prices more than once in two years.

Evacuation concerns dominate

At the analyst briefing on 28 May, the company reiterated its FY12 production target of 452mt and an offtake target of 454mt during the 4QFY11. As an internal goal, the company also hopes to evacuate 20mt of net inventory from 70mt at end FY11. The 30mt incremental offtake volume is contingent on 20mt incremental offtake from railways, assuming offtake by road increases by 10% and accounts for the remaining 10mt. This translates to a requirement of about 15 additional rakes/day. Average rake availability was 162/day in FY11 and 157/day in FY10. We note coal movement by rail has increased by an average of only 2% pa during the past three years. We estimate offtake of 448mt/468mt over FY12/13.

We fine-tune model estimates, maintain Sell

We increase FY12/13F average realisations by 3% to Rs1,370/t and Rs1,452/t, respectively. We increase our operating cost assumptions by 4-5% to factor in higher contractual and overhead expenses. Our FY12/13 EBITDA estimates increase by 7%. Accordingly, our new DCF-based target price is Rs315 (from Rs290). We note the stock is trading at 10.4x/8.7x FY12/13F EV/EBITDA, a significant premium to its global peers. We maintain Sell.

Important disclosures can be found in the Disclosures Appendix.

4QFY11 analyst meet highlights

The following are the key takeaways from Coal India 4QFY11 analyst briefing on 28 May 2011.

- Average realisation of raw coal jumped 15% qoq in 4QFY11 to Rs1,316/t. This was driven by 1) booking of a bonus earned through deliveries beyond 90% of fuel supply agreements (FSAs), which had an impact of Rs6.7bn; 2) booking of the negotiated increase in the price of coking coal supplied to SAIL, from Rs6000/t to Rs7000/t, which had an impact of Rs4bn; and 3) the one-month impact of the end-February price hike.
- Rake availability improved substantially in April (about 180 rakes/day), which led to 9% offtake growth yoy. However, offtake was down mom in May due to law and order issues in Jharkhand that affected some of the major coal fields.
- The movement of coal from pit head to railway head has also been constrained in the past due to a delay in finalising contractors for transportation. The company expects this issue to ease going forward.
- Capital expenditure was Rs25bn for FY11; budgeted capital expenditure for FY12 is Rs45bn.
- Coal delivered to power utilities was 304mt in FY11 and 347mt is being offered in FY12. Of this, 306mt is for plants through FSAs signed before 31 March 2009 and the balance of 41mt is for new plants commissioned post 2009 at 50% FSA.
- The company's practice of providing for overburden removal (OBR) could be halted in FY12 as it moves towards IFRS. We note our adjusted EBITDA already excludes OBR provisions.

Key forecasts and assumptions

Table 1 : Key forecasts and assumptions

	FY08	FY09	FY10	FY11	FY12F	FY13F
Raw coal production (mt)	379	404	431	431	450	468
Raw coal dispatch (mt)	375	401	415	424	448	468
Raw coal sold (mt)	354	379	394	402	422	440
Beneficiated coal sold (mt)	14	15	15	16	18	20
Total coal sold (mt)	368	394	409	418	440	460
Avg realisation of raw coal (Rs/t)	841	927	1,048	1,183	1,322	1,401
Avg realisation of beneficiated coal (Rs/t)	1,890	2,267	2,134	2,348	2,489	2,563
Avg realisation of all coal (Rs/t)	886	984	1,091	1,227	1,370	1,452

Source: Company data, RBS forecasts

Table 2 : RBS vs consensus

	RBS estimates		Bloomberg estimates		Difference	
	FY12F	FY13F	FY12F	FY13F	FY12F	FY13F
Revenues (R\$bn)	604.4	668.8	602.9	665.6	0%	0%
Adj. EBITDA (R\$bn)	191.6	217.6	179.9	205.6	6%	6%
Net profit (R\$bn)	125.7	142.5	141.5	162.9	-11%	-13%
EPS (Rs)	19.9	22.6	22.5	25.6	-11%	-12%
BVPS	66.8	82.8	68.8	87.0	-3%	-5%
ROAE	33%	30%	36%	32%	-232bp	-211bp

