Coal India Ltd. (CIL) – Q3FY12 results higher-than-expectations; recent PMO directive not as bad as it seems; maintain Accumulate rating with a revised target price of ₹367

Rating	CMP	Target	Upside / Downside %
Accumulate	322.2	367	13.9

Source: NSE, ABML Research

Coal India Ltd. (CIL) Q3FY12 results were above our expectations on account of higher-than-expected realisations from e-auction sales

Key Highlights

- CIL's consolidated net sales grew 21.0% YoY to ₹15.3bn. Production increased 0.7% YoY to 114.6mn tonnes. Dispatch declined 0.5% YoY to 110.0 mn tonnes. The YoY increase in net sales was on account of the price increases taken in February 2011 and higher realisations from e-auction coal sales. **E-auction coal realisations increased 17.1% QoQ to ₹2852 per tonne**
- CIL's consolidated EBITDA grew 33.6% YoY to ₹45.5bn on account of increase in coal realisations. Provisioning for wages were to the tune of ₹7.5bn
- CIL's consolidated adjusted PAT grew 53.4% YoY to ₹40.3b on account of higher EBITDA and non-operating income. Non-operating income increased 48.4% YoY to ₹18.6bn.

Outlook and Valuations

- **Revise FY12E EPS upwards and FY13E EPS downwards:** On account of less-than expected coal production and sales volume for 9MFY12 (production decline of 2.7% to 291.2mn tonnes and almost flattish sales of 299.6mn tonnes), we reduce our production and sales volume assumptions for FY12E by 2.0% and 4.6% to 427mn tonnes and 433mn tonnes respectively. On account of higher-than-expected e-auction realisations, though, our adjusted FY12E EPS increases by 3.2% to ₹23.7. For FY13E, we reduce our production volume assumption by 2% to 448mn tonnes and slightly increase our sales volume assumption by 0.2% to 466mn tonnes. On account of lower e-auction sales, though, our FY13E EPS decreases by 4.4% to ₹26.9.
- **Recent PMO directive to sign FSA's with LoA based power projects at 80% penalty trigger level is not as bad as it seems:** We estimate incremental coal supply obligation from the PMO's directive for CIL at ~62.3mn tonnes for FY13E. We believe that CIL would be able to meet it through **(1) release of inventory, (2) diversion of e-auction coal, (3) diversion of coal from existing FSA's where it is supplying higher than the threshold, and 4) increase in coal production. However, CIL is likely to face a production shortfall of ~18-20mn tonnes annually from FY14E onwards to meet the likely coal supply obligation from the PMO's directive as the benefit of sale of excess inventory wouldn't be available in FY14E. This shortfall is likely to be met through coal imports, which, we believe will be a pass through for CIL (Refer Page-2 for details)**
- **Valuations:** With the revision of earnings estimates, likely higher coal production through faster MoEF clearances over the medium-to-long term and incorporation of a lower risk free rate of 8.25% from 8.75% earlier – decreasing the cost of equity to 12.8% from 13.25% earlier -- our 1 year forward DCF value increases by 5.0% to ₹367 from ₹350 earlier**. Note that we have already factored in the full impact of the 26% profit sharing provision of the MMDR bill (17.2% of our 1 year forward DCF value of CIL). Our target price implies a potential upside of 13.9% from the CMP. We, thus, retain our Accumulate rating on Coal India.**

Company Data

BSE Code	533278
NSE Code	COALINDIA
Equity Capital (₹ mn)	63163.6
Face Value (₹)	10.0
Market Cap (₹ bn)	2034.8
Avg Daily Volume (Qtly)	4645103
52 week H/L (₹)	422.4/289.0

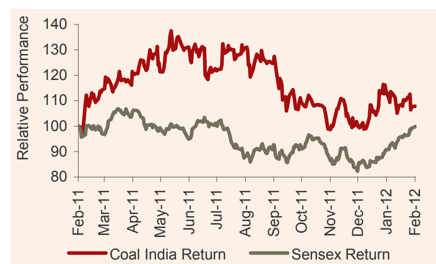
Source: NSE, BSE

Shareholding (%)

