Coal India (COAL.BO)

Buy: Worries Fading; Time to Warm Up

- Company Update
- Target Price Change
- Estimate Change

- **All in the price?** — The overhang of higher wages /concerns on the use of cash seem to have faded. Coal India's (CIL) stock appears to be factoring in current coal price trends and the Draft Mining Bill. In our view, there is limited downside from here with the odds in favour of a price hike, faster clearances and a high dividend payout. The triggers are likely to be more event-based than secular in their stock price impact; but we would stay positioned for them. CIL has underperformed the Sensex by 16% over six months. At 11.8x FY13E PE (excl OBR adj) vs Asian peers at 8-11x, some valuation lustre vs peers has worn off. With upside to pricing, we would be long-term buyers.
- **CIL unlikely to import in the near term** — Despite the directive asking CIL sign FSAs/meet the shortfall on contracted volumes using imported coal, we think CIL is unlikely to resort to imports over the next couple of years. If adequate rakes are made available, CIL would be able to meet its contractual commitments by enhancing production and de-stocking in the near term. We think CIL will need to import long term and estimate ~50mt of imports by CIL in FY17. While imported coal pricing remains uncertain, we feel that CIL will find a way to pass on the higher costs.
- **Estimate changes** — We cap e-auction volumes at 45mt in FY13-14 but raise e-auction prices by 13-23% in FY12-14 on recent trends. We cut FY12 PAT by 6% on higher wages (+33% yoy vs +21%). We hike FY13 PAT by 2% on higher despatches (460mt vs 451mt); stronger e-auction prices offset by higher wages; lower e-auction volumes and lower prices for raw/high grade/washed coal. We expect CIL to raise prices of FSA coal (including A/B grades) by 4% in Apr12; with potential upside risk.
- **Valuations** — Our TP is based on two scenarios: #1 assumes no profit sharing – derived price Rs388 (vs Rs393); #2 assumes 26% profit sharing from FY14, derived price Rs362 (vs Rs367); with a 50:50 weighting. At our TP, CIL would trade at 13.4x FY13PE (excl OBR adj).
- **Sensitivity/risks** — PAT would rise 3% if average realizations rise 1%. A 1% change in wage costs impacts PAT by 1.3%. 1% change in volumes would impact PAT by 1.7%.

Buy	**1**
Price (09 Mar 12)	Rs332.00
Target price	Rs375.00
from Rs380.00	
Expected share price return	13.0%
Expected dividend yield	3.0%
Expected total return	**16.0%**
Market Cap	Rs2,097,033M
	US$41,874M

Price Performance
(RIC: COAL.BO, BB: COAL IN)

Statistical Abstract

Year to 31 Mar	Net Profit (RsM)	Diluted EPS (Rs)	EPS growth (%)	P/E (x)	P/B (x)	ROE (%)	Yield (%)
2010A	98,337	15.57	142.1	21.3	8.1	43.9	1.1
2011A	108,674	17.21	10.5	19.3	6.3	36.8	1.2
2012E	137,744	21.81	26.8	15.2	5.1	37.2	3.0
2013E	152,951	24.22	11.0	13.7	4.1	33.3	2.4
2014E	169,188	26.79	10.6	12.4	3.4	30.0	3.0

Source: Powered by dataCentral

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See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

COAL.BO: Fiscal year end 31-Mar — Price: Rs332.00; TP: Rs375.00; Market Cap: Rs2,097,033m; Recomm: Buy

Profit & Loss (Rsm)	2010	2011	2012E	2013E	2014E
Sales revenue	466,843	526,162	599,162	655,440	697,560
Cost of sales	-362,481	-395,918	-456,360	-501,323	-524,418
Gross profit	104,362	130,244	142,802	154,117	173,141
Gross Margin (%)	22.4	24.8	23.8	23.5	24.8
EBITDA	**117,656**	**146,973**	**163,294**	**173,823**	**193,149**
EBITDA Margin (%)	25.2	27.9	27.3	26.5	27.7
Depreciation	-13,295	-16,729	-20,492	-19,706	-20,008
Amortisation	0	0	0	0	0
EBIT	**104,362**	**130,244**	**142,802**	**154,117**	**173,141**
EBIT Margin (%)	22.4	24.8	23.8	23.5	24.8
Net interest	-886	-791	-482	-466	-466
Associates	0	0	0	0	0
Non-op/Except	36,711	35,781	56,732	68,018	72,525
Pre-tax profit	**140,186**	**165,234**	**199,053**	**221,669**	**245,200**
Tax	-43,425	-55,959	-61,308	-68,717	-76,012
Extraord./Min.Int./Pref.div.	1,576	-602	0	0	0
Reported net profit	**98,337**	**108,674**	**137,744**	**152,951**	**169,188**
Net Margin (%)	21.1	20.7	23.0	23.3	24.3
Core NPAT	98,337	108,674	137,744	152,951	169,188