Source: RBS forecasts, Bloomberg consensus forecasts

Table 3 : Key forecast changes

	RBS estimates		Prior estimates		Difference	
	FY12F	FY13F	FY12F	FY13F	FY12F	FY13F
Revenues (R\$bn)	604.4	668.8	587.1	650.4	3%	3%
Adj. EBITDA (R\$bn)	191.6	217.6	178.3	204.1	7%	7%
Net profit (R\$bn)	125.7	142.5	121.8	136.9	3%	4%
EPS (Rs)	19.9	22.6	19.3	21.7	3%	4%
BVPS (Rs)	66.8	82.8	66.3	81.6	1%	2%
ROAE	33%	30%	32%	29%	127bps	115bps

Source: RBS forecasts

Table 4 : Peer valuation

Company	Bloomberg code	27 May 11 price (LC)	Market cap (US\$m)	P/B (x)			P/E (x)			EV/EBITDA (x)		
				FY10A	FY11F	FY12F	FY10A	FY11F	FY12F	FY10A	FY11F	FY12F
Coal India	COAL IN	387.9	54,250	7.4	5.8	4.7	22.4	19.5	17.2	12.0	10.4	8.7
China Shenhua	1088 HK	37.2	85,747	3.3	2.7	2.2	17.5	13.1	11.7	8.6	7.1	6.2
China Coal Energy	1898 HK	10.1	19,302	1.6	1.4	1.2	15.8	11.1	8.4	6.3	5.2	4.4
Yanzhou Coal	1171 HK	30.6	22,496	3.5	2.8	2.3	18.0	10.7	11.7	10.6	6.5	6.6
Peabody*	BTU US	61.6	16,417	3.6	2.9	2.2	21.0	13.6	10.3	9.9	7.4	5.9
Consol Energy*	CNX US	50.8	11,309	3.5	3.2	2.7	22.6	17.3	11.4	10.8	8.6	6.5
Average				3.1	2.6	2.1	19.0	13.2	10.7	9.2	7.0	5.9

Note: Coal India corresponds to FY11-FY13.

* Peabody and Consol energy using Bloomberg consensus estimates.

Source: RBS estimates, Bloomberg

Income statement

Rsm	FY09A	FY10A	FY11F	FY12F	FY13F
Revenue	387888	446153	502336	604358	668832
Cost of sales	-46979	-41628	-39781	-54103	-59686
Operating costs	-271816	-267074	-295800	-358651	-391495
EBITDA	69094	137450	166755	191604	217650
DDA & Impairment (ex gw)	-16376	-13236	-16729	-17696	-21939
EBITA	52718	124214	150026	173908	195711
Goodwill (amort/impaird)	n/a	n/a	n/a	n/a	n/a
EBIT	52718	124214	150026	173908	195711
Net interest	-1789	-1560	-790.6	-1088	-1084
Associates (pre-tax)	n/a	n/a	n/a	n/a	n/a
Forex gain / (loss)	n/a	n/a	n/a	n/a	n/a
Exceptionals (pre-tax)	-459.3	1901	-601.8	0.00	0.00
Other pre-tax items	27665	19776	15999	20510	18069
Reported PTP	78135	144331	164632	193331	212695
Taxation	-37509	-45994	-55959	-67666	-70190
Minority interests	n/a	n/a	n/a	n/a	n/a
Exceptionals (post-tax)	n/a	n/a	n/a	n/a	n/a
Other post-tax items	0.00	0.00	0.00	0.00	0.00
Reported net profit	40626	98337	108674	125665	142506
Normalised Items Excl. GW	-459.3	1901	-601.8	0.00	0.00
Normalised net profit	41086	96436	109275	125665	142506