Holders	Dec 11	Sep 11	Jun 11
Promoters	90.00	90.00	90.00
FIIs	5.55	6.32	6.37
MFs/Banks & FI's	1.81	1.57	1.54
Public & Others	2.64	2.11	2.09

Source: BSE

Chart: Coal India vs. Sensex



Source: Capitaline

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Financial Snapshot (₹ mn)

In ₹ mn	Sales	YoY(%)	EBITDA	YoY(%)	PAT	YoY(%)	EPS(₹)	YoY(%)	EBITDA (%)	RoE(%)	P/E(x)	EV/EBITDA (x)	P/B(x)
FY11	520,212	5.8	152,666	19.6	109,046	10.9	17.3	10.9	29.3	32.3	18.7	10.4	6.1
FY12E	624,290	20.0	187,718	23.0	149,669	37.3	23.7	37.3	30.1	34.8	13.6	7.8	4.8
FY13E	658,400	5.5	212,833	13.4	169,918	13.5	26.9	13.5	32.3	28.4	12.0	6.5	3.0

Source: ABML Research, company data

The recent PMO directive to sign FSA's with LoA based power projects at 80% penalty trigger level might not be as bad as it seems

According to the PMO directive, Coal India Limited (CIL) will be required to "sign FSAs with power plants that have entered into long-term PPAs with power distribution companies and have been commissioned/ would get commissioned on or before 31st March 2015. For power plants that have been commissioned up to 31st December 2011, FSAs will be signed before 31st March 2012. The FSAs will be signed for full quantity of coal mentioned in the Letters of Assurance (LoAs) for a period of 20 years with trigger level of 80% for levy of disincentive and 90% for levy of incentive. In case of any shortfall in fulfilling its commitment under the FSAs from its own production, Coal India Limited will arrange for supply of coal through imports or through arrangement with State/Central PSUs who have been allotted coal blocks".

As on 25th January 2012, CIL had LoAs signed for ~108.9GW of power capacity. Out of this, 26.4GW LoA based power plants have been commissioned/likely to be commissioned by FY12. **The PMO directive would immediately cover ~26GW of LoA-based power plants commissioned between FY10 and FY12. Also, it would cover an equivalent amount of power capacity slated to come up in the next three years, thereby covering a little more than 50GW of power capacity till FY15. The 26GW of LoA-based power plants commissioned between FY10 and FY12 would entail a coal linkage requirement of 111.2 mn tonnes of coal. However, we estimate an approval rate of 70% due to reasons like long term PPA's not being signed for full capacity and delays in commissioning. We estimate annual contracted quantity of coal for LoA based power projects to be supplied at 77.8mn tonnes. This, at 80% supply rate, would imply a likely incremental coal supply obligation for CIL of ~62.3mn tonnes (Refer Table-1).**

Table 1: Likely coal supply obligation for CIL under the recent PMO directive for LoA based power plants commissioned/likely to be commissioned by FY12

Particulars	Power Capacity (in GW)	Coal linkage (mn tonnes)
FY10	3.8	17.8
FY11	5.9	23.5
FY12	16.7	70.0
Total	**26.4**	**111.2**
Likely approval rate for LoA based projects (%)		70%
Likely annual contracted quantity		77.8
Coal supply obligation at 80% supply rate		62.3

Source: ABML Research, Ministry of Coal

In FY13E, CIL is likely to meet the immediate incremental coal supply obligation due to the PMO's directive in FY13E through the following measures: (1) release of inventory, (2) diversion of e-auction coal, (3) diversion of coal from existing FSA's, and 4) increase in coal production (Refer Table-2). With coal sales flattish in 9MFY12, CIL should be able to offload ~18mn tonnes of excess coal inventory in FY13E. With the government's policy push to increase coal supply and active monitoring by the PMO, rake availability should improve going forward. Currently, CIL is selling ~11% of its sales through the e-auction rate. This is likely to decrease to 7-9% of sales going forward, and could, thus, release about 10mn tonnes of coal. Currently, CIL is selling at ~95-96% rate of the annual contracted quantities of existing FSA's, the penalty trigger level for which is 90% for power FSA's and 50% for non-power FSA's. A 4-5% diversion could easily release ~15mn tonnes of coal. Finally, we expect annual production to increase incrementally by 20 mn tonnes every year. With the government's policy push to increase coal supply, MoEF clearances are likely to be fast-tracked.