Per share data	2010	2011	2012E	2013E	2014E
Reported EPS (Rs)	15.57	17.21	21.81	24.22	26.79
Core EPS (Rs)	15.57	17.21	21.81	24.22	26.79
DPS (Rs)	3.50	3.90	10.00	8.00	10.00
CFPS (Rs)	16.77	14.24	34.75	34.49	36.87
FCFPS (Rs)	13.64	11.42	29.27	28.31	30.61
BVPS (Rs)	40.84	52.75	64.55	80.77	97.56
Wtd avg ord shares (m)	6,316	6,316	6,316	6,316	6,316
Wtd avg diluted shares (m)	6,316	6,316	6,316	6,316	6,316

Growth rates	2010	2011	2012E	2013E	2014E
Sales revenue (%)	14.4	12.7	13.9	9.4	6.4
EBIT (%)	365.9	24.8	9.6	7.9	12.3
Core NPAT (%)	142.1	10.5	26.8	11.0	10.6
Core EPS (%)	142.1	10.5	26.8	11.0	10.6

Balance Sheet (Rsm)	2010	2011	2012E	2013E	2014E
Cash & cash equiv.	390,782	458,623	581,387	710,727	841,967
Accounts receivables	21,686	30,256	36,114	39,506	42,045
Inventory	44,018	55,856	68,004	66,988	69,945
Net fixed & other tangibles	142,461	150,610	164,718	184,012	203,504
Goodwill & intangibles	9,620	8,766	8,766	8,766	8,766
Financial & other assets	99,583	109,862	90,862	95,862	100,862
Total assets	**708,151**	**813,973**	**949,851**	**1,105,861**	**1,267,088**
Accounts payable	43,358	52,828	52,908	57,968	62,401
Short-term debt	0	0	0	0	0
Long-term debt	19,631	15,536	15,536	15,536	15,536
Provisions & other liab	386,973	412,111	473,328	521,858	572,628
Total liabilities	**449,963**	**480,475**	**541,772**	**595,362**	**650,564**
Shareholders' equity	257,952	333,172	407,753	510,173	616,198
Minority interests	236	326	326	326	326
Total equity	**258,188**	**333,498**	**408,079**	**510,499**	**616,524**
Net debt	**-371,151**	**-443,087**	**-565,851**	**-695,191**	**-826,431**
Net debt to equity (%)	-143.8	-132.9	-138.7	-136.2	-134.0

Valuation ratios	2010	2011	2012E	2013E	2014E
PE (x)	21.3	19.3	15.2	13.7	12.4
PB (x)	8.1	6.3	5.1	4.1	3.4
EV/EBITDA (x)	15.6	11.7	10.1	8.8	7.3
FCF yield (%)	4.1	3.4	8.8	8.5	9.2
Dividend yield (%)	1.1	1.2	3.0	2.4	3.0
Payout ratio (%)	22	23	46	33	37
ROE (%)	43.9	36.8	37.2	33.3	30.0

Cashflow (Rsm)	2010	2011	2012E	2013E	2014E
EBITDA	117,656	146,973	163,294	173,823	193,149
Working capital	63,910	-12,081	39,192	37,305	35,912
Other	-75,611	-44,918	17,024	6,709	3,808
Operating cashflow	**105,956**	**89,974**	**219,509**	**217,837**	**232,870**
Capex	-19,815	-17,832	-34,600	-39,000	-39,500
Net acq/disposals	2,230	2,185	0	0	0
Other	27,082	22,622	0	0	0
Investing cashflow	**9,497**	**6,975**	**-34,600**	**-39,000**	**-39,500**
Dividends paid	-22,100	-24,634	-63,164	-50,531	-63,164
Financing cashflow	**-21,621**	**-29,108**	**-62,145**	**-49,497**	**-62,130**
Net change in cash	**93,832**	**67,841**	**122,764**	**129,340**	**131,240**
FCF ex acquisns & explorn	**88,371**	**74,327**	**184,909**	**178,837**	**193,370**

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Investment Summary

New FSAs to be signed by Coal India have been a cause of concern as CIL has reported sluggish volume growth in the past few years. News reports suggest that CIL would not be able to meet the additional demand and would have to resort to imports (and whether the higher pricing would be passed on).

CIL is unlikely to import in the next couple of years and should be able to meet coal supply under the new FSA directive if adequate rakes are available. CIL is likely to import long term but likely to pass the cost of imports. E-auction volumes may be capped.