Source: Company data, RBS forecasts

year to Mar

Balance sheet

Rsm	FY09A	FY10A	FY11F	FY12F	FY13F
Cash & market secs (1)	296950	390778	458623	464748	565519
Other current assets	172414	152466	185337	202826	213879
Tangible fixed assets	129283	142416	150610	189269	217538
Intang assets (incl gw)	n/a	n/a	n/a	n/a	n/a
Oth non-curr assets	24600	22496	19403	19403	19403
Total assets	623247	708156	813973	876246	1016339
Short term debt (2)	n/a	n/a	n/a	n/a	n/a
Trade & oth current liab	399423	413825	448725	422018	461198
Long term debt (3)	21485	20869	15536	15486	15436
Oth non-current liab	12238	14774	16214	16214	16214
Total liabilities	433147	449468	480475	453717	492848
Total equity (incl min)	190101	258689	333498	422529	523491
Total liab & sh equity	623247	708156	813973	876246	1016339
Net debt	-275465	-369909	-443087	-449262	-550083

Source: Company data, RBS forecasts

year ended Mar

Cash flow statement

Rsm	FY09A	FY10A	FY11F	FY12F	FY13F
EBITDA	69094	137450	166755	191604	217650
Change in working capital	54307	22183	-21025	-74587	-5239
Net interest (pd) / rec	-1789	-1560	-790.6	-1088	-1084
Taxes paid	-27907	-39990	-55959	-67666	-70190
Other oper cash items	23489	14943	48367	45633	52312
Cash flow from ops (1)	117194	133026	137347	93897	193449
Capex (2)	-18746	-19804	-36093	-50000	-50000
Disposals/(acquisitions)	0.00	0.00	0.00	0.00	0.00
Other investing cash flow	2127	2230	0.00	0.00	0.00
Cash flow from invest (3)	-16619	-17573	-36093	-50000	-50000
Incr / (decr) in equity	0.00	0.00	0.00	0.00	0.00
Incr / (decr) in debt	2646	-616.3	-5333	-49.5	-50.0
Ordinary dividend paid	-17054	-22100	-28725	-36635	-41544
Preferred dividends (4)	n/a	n/a	n/a	n/a	n/a
Other financing cash flow	1169	1091	648.8	-1088	-1084
Cash flow from fin (5)	-13239	-21625	-33410	-37772	-42678
Forex & disc ops (6)	n/a	n/a	n/a	n/a	n/a
Inc/(decr) cash (1+3+5+6)	87335	93828	67845	6125	100771
Equity FCF (1+2+4)	98447	113222	101255	43897	143449

Lines in bold can be derived from the immediately preceding lines.
Source: Company data, RBS forecasts