Table 2: CIL's likely strategy to meet the incremental coal supply obligation under the recent PMO directive for LoA based power plants in FY13E

Particulars	Coal (mn tonnes)
Release of coal inventory	18
Diversion from e-auction coal	10
Diversion of coal from existing FSA's	15
Increase in production	20
Total increase in supply for LoA based power projects	**63**

Source: ABML Research

For projects commissioned between FY12E and FY15E, additional coal supply obligation could amount to another 60-70mn tonnes, which could be mostly met through incremental production of ~60mn tonnes over FY14E-FY16E.

However, from FY14E onwards, CIL wouldn't have the benefit of sale of excess inventory it is likely to enjoy in FY13E. CIL is likely to face a production shortfall of ~18-20mn tonnes annually from FY14E onwards to meet the likely coal supply obligation due to the PMO directive. However, the PMO's directive does leave room for comfort as it allows CIL to meet any shortfall in commitment under the new FSA's from its own coal production "through imports or through arrangement with State/Central PSUs who have been allotted coal blocks". Thus, CIL may have to import around 20mn tonnes of coal annually from FY14E onwards.

The mechanism of executing the imports is yet to be finalised. The following questions would need answers: (1) What will be the acceptable ratio between imported and domestic coal for power producers so that it meets the cost requirements of their power projects (2) Will pricing be based on usage of the kind of coal –domestic and imported- or would there be pooled pricing among new FSA's or will it be extended to old FSA's too and (3) Will CIL have to bear some of the imported coal cost.

In our opinion, pooled pricing is unlikely to get extended to existing FSA's given the lack of political will to raise electricity prices and the precarious financial condition of the state electricity boards. Also, CIL is unlikely to bear some of the cost of imported coal as it would seriously affect investor sentiment and the government's disinvestment programme. **Our sense is that there could be pooled pricing among the new FSA's. The power projects near the port are likely to receive more quantity of imported coal on account of the (1) plants having been designed to use more of imported coal and (2) domestic coal being of lower quality and requiring high inland freight costs. If wholly imported coal pricing is applied to port based power projects then it is unlikely to meet their cost requirements on account of high international coal prices and pass-through of raw material cost increases not being entirely available. Spreading imported coal costs over a number of power projects through pooled pricing would help in making port based power projects economically viable. Also CIL, being the agency for coal imports, would help reduce the overall cost of imported coal as large purchases would enable CIL to extract bulk discounts.**

Overall, we think that while the recent PMO directive is likely to lower coal sales through the e-auction route and thus lead to lower overall coal realisations, it is not as bad as it may seem and the negative impact can be countered through back-ended notified coal price increases whenever the political climate is conducive to increasing electricity prices.