Our analysis suggests that signing new FSAs need not be a major negative for CIL: 1) The additional volume required in FY13 (for plants commissioned by Dec11) would be around 33mt and would require 18-19 additional rakes per day (vs 170-175/day in FY12); 2) Imported coal may not be required for the next few years; 3) There is a limitation to the level of imported coal that can be blended (20-30%) by Indian power companies; 4) While imported coal pricing remains uncertain (pass through or pooling), we feel that CIL will find a way to pass on the higher costs; 5) We cap e-auction volumes (based on press reports) at 45mtpa – this could have upside risk.

We expect stock upside from a price hike announcement, faster clearances and high dividend payout.

The focus on coal by government officials may be a blessing and help in faster clearances. The overhang of wage negotiations, use of cash, delays in price hikes, negative impact of the Draft Mining Bill seem to be factored into the stock price. We believe there is limited downside from current levels. Upside triggers could come from a price hike (wef April12), higher volumes and a high dividend payout.

The triggers are likely to be more event-based than secular in their stock price impact, but we would stay positioned for them. CIL has underperformed the Sensex by 16% over six months. It trades at 11.8x FY13E PE (excl OBR adj) vs Asian peers at 8-11x. Some valuation lustre vs peers has worn off − with upside to pricing, we would be long-term buyers.

We tweak our target price marginally to Rs375 (from Rs380) to incorporate higher wages, revised volumes and prices. Our TP is based on two scenarios: #1 assumes no profit sharing – derived price Rs388; #2 assumes 26% profit sharing from FY14, derived price Rs362; with a 50:50 weighting. At our TP, CIL would trade at 13.4x FY13PE (excl OBR adj).

Estimate Changes

Figure 1. Estimate changes, FY12- 14E

	FY12E			FY13E			FY14E		
	Old	**New**	**% chg**	**Old**	**New**	**% chg**	**Old**	**New**	**% chg**
Rs/US$ rate	47.1	48.0		47.1	49.5		45.9	48.9	6%
Net sales (Rs bn)	592.7	599.2	1%	643.4	655.4	2%	713.0	697.6	-2%
EBITDA (Rs bn)	173.3	163.3	-6%	169.5	173.8	3%	208.1	193.1	-7%
Net profit (Rs bn)	146.5	137.7	-6%	149.5	153.0	2%	179.1	169.2	-6%
EPS (Rs)	23.2	21.8	-6%	23.7	24.2	2%	28.4	26.8	-6%
Coal production volumes (mt)	417.0	430.0	3%	447.0	456.0	2%	474.0	481.0	1%
Coal despatch volumes (mt)	430.0	431.0	0%	451.0	460.1	2%	476.2	483.2	1%
Raw coal sales excl e-auction (mt)	365.3	362.2	-1%	377.7	393.5	4%	382.9	401.6	5%
E-auction sales (mt)	46.7	48.7	4%	49.2	45.0	-8%	52.1	45.0	-14%
Washed coal sales (mt)	15.4	14.7	-5%	19.1	16.6	-13%	32.5	28.1	-13%
Average realisation (Rs/t)	1,376	1,387	1%	1,434	1,427	0%	1,516	1,456	-4%
Average realisation ($/t)	28	28	1%	29	29	0%	30	29	-4%

Source: Citi Investment Research and Analysis estimates

New Target Price vs Old

Figure 2. New TP vs old

	New	**Old**
EPS (Rs)	24.2	23.7
PE multiple (x)	9.0	9.0
PE based target price - 40%	218	213
DCF (+30%) based target price (Rs) - 60%	479	491
Target price (Rs), weighted 40:60	**375**	**380**

Source: Citi Investment Research and Analysis estimates. *Note - The TP assumes 26% profit sharing to commence from FY14 (based on our interaction with the Secretary, Ministry of Mines). The values are based on the average of two scenarios.

CIL does not have a long valuation history since it listed only in November 2010. We arrive at our target price of Rs375 using: (1) a valuation based on DCF + 30% premium (Rs479 vs. Rs491 earlier) and (2) 9x FY13 PE based valuation (Rs218 vs. Rs213), with a 60/40 weighting. The Indonesian and Chinese coal producers are currently trading in a range of 8-11x.

Our TP calculation incorporates both CIL's asset valuation and also its earnings potential. Our DCF valuation is enhanced by 30% to account for the probable reserves (8.3bn tonnes - an additional 78% over the proven reserves) that we have not incorporated in our valuation. We have not taken a terminal value and thus also use a PE-based valuation as it assumes new reserves replace the ones exhausted. The lower weightage to PE seems justified given CIL's limited exposure to international prices and that the benefits of beneficiation are likely to have a meaningful impact only after 3-4 years - thus PE alone cannot fully capture a fair valuation. At our TP, CIL would trade at 13.4x FY13 PE (excluding overburden removal adjustment).