year to Mar

Standard ratios	Coal India					China Coal Energy			China Shenhua Energy		
Performance	FY09A	FY10A	FY11F	FY12F	FY13F	FY11F	FY12F	FY13F	FY11F	FY12F	FY13F
Sales growth (%)	18.9	15.0	12.6	20.3	10.7	18.0	18.0	5.51	28.5	22.5	16.7
EBITDA growth (%)	-1.12	98.9	21.3	14.9	13.6	25.6	25.4	5.72	18.9	8.63	13.9
EBIT growth (%)	-4.24	135.6	20.8	15.9	12.5	25.3	25.9	1.17	21.3	8.71	15.4
Normalised EPS growth (%)	-1.67	134.7	13.3	15.0	13.4	35.0	26.5	0.09	26.1	8.08	13.9
EBITDA margin (%)	17.8	30.8	33.2	31.7	32.5	22.0	23.3	23.4	42.5	37.7	36.8
EBIT margin (%)	13.6	27.8	29.9	28.8	29.3	16.7	17.8	17.1	35.1	31.1	30.8
Net profit margin (%)	10.6	21.6	21.8	20.8	21.3	12.2	13.0	12.4	23.9	21.1	20.6
Return on avg assets (%)	-1.47	6.85	8.16	8.43	9.35	8.47	9.72	9.05	15.1	14.7	15.1
Return on avg equity (%)	22.7	43.0	36.9	33.3	30.1	12.9	14.7	13.2	21.7	20.4	20.4
ROIC (%)	-310.7	-145.5	-134.9	-158.7	-732.1	14.3	15.5	13.3	24.5	23.7	25.9
ROIC - WACC (%)	-323.7	-158.5	-147.9	-171.7	-745.1	4.40	5.59	3.44	14.6	13.9	16.0
				year to Mar			year to Dec			year to Dec	
Valuation											
EV/sales (x)	5.72	4.76	4.08	3.38	2.91	1.18	1.05	0.97	3.08	2.40	1.94
EV/EBITDA (x)	32.1	15.5	12.3	10.7	8.93	5.39	4.49	4.16	7.26	6.39	5.27
EV/EBITDA @ tgt price (x)	24.8	11.8	9.27	8.04	6.61	6.23	5.16	4.79	8.05	7.11	5.91
EV/EBIT (x)	42.1	17.1	13.7	11.8	9.94	7.09	5.88	5.69	8.79	7.73	6.29
EV/invested capital (x)	n/m	n/m	n/m	n/m	n/m	1.15	1.02	0.93	2.40	2.17	1.93
Price/book value (x)	13.1	9.65	7.49	5.91	4.77	1.38	1.23	1.12	2.68	2.36	2.07
Equity FCF yield (%)	3.95	4.54	4.06	1.76	5.75	-1.00	-1.25	5.29	5.72	7.28	8.83
Normalised PE (x)	60.7	25.9	22.8	19.9	17.5	11.2	8.86	8.86	13.3	12.3	10.8
Norm PE @tgt price (x)	48.4	20.6	18.2	15.8	14.0	12.7	10.1	10.1	14.7	13.6	11.9
Dividend yield (%)	0.68	0.89	0.99	1.26	1.43	2.68	3.38	3.39	3.01	3.25	3.70
				year to Mar			year to Dec			year to Dec	
Per share data	FY09A	FY10A	FY11F	FY12F	FY13F	Solvency	FY09A	FY10A	FY11F	FY12F	FY13F
Tot adj dil sh, ave (m)	6316	6316	6316	6316	6316	Net debt to equity (%)	-144.9	-143.0	-132.9	-106.3	-105.1
Reported EPS (INR)	6.43	15.6	17.2	19.9	22.6	Net debt to tot ass (%)	-44.2	-52.2	-54.4	-51.3	-54.1
Normalised EPS (INR)	6.50	15.3	17.3	19.9	22.6	Net debt to EBITDA	-3.99	-2.69	-2.66	-2.34	-2.53
Dividend per share (INR)	2.70	3.50	3.90	4.97	5.64	Current ratio (x)	1.18	1.31	1.44	1.58	1.69
Equity FCF per share (INR)	15.6	17.9	16.0	6.95	22.7	Operating CF int cov (x)	82.1	111.9	245.5	149.6	244.2
Book value per sh (INR)	30.1	40.9	52.7	66.8	82.8	Dividend cover (x)	1.82	3.28	3.80	3.43	3.43
				year to Mar						year to Mar	

Priced as follows: COAL.BO - Rs394.95; 1898.HK - HK\$10.22; 1088.HK - HK\$37.45
Source: Company data, RBS forecasts

Valuation methodology

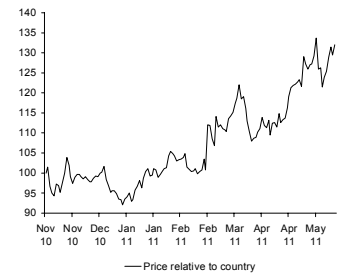
DCV valuation	Rsbn
PV of cash flows of explicit period (2012-15F)	224
PV of cash flows of second stage (2016-30F)	782
PV of terminal value	267
Enterprise value	1,272
Net debt	(460)
Equity value	1,732
Wtd avg number of shares (m)	6.316
Estimated DCF value per share	274
Premium*	15%
Estimated value per share (Rs)	315
Target price(Rs)	315

* We apply a premium to our DCF valuation to account for: 1) a pricing differential with international peers; and 2) substantial reserves.
Source: RBS forecasts

Company description

Sell Price relative to country

Coal India is the world's largest coal producer with annual output of more than 400mt. It has reserves of about 18bn tonnes, which at the current level of output would last more than 40 years. Coal India sells mainly power-grade coal that is characterised by low calorific value and high ash content. The pricing for coal has a low correlation with international prices and is revised once every two years. There is very low geographical diversification, with almost all of the coal being produced and sold in India. Coal India has a near-monopoly status, with more than 80% market share.