Consolidated Financial Results (Q3FY12) - CIL

₹ mn	Q3FY12	Q3FY11	YoY (%)	Q2FY12	QoQ (%)
Net Sales	**153492.8**	**126867.3**	**21.0**	**131480.8**	**16.7**
Total Expenses	108018.4	92833.1	16.4	106662.3	1.3
Cost of Materials consumed	14063.9	13789	2.0	12332	14.0
(Accretion)/Decretion of stock	(513.3)	(1,436.0)	(64.3)	5578.9	(109.2)
Employee expenses	56220.5	46702.6	20.4	56907	(1.2)
Power & Fuel	4963.4	4632.2	7.1	5247.9	(5.4)
Welfare Expenses	3465.7	3402.2	1.9	3368.1	2.9
Repairs	1497.3	1389.7	7.7	1014.3	47.6
Contractual expenses	12483.5	11653.9	7.1	9645.1	29.4
Other Expenditure	4897.7	5088.6	(3.8)	5478.9	(10.6)
Provisions/Write off	3330.5	671.7	395.8	2727.4	22.1
Overburden Removal adjustment	7609.2	6939.2	9.7	4362.7	74.4
EBITDA	**45474.4**	**34034.2**	**33.6**	**24818.5**	**83.2**
Depreciation	5256.7	4310.2	22.0	5733.7	(8.3)
Non-operating income	18558.7	12506.7	48.4	17941.9	3.4
EBIT	**58776.4**	**42230.7**	**39.2**	**37026.7**	**58.7**
Interest	129.4	122.5	5.6	128.4	0.8
Extraordinary income/(loss)	52.2	(123.4)	(142.3)	91.8	(43.1)
PBT	**58699.2**	**41984.8**	**39.8**	**36990.1**	**58.7**
Tax	18321.6	15769.3	16.2	11132.3	64.6
PAT	**40377.6**	**26215.5**	**54.0**	**25857.8**	**56.2**
Adjusted PAT	**40341.7**	**26292.6**	**53.4**	**25793.6**	**56.4**
Equity	63163.6	63163.6	0.0	63163.6	0.0
EPS	**6.39**	**4.15**	**54.0**	**4.09**	**56.2**
Adjusted EPS	**6.39**	**4.16**	**53.4**	**4.08**	**56.4**

Key Ratios (%)	Q3FY12	Q3FY11	YoY (%)	Q2FY12	QoQ (%)
EBIDTA Margin	29.6	26.8		18.9	
Interest / Sales	0.1	0.1		0.1	
Tax / PBT	31.2	37.6		30.1	
NPM	26.3	20.7		19.7	

Source: ABML Research, company data

Risk Factors

- Lower–than-expected notified price hikes
- Lower-than-expected production due to environmental clearance issues, CEPI, no-go areas, land acquisition, Maoist activities
- Lower-than-expected sales volume due to inadequate railway infrastructure
- Lower-than-expected beneficiated coal production
- Lower-than-expected e-auction coal sales

Recommendation summary

Date	Reports	Rating	Last Closing Price (₹)	Target Price (₹)	Upside / Downside %
24-06-11	Initiating Coverage	Accumulate	376.1	403	7.2
19-08-11	Result Update (Q1FY12)	Accumulate	393.5	398	1.2
16-11-11	Result Update (Q2FY12)	Accumulate	311.7	350	12.3
22-02-12	Result /Event Update (Q3FY12)	Accumulate	322.2	367	13.9

Source: ABML Research

Consolidated Financials – Coal India Ltd. (CIL)

Profit & Loss

In ₹ million	FY11	FY12E	FY13E	FY14E
Net sales	**520,212**	**624,290**	**658,400**	**692,635**
YoY (%)	6	20	5	5
Total expenses	367,545	436,572	445,567	469,094
Inc/dec in stock	(12,533)	0	0	0
Raw material cost	0	0	0	0
Staff cost	182,110	228,080	239,555	251,605
Operating expenses	121,639	129,451	146,283	154,432
Overburden removal adj	26,185	26,185	0	0
Other expenses	50,145	52,857	59,730	63,057
EBIDTA	**152,666**	**187,718**	**212,833**	**223,541**
YoY (%)	20	23	13	5
EBIDTA (%)	**29.3**	**30.1**	**32.3**	**32.3**
Depreciation	16,729	20,889	21,598	22,331
Non-operating income	30,087	50,874	55,813	56,476
EBIT	**166,025**	**217,703**	**247,049**	**257,686**
Interest	791	791	791	791
Extraordinary inc./(exp.)	(602)	(24,724)	0	0
Restatement adjustments	0	0	0	0
PBT	**164,632**	**192,188**	**246,258**	**256,895**
(-) Tax	55,959	59,578	128,093	82,206
Tax/ PBT (%)	34	31	52	32
PAT	**108,674**	**132,610**	**118,165**	**174,689**
Share of Associates	0	0	0	0
MI	0	0	0	0
PAT (after MI)	**108,674**	**132,610**	**118,165**	**174,689**
YoY (%)	11	22	(11)	48
Adj. net profit (after MI)	**109,046**	**149,669**	**169,918**	**174,689**
YoY (%)	11	37	14	3