Global Valuations

Figure 3. Global Comps

Company Name	RIC Code	Rating	YE	Mkt Cap USD $m	Ccy	Share Price	Share Target	Upside	P/E (x) 2012E	P/E (x) 2013E	EV/EBITDA (x) 2012E	EV/EBITDA (x) 2013E	P/B (x) 2012E	P/B (x) 2013E
Australia														
Whitehaven Coal Ltd	WHC.AU	1	30-Jun	2,779	AUD	5.31	6.50	22%	23.2	9.8	12.4	6.0	2.3	1.9
Indonesia														
Bumi Resources	BUMI.ID	1	31-Dec	5,399	IDR	2,375	2,900	22%	7.8	5.1	4.9	3.5	2.0	1.6
Adaro Energy	ADRO.ID	1	31-Dec	6,686	IDR	1,910	2,250	18%	8.2	7.2	4.9	4.0	2.1	1.7
Indo Tambangraya	ITMG.ID	1	31-Dec	5,126	IDR	41,450	45,450	10%	9.5	7.0	5.5	3.8	3.8	2.9
PT Bukit Asam	PTBA.ID	1	31-Dec	5,207	IDR	20,650	23,000	11%	10.8	9.6	6.6	5.4	4.2	3.5
China														
China Coal Energy	1898.CN	1	31-Dec	15,917	HKD	9.32	10.30	11%	8.1	6.5	4.9	4.1	1.1	1.0
China Shenhua Energy	1088.CN	1	31-Dec	87,875	HKD	34.30	40.70	19%	11.2	10.5	6.0	5.3	2.1	1.9
USA														
Arch Coal	ACI.US	1	31-Dec	2,536	USD	11.89	21.00	77%	11.8	9.9	6.3	5.5	0.7	0.7
Peabody Energy	BTU.US	1	31-Dec	8,369	USD	30.74	54.00	76%	9.6	6.2	5.1	3.7	1.3	1.1
CONSOL Energy	CNX.US	1	31-Dec	7,471	USD	32.90	40.00	22%	19.7	11.8	10.6	7.9	1.9	1.7
Diversified Coal														
Anglo American PLC	AAL.GB	2	31-Dec	52,186	GBP	25.02	30.00	20%	8.4	7.2	4.5	3.5	1.1	1.0
BHP Billiton Ltd	BHP.AU	1	30-Jun	179,559	AUD	34.05	45.00	32%	10.0	9.1	5.1	4.8	2.8	2.3
Rio Tinto Ltd	RIO.AU	1	31-Dec	95,317	AUD	62.42	95.00	52%	8.3	7.3	3.1	2.5	1.6	1.3

Source: Citi Investment Research and Analysis estimates

Volumes

The Prime Minister's Office (PMO) asked CIL to sign Fuel Supply Agreements (FSAs) with power plants that have entered into long-term PPAs and commissioned by 31 Mar 2015. For plants set up by 31 Dec 2011, FSAs will be signed before 31 Mar 2012. The FSAs will be for full quantity of coal in the Letters of Assurance (LoAs) for 20 years. CIL will have to pay compensation if they supply less than 80% and a premium for more than 90%. For any shortfall, CIL will arrange for imports or through State/Central PSUs who have been allotted coal blocks.

CIL is not likely to import in FY13.

Our analysis (below) seems to suggest that CIL is unlikely to import coal over the next couple of years. If adequate rakes are made available, CIL would be able to meet 80% of the Annual Contracted Quantity (ACQ) under the new FSAs (still to be signed) and 90% of the ACQ under the old FSAs by enhancing production and de-stocking.

Expect FY12 despatches at 431mt (+1.5%) and FY13 despatches at 460mt (+7% yoy).

While rake availability has improved considerably to ~200rakes/day currently vs 167rakes/day during 9MFY12; we believe rake availability for FY13 is likely to be 185-190/day and estimate despatches at 460mt in FY13, +7% yoy (451mt earlier). Inventory is likely to be 65-68mt by the end of FY12. Citi est: FY12 production at 430mt (flat yoy) and despatches at 431mt (+1.5% yoy).

E-auction volumes maybe capped; upside to pricing.

We lower our e-auction volume estimates to 45mt (10% of despatches) in FY13 (vs 49mt 11% of despatches earlier). Media reports (Bloomberg) indicate e-auction volumes are likely to be capped at 45mtpa till 2017 or 7% of output (vs 10-12% currently) to meet the requirements of the power sector. We believe there could be upside to e-auction volumes as 80% of the e-auction quantity is currently transported via road and may not be a feasible option for power producers. Our analysis suggests for every tonne of e-auction coal diverted at FSA prices, profits would decline 0.8%. There could be upside to e-auction prices if volumes are capped − given the demand from the non-power producers.