Strategic analysis

Average SWOT company score: 3

Revenue breakdown, FY10

Strengths 4

Coal India enjoys a near-monopoly status, with more than 80% market share. Coal markets continue to be regulated and new allottees are allowed to mine coal only for captive consumption.

Weaknesses 3

Heavy reliance on open cast mining, which requires continuous land purchases and a series of environmental and forest clearances. The clearances can take more than 5-10 years to come through and pose a serious challenge to achieving volume growth.

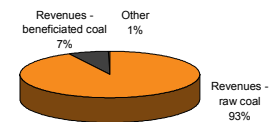
Opportunities 3

Coal India has large cash reserves of more than US\$9bn that could be used to acquire assets, especially coking coal assets in overseas locations, which would both increase geographical diversity and reduce concentration on a single market.

Threats 1

The mining sector looks set for an overhaul, with the introduction of a new mining act that, among other things, calls for sharing 26% of profits with locally displaced persons and would sharply affect profitability.

Scoring range is 1-5 (high score is good)



Source: Company data

Market data

Headquarters
10 Netaji Subhas Road, Kolkata, West Bengal
700 001, India

Website
www.coalindia.in

Shares in issue
6316.4m

Freefloat
10%

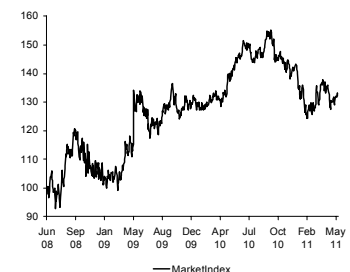
Majority shareholders
President of India (90%)

Country view: India

Country rel to Asia Pacific

The Indian market over the past four to five months has begun to reflect some of its fundamental headwinds, effectively products of overheating and a lack of structural reform. We increasingly suspect that the economy will return to its historical range of 6.5-7.5% growth and we believe equities could see a similar valuations de-rating in the years ahead.

The country view is set in consultation with the relevant company analyst but is the ultimate responsibility of the Strategy Team.



Competitive position

Average competitive score: 2-

Broker recommendations

Supplier power 2-

Coal India is the largest supplier of coal to the Indian power sector. However, Coal India's output growth has been lagging growth in demand, resulting in increased imports.

Barriers to entry 1-

The Government of India has been moving towards deregulation of the coal sector to meet growing demand, but it will take several years for any meaningful competition to emerge.

Customer power 2+

With Coal India being unable to match the growth in demand, the availability of coal in the domestic market has worsened.

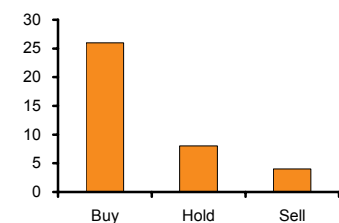
Substitute products 2+

Oil and gas are substitutes for coal as energy sources. However, prices for these alternatives are substantially higher and would require large-scale imports.

Rivalry 1-

Coal India has a dominant position in the Indian coal industry and most new entrants have yet to establish themselves.

Scoring range 1-5 (high score is good) Plus = getting better Minus = getting worse



Source: Bloomberg

Recommendation structure

Absolute performance, short term (trading) recommendation: A Trading Buy recommendation implies upside of 5% or more and a Trading Sell indicates downside of 5% or more. The trading recommendation time horizon is 0-60 days. For Australian coverage, a Trading Buy recommendation implies upside of 5% or more from the suggested entry price range, and a Trading Sell recommendation implies downside of 5% or more from the suggested entry price range. The trading recommendation time horizon is 0-60 days.