Balance Sheet

In ₹ mn	FY11	FY12E	FY13E	FY14E
Equity capital	63,164	63,164	63,164	63,164
Reserves	270,008	361,988	616,459	737,625
Net worth	**333,172**	**425,152**	**679,623**	**800,789**
MI	326	326	326	326
Total borrowings	15,536	15,536	15,536	15,536
Shifting & Rehab. Fund	16,214	18,214	20,214	22,214
Overburden removal adj.	146,325	172,510	0	0
Total liabilities	**511,573**	**631,737**	**715,698**	**838,864**
Asset Block	150,610	162,221	178,374	196,818
Investments	10,637	10,637	10,637	10,637
Current assets	**643,960**	**769,063**	**842,635**	**948,362**
Inventories	55,856	47,844	48,829	52,693
Debtors	30,256	33,189	35,017	36,872
Cash	458,623	586,559	658,118	759,523
Loans and advances	99,225	101,472	100,671	99,274
Current liabilities	245,639	227,382	232,067	234,939
Provisions	56,761	91,568	92,647	90,779
Net current assets	**341,560**	**450,113**	**517,922**	**622,644**
Net Deferred tax asset	8,732	8,732	8,732	8,732
Miscellaneous expenses	34	34	34	34
Total assets	**511,573**	**631,737**	**715,698**	**838,864**

Key Ratios	FY11	FY12E	FY13E	FY14E
Diluted EPS (₹)	17.2	21.0	18.7	27.7
Adjusted diluted EPS (₹)	17.3	23.7	26.9	27.7
CEPS (₹)	19.9	24.3	22.1	31.2
Book value (₹)	52.7	67.3	107.6	126.8
Dividend per share (₹)	0.6	0.7	0.0	0.0
Net debt-equity (x)	(1.3)	(1.3)	(0.9)	(0.9)
ROCE	21.7	24.1	23.7	20.7
ROE	32.3	34.8	28.4	21.6

Valuations

PE (x)	18.7	13.6	12.0	11.6
Cash PE (x)	16.2	13.3	14.6	10.3
Price/book value (x)	6.1	4.8	3.0	2.5
Dividend yield (%)	0.2	0.2	0.0	0.0
P/sales	3.9	3.3	3.1	2.9
EV/sales (x)	3.1	2.3	2.1	1.9
EV/EBITDA (x)	10.4	7.8	6.5	5.8

Cash Flow (in ₹ mn)	FY11	FY12E	FY13E	FY14E
Net profit (before MI)	108,674	132,610	118,165	174,689
Depn and w/o	16,729	20,889	21,598	22,331
Change in working cap	(24,288)	19,383	3,751	(3,317)
Non-operating income	30,087	50,874	55,813	56,476
Others	29,151	52,909	53,753	2,000
Operating cash flow	**100,179**	**174,916**	**141,453**	**139,227**
Non-operating income	30,087	50,874	55,813	56,476
Capex	(24,749)	(32,500)	(37,750)	(40,775)
Investments	2,186	0	0	0
Others	(620)	(24,724)	(51,753)	0
Investing cash flow	**6,905**	**(6,350)**	**(33,690)**	**15,701**
Dividend	(33,296)	(40,630)	(36,204)	(53,522)
Equity	0	0	0	0
Debt	(5,333)	0	0	0
Others	(609)	0	0	0
Financing cash flow	**(39,238)**	**(40,630)**	**(36,204)**	**(53,522)**
Net change in cash	67,845	127,936	71,559	101,405
Opening cash	390,778	458,623	586,559	658,118
Closing cash	458,623	586,559	658,118	759,523

Source: ABML Research, company data

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ABML research is also accessible in Bloomberg at ABMR

Our Rating Methodology

Stock Ratings	Absolute Returns (R)
Buy	R > 15%
Accumulate	5% < R ≤ 15%
Neutral	-5% < R ≤ 5%
Reduce	-10% < R ≤ 5%
Sell	R ≤ -10%

Disclaimer:

Analyst holding in the stock: NIL