We expect 30% of production to be washed by FY15 vs 5% in FY13.

We expect 5% of production to be washed in FY13 and 30% by FY15 (vs 33% earlier). Of the 20 washeries planned (111mtpa), environmental clearance has been obtained for three washeries; the formal agreement is yet to be signed and it would take around two years for the washeries to become operational. CIL expects an additional 20mt to be washed by the end of FY14 and the 111mt capacity to be in place by end FY17.

CIL unlikely to import in the near term

Figure 4. Fuel Supply Agreements

	For power utilities existing as on 31 Mar09	For power projects commissioned after 31 Mar09	
		OLD	NEW
Valid for	20 yrs	5 yrs	20 yrs
Penalty trigger	Below 90% of ACQ	Below 50% of ACQ	Below 80% of ACQ
Performance incentive	Above 90% of ACQ	Above 90% of ACQ	Above 90% of ACQ

Source: Ministry of Coal, Citi Investment Research and Analysis

The old FSA regime

Power plants commissioned before 31 March 09: Under the current FSAs with power utilities existing as on 31 Mar 2009, CIL had signed contracts for 20 years and would have to pay compensation if it supplied less than 90% of the contracted quantity. Supply in excess of 90% attracts a pricing premium.

- The Annual Contracted Quantity (ACQ) by CIL for the plants commissioned before 31 March 09 is 304.8mt (Source: Ministry of Coal).
- The trigger level for the penalty continues to be below 90%.
- Media reports indicate that CIL has been supplying coal at ~95-96% to earn a premium.

Power plants commissioned after 31 March 09: Due to a shortage of coal, compensation was payable only if 50% of the contracted quantity could not be supplied (rather than 90%).

CIL asked to sign new FSAs

Though the PMO's directive suggests that CIL should meet its shortfall using imported coal; our analysis indicates that CIL is unlikely to resort to coal imports over the next couple of years. If adequate rakes are made available, CIL would be able to meet 80% of the ACQ (Annual Committed Quantity) under the new FSAs (still to be signed) and 90% of the ACQ under the old FSAs by enhancing production and de-stocking.

The Prime Minister's Office (PMO) asked CIL to sign FSAs with power plants that have entered into long-term PPAs and commissioned by 31 Mar 2015. For plants set up by 31 Dec 2011, FSAs will be signed before 31 Mar 2012. CIL will have to pay compensation if they supply less than 80% (vs 50% earlier) and will earn a premium for supplying more than 90%. For any shortfall, CIL will arrange for imports or through State/Central PSUs who have been allotted coal blocks.

- According to the Ministry of Coal, 172 LoAs have been issued as of 25 Jan 2012 for a power capacity of 108,900MW – the quantity of coal being 424mt (in addition to the 305mt committed for plants commissioned before 31 March 2009).
- Of the 109GW of capacity; 19,800MW has been commissioned upto Dec 11 with a coal requirement of ~83mt. Another 8,450MW is likely to be commissioned by March 12 with an additional coal requirement of 36mt.
- According to the PMO's directive, CIL will have to sign FSAs for the 19,800MW of capacity commissioned between Apr 09 and Dec 11 by March 12 (assuming the entire 19,800MW has long term PPAs). This implies that in addition to 305mt (for plants commissioned before 31 March 2009), CIL would have to provide an additional 66mt in FY13 (80% of 83mt).
- Imports unlikely in FY13: Our analysis suggests that CIL is currently supplying ~19mt to the new power plants (commissioned after Mar 09). To meet the additional 47mt, CIL could use 1) incremental production of 26mt expected in

Figure 5. CIL despatch breakdown

(mt)	FY10	FY11	FY12	FY13
Old FSAs	293	290	290	275
New MOUs/FSAs	5	14	19	66
Non-power sector	118	121	122	122
Total despatches	416	425	434	464

Source: Citi Investment Research and Analysis

FY13; 2) divert ~14mt from existing FSAs (currently 95% is being supplied vs 90% of the 305mt committed); 3) divert ~30mt of inventory − if enough rakes were made available.

- As CIL can divert some quantity (~14mt) from existing contracts FSA contracts and already supplies ~19mt to new power plants, incremental rail/road capacity would only be required for 33mt of coal in FY13 to meet the new FSA commitment (80%). If we assume railways are used for ~75% of the volumes, CIL would need additional 18-19 rakes per day vs FY12 (3,500 tonnes per rake). Average rake availability in FY12 is estimated at ~170-175 per day. Hence, if rake availability is not a constraint in FY13, CIL is not likely to import coal.