Absolute performance, long term (fundamental) recommendation: The recommendation is based on implied upside/downside for the stock from the target price and, except as follows, only reflects capital appreciation. A Buy/Sell implies upside/downside of 10% or more and a Hold less than 10%. For UK-based Investment Funds research, the recommendation structure is not based on upside/downside to the target price. Rather it is the subjective view of the analyst based on an assessment of the resources and track record of the fund management company. For research on Australian listed property trusts (LPT) or real estate investment trusts (REIT), the recommendation is based upon total return, ie, the estimated total return of capital gain, dividends and distributions received for any particular stock over the investment horizon.

Performance parameters and horizon: Given the volatility of share prices and our pre-disposition not to change recommendations frequently, these performance parameters should be interpreted flexibly. Performance in this context only reflects capital appreciation and the horizon is 12 months.

Market or sector view: This view is the responsibility of the strategy team and a relative call on the performance of the market/sector relative to the region. Overweight/Underweight implies upside/downside of 10% or more and Neutral implies less than 10% upside/downside.

Target price: The target price is the level the stock should currently trade at if the market were to accept the analyst's view of the stock and if the necessary catalysts were in place to effect this change in perception within the performance horizon. In this way, therefore, the target price abstracts from the need to take a view on the market or sector. If it is felt that the catalysts are not fully in place to effect a re-rating of the stock to its warranted value, the target price will differ from 'fair' value.

Distribution of recommendations

The tables below show the distribution of recommendations (both long term and trading). The first column displays the distribution of recommendations globally and the second column shows the distribution for the region. Numbers in brackets show the percentage for each category where there is an investment banking relationship. These numbers include recommendations produced by third parties with which RBS has joint ventures or strategic alliances.

Long term recommendations (as at 31 May 2011)

	Global total (IB%)	Asia Pacific total (IB%)
Buy	788 (13)	512 (3)
Hold	410 (7)	227 (2)
Sell	90 (2)	56 (0)
Total (IB%)	1288 (10)	795 (2)

Source: RBS

Trading recommendations (as at 31 May 2011)

	Global total (IB%)	Asia Pacific total (IB%)
Trading Buy	3 (0)	3 (0)
Trading Sell	2 (0)	2 (0)
Total (IB%)	5 (0)	5 (0)

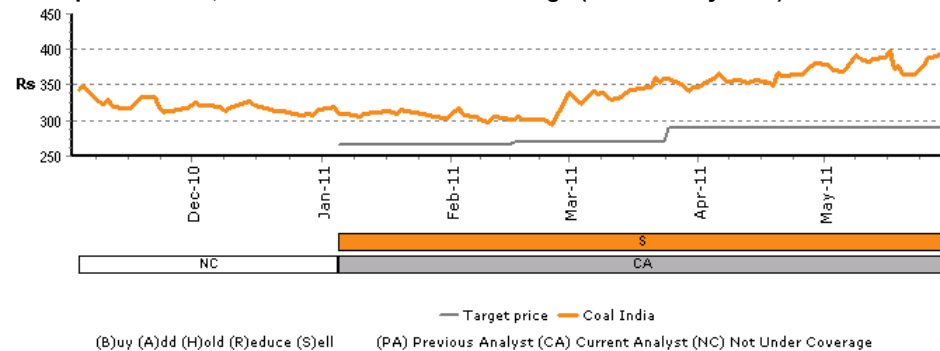
Source: RBS

Valuation and risks to target price

Coal India (RIC: COAL.BO, Rec: Sell, CP: Rs394.95, TP: Rs315.00): We apply a premium to our DCF valuation to account for: 1) a pricing differential with international peers; and 2) substantial reserves. Key upside risks are higher volume and realisation growth than expected. Key downside triggers could be higher-than-expected regulatory costs, and implementation of a high mining profit-sharing tax and a delay in the next notified price hike. Also, the new mining act calls for a 26% profit-sharing with locals, which could have an impact on earnings and valuations.

Coal India coverage data

Stock performance, recommendations and coverage (as at 30 May 2011)



Trading recommendation history (as at 31 May 2011)

Date	Rec	Analyst
	n/a	

Source: RBS

Rahul Jain started covering this stock on 4 Jan 11. Moved to new recommendation structure between 1 November 2005 and 31 January 2006. Source: RBS

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