  Media reports indicate that, if CIL is able to supply the coal but rake availability is a constraint; CIL is not likely to be penalized. Note that under its current agreements with the buyers, CIL makes the coal available at the pit head and transporting the coal is the responsibility of the buyer. The hike in rail freight (~20%) announced on 7 March 12 due to reclassification will have to be borne by buyers.

Long term: CIL likely to import

- Of the total108,900MW for which CIL has signed FSAs for ~424mt of coal, 273mt pertains to the 12th 5-year plan (FY13-17) according to CIL. This implies roughly 70,000MW (for which FSA's have been signed) are likely to be commissioned by FY17. CIL does not expect all the capacities to come on-stream as planned. If we assume 80% of these capacities are commissioned by FY17 (making the requirement ~220mt), then CIL would have to supply 175mt of coal by FY17 (80% of the ACQ) for the new plants assuming the entire 70,000MW has signed long-term PPAs. Our estimates suggest CIL's production should rise by ~120mt on a conservative basis by FY17 (from FY12). CIL believes if all clearances are in place its FY17, production could rise to 615mt, i.e. an increase of 185mt over FY12. **Our sense is that imports in FY17 by CIL could be ~50mt** .

We however lack clarity on a few issues with respect to imports:

- **Power plants may prefer importing directly:** CIL was mandated to import 6mt of coal in FY10 but could find customers for only 0.4mt. The target was to import 6mt in FY11 again – but CIL has been unable to conclude terms and conditions. CIL was seeking to deliver coal at the port but customers have not agreed to it.

Pass through or pooling?

- **Pricing of imported coal:** We feel that CIL is likely to pass on the higher cost of imports to buyers. The question that remains unanswered is whether imported coal prices would be a pass through for CIL or whether there would be a pooling of prices. Our view is that clarity on this issue is unlikely to emerge in the near future as CIL may not need to import coal anytime soon. If pooling is permitted, power companies are likely to purchased imported coal through CIL, or else they may prefer importing on their own.

Blending limits for imported coal.

- **Proportion of imports**: There is a limit to the amount of imported coal Indian power plants can blend. Technology used at many power stations prevents them from going beyond a certain limit for blending local and imported coal. The plants likely to be commissioned over the next 4-5 years are likely to be able to blend 20-30% of imported coal.

Clearances

Status of Environment and Forest clearances

- According to media reports (Times of India), an environment ministry's panel has recommended three CIL projects, including one for capacity augmentation, for green clearance. The projects include: 1) Samleshwari (IB valley, Orissa) − plans to enhance capacity from 5mtpa to 11mtpa; 2) Gose (11mtpa, Central Coalfields); 3) Dakra (1mtpa) – awaiting renewal of mining lease.

- Currently ~168projects of CIL are awaiting environment and forest clearances; of which 67 are greenfield. 114 projects are awaiting stage one clearance, 92 of which are at the State level and the remaining from the Ministry of Environment and Forests. 54 proposals are awaiting final clearance, including 31 at the State level.

CEPI moratorium lifted on ~60% of impacted clusters

- The Ministry of Environment and Forests had imposed a moratorium on coal projects in India on critically polluted clusters in Jan 2010 until Aug 2010, further extended in several stages up to March 2011 and subsequently to Sep 2011. 43 clusters were impacted during the initial moratorium. As of 31 July 2011, the moratorium has been lifted on projects in 25 clusters (out of 43). The moratorium on the remaining 18 clusters has been extended to 31 March 2012.

- The moratorium was imposed on seven CIL coalfields - Chandrapur, Korba, Dhanbad, Talcher, Singrauli, Asansol and IB Valley. It has been lifted on all the coalfields except Korba and Chandrapur. A high-level committee has recommended the moratorium be lifted in order to ensure sufficient production of coal in the country. Korba's proven and probable reserves are estimated at ~2.4bn tonnes (of CIL's total of 18.9bn).

Pricing

CIL is likely to review its prices in April 12. We expect CIL to raise prices of FSA coal (including A/B grades) by 4% in Apr 12; with potential upside risk.

CIL has changed the pricing mechanism of non-coking coal from Useful Heat Value (UHV) based grading system to Gross Caloric Value (GCV) based wef 1Jan 12. Under the new GCV grading, coal would be classified under 17 slabs (300kcal each) from 2,200-7,000kcal and above 7,000kcal. This compares to the earlier UHV classification into seven grades (based on ash and moisture). Based on the pricing data, we believe the new prices are largely revenue neutral.

Figure 6. Price forecast changes (FY12-14E)

	FY12E			FY13E			FY14E		
	Old	New	% chg	Old	New	% chg	Old	New	% chg
Average realisation (Rs/t)	1,376	1,387	1%	1,434	1,427	0%	1,516	1,456	-4%
Average realisation ($/t)	28	28	1%	29	29	0%	30	29	-4%
Raw coal realisation excl E-auction (Rs/t)	1,221	1,192	-2%	1,287	1,242	-3%	1,363	1,269	-7%
Raw coal realisation excl E-auction (Rs/t)	25	24	-2%	26	25	-3%	28	26	-7%
E-auction realisation (Rs/t)	2,326	2,634	13%	2,316	2,850	23%	2,375	2,907	22%
E-auction realisation ($/t)	47	54	13%	47	58	23%	48	59	22%
Washed coal realisation (Rs/t)	2,222	2,152	-3%	2,061	1,945	-6%	1,943	1,810	-7%
Washed coal realisation ($/t)	45	44	-3%	42	40	-6%	40	37	-7%

Source: Citi Investment Research and Analysis estimates

Figure 7. Citi Global Forecasts

	FY08A	FY09A	FY10A	FY11A	FY12E	FY13E	FY14E	LT
Thermal coal (US$/t)	56	125	70	98	130	123	138	109
- yoy chg (%)		123%	-44%	40%	33%	-5%	12%	
Coking coal (US$/t)	97	305	128	215	291	260	245	200
- yoy chg (%)		214%	-58%	68%	36%	-11%	-6%	

Source: Citi Investment Research and Analysis estimates

Wages

The financial outflow on account of wage revision will be is likely to be Rs65bn pa.

Compensation for CIL's non-executive employees is governed by the National Coal Wage Agreement between the trade unions and CIL, which is fixed from time to time for five years. The wage revision was due in July 2011 and was finalized on 31 Jan 2012 with retrospective effect. The revision was concluded in six months vs 13 months for the previous revision.

According to CIL, the financial outflow on account of wage revision will be is likely to be Rs65bn pa. Gross wages for non-executive employees have been raised by 25%. Other highlights include a special allowance of 4% of revised basic; HRA of 2% of the basic pay for those who have not been provided with residential accommodation in other than urban area; post retirement medicare scheme for retired non-executives and their spouses (to be finalized). Of the Rs65bn impact, Rs17bn is expected to be on account of gratuity and leave encashment.

Compensation for executive employees is determined by the Government of India and fixed for ten years. Current compensation was finalized in May 2009 and is effective for ten years from 1 January 2007.

Given the lack of clarity on the exact breakdown of the wage increases, there could be upside risk to our profits.

Our earlier estimates assumed a 50% increase in cost per employee over two years, i.e. FY12 and FY13, including the impact of inflation. Assuming an annual impact of Rs65bn+ inflation, we now expect the cost per employee to increase 56% over FY12 and FY13. Given the lack of clarity on the exact breakdown of the wage increases, there could be upside risk to our profits.

Balance sheet, Capex and Dividend

CIL has ~$11bn of cash on its books.

Capex: CIL expects to spend ~$1bn pa on expansion capex.

Investment in railways: According to press reports (Indiamart), the government has asked CIL to invest in rail infrastructure linking major projects. CIL has decided to take up two rail connectivity projects linking Mand-Raigarh deposits in Chhattisgarh in a JV with SAIL and other PSUs. This will have a potential to produce 200mtpa of coal and the project cost is estimated at Rs15.5bn (~$320m). In addition, CIL is likely to fund 100 kms of Tori-Shibpur-Hazaribagh rail project to fulfill 100mtpa of coal requirements.

Dividend: Media reports (Economic Times) indicate CIL has proposed to pay a dividend of Rs 56.8bn to the government (90% shareholder) for FY12. This amounts to Rs63.2bn for 100% holding or Rs10/share (46% payout) compared to Rs3.9/share (22% payout) in FY11.

Coal India

Company description

Coal India (CIL) is the world's largest coal producer, with production of 431mt (flat yoy), despatches of 424mt (+2%) in FY11, 18.9bn tonnes of proven and probable reserves. It has eight subsidiaries in India - seven of which carry out coal production and Central Mine Planning and Design Institute Ltd, which provides technical expertise and consultancy to CIL/others. CIL was established in 1973 and 90% of its equity is currently held by the Indian government. Non-coking coal accounted for ~90% of production in FY11 and accounts for ~95% of the company's reserve estimates. CIL accounts for ~80% of India's coal production. Power generation accounts for ~70-75% of CIL's volumes. NTPC is its largest customer and accounted for ~27-28% of its raw coal despatches. ~90% of CIL's production is from open-cast mines, where production cost ($12/t) is significantly cheaper than underground mines ($62/t). CIL has ~374k employees as of 31 Jan12.

Investment strategy

We rate CIL as Buy (1) with a target price of Rs375. The overhang of wage negotiations and concerns on the potential use of cash seem to have faded away. CIL’s stock appears to be factoring in current coal price trends and implementation of the Draft Mining Bill. In our view, there is limited downside from here with the odds in favour of a price hike, faster clearances and a high dividend payout. The triggers are likely to be more event-based than secular in their stock price impact; but we would stay positioned for them. The stock trades at 11.8x FY13E PE (excl OBR adj) vs Asian peers at 8-11x. Some valuation lustre vs peers has worn off − with upside to pricing, we would be long-term buyers.

Valuation

Our TP is derived using a combination of two scenarios: #1 assumes no profit sharing - derived price Rs388; #2 assumes 26% profit sharing in FY14 and beyond (based on our interactions with the Secretray, Ministry of Mines) - derived price Rs362; with a 50:50 weighting. CIL does not have a long valuation history since it listed in Nov 2010. We arrive at our TP of Rs375 using: (1) a valuation based on DCF+30% premium (Rs479) and (2) 9x FY13 PE based valuation (Rs218); with a 60/40 weighting. The 9x multiple lies within the current trading range (8-11x) of the Indonesian and Chinese coal producers. At our TP, CIL would trade at 13.4x FY13PE (excl OBR adj).

Risks

Key downside risks to our investment thesis on CIL are: risks of restrictions imposed by regulators related to forest clearance and environmental safeguards; difficulties in obtaining reserves/resources; a proposed 26% profit-sharing requirement contained in the New Mining Bill; land acquisition; ban on e-auction coal; logistical constraints including rail transport bottlenecks; restricted ability to raise coal prices; coal imports without a pass through; unrelated investments; disruption of operations in politically unstable areas; auction for future reserves; and non-availability of critical equipment.

Appendix A-1

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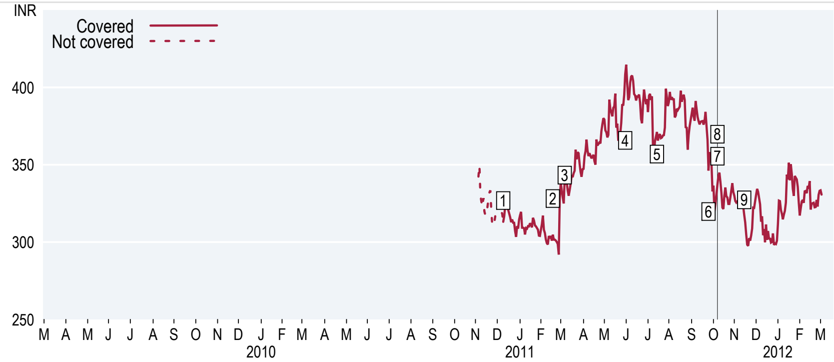
IMPORTANT DISCLOSURES

Coal India (COAL.BO)

Ratings and Target Price History
Fundamental Research

Analyst: Raashi Chopra, CFA
Covered since December 9 2010



	Date	Rating	Target Price	Closing Price
1	9-Dec-10	*1L	*358.00	313.10
2	17-Feb-11	1L	*350.00	304.80
3	7-Mar-11	1L	*395.00	340.95
4	31-May-11	1L	*471.00	408.45
5	14-Jul-11	1L	*430.00	371.20
6	26-Sep-11	1L	*418.00	346.20
7	7-Oct-11	Stock rating system changed		
8	7-Oct-11	*1	418.00	337.25
9	15-Nov-11	1	*380.00	317.60

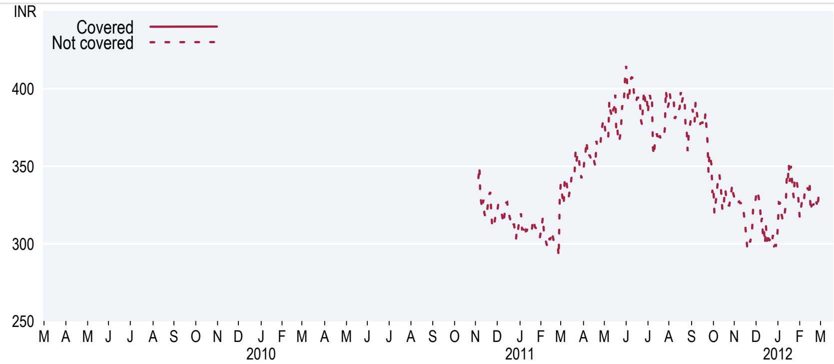
* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Coal India (COAL.BO)

Ratings and Target Price History
Best Ideas Research
Relative Call (3 Month)

Analyst: Raashi Chopra, CFA
Covered since December 9 2010



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