kotak Institutional Equities

Coal India (COAL)

Metals & Mining

ADD

APRIL 03, 2012

UPDATE

Coverage view: Cautious

Price (Rs): 343

Target price (Rs): 380

BSE-30: 17,597

FSA with a diluted penalty clause? As per media reports, a Presidential directive asking Coal India (CIL) to sign fuel supply agreements (FSAs) has been issued. However, the terms of the penalty clause for shortfall below the directed 80% assurance level will be decided by CIL itself. In our view, CIL will likely be inclined to dilute the penalty clauses for short-supply of assured quantities, thereby reducing the efficacy of the FSA. Continued uncertainty over the terms of an FSA will likely weigh on stock performance.

Company data and valuation summary

Coal India

Stock data			
52-week range (Rs) (high,low)			422-294
Market Cap. (Rs bn)			2,168.4
Shareholding pattern (%)			
Promoters			90.0
FIIs			5.5
MFs			1.0
Price performance (%)	1M	3M	12M
Absolute	3.5	4.9	(1.0)
Rel. to BSE-30	3.7	(5.0)	9.2

Forecasts/Valuations	2012	2013E	2014E
EPS (Rs)	23.4	26.9	32.2
EPS growth (%)	35.1	14.9	19.9
P/E (X)	14.7	12.8	10.7
Sales (Rs bn)	642.6	698.7	761.3
Net profits (Rs bn)	147.7	169.6	203.4
EBITDA (Rs bn)	193.8	206.7	236.8
EV/EBITDA (X)	8.3	7.2	5.6
ROE (%)	37.3	34.1	33.0
Div. Yield (%)	2.0	2.3	2.8

Government invokes Presidential directive to CIL, leaves penalty clause at Board's discretion

As per media flash, the Government has issued a Presidential directive to Coal India (under clause 37 of MOA of CIL) to sign FSAs with power utilities as directed by the PMO in February 2012. However, the penalty clause for not meeting the assured quantity level of 80% has been left to the discretion of CIL. This comes in the wake of recent standstill on signing of FSAs after objections were raised by the independent directors. In our view, CIL will likely be inclined to dilute the penalty clauses and even provide for meeting shortfalls through imports (as directed by the PMO), thereby safeguarding its interest, and reduce the efficacy of an FSA given the current demand-supply gap.

Imports inevitable in our view; ministry confident of ramping up domestic production

Import of coal to meet the ever-increasing energy requirements is inevitable at current production levels of CIL, although the ministry remains confident of ramping up domestic coal production. The moot question that still remains unanswered is—who will pay for potential coal imports, (1) the procuring plant at the market price, (2) all power plants using a pooled mechanism, (3) Coal India through some subsidization, or (4) a combination of all. A general consensus appears to have evolved (and has been corroborated by CIL management) that CIL will be fully reimbursed for its import bills.

In our view, the quantum of imports required to meet the 80% FSA levels will likely be to the tune of 30-40 mtpa based on our production targets and assumed delays in commissioning of power plants (see Exhibit 1), though achievement of planned targets can help plug the gap for meeting FSA commitments.

Maintain ADD with a target price of Rs380

We maintain our ADD rating with a target price of Rs380/share, though concede that clarity on terms and conditions of the proposed fuel supply agreement is key to stock performance. Our target price is based on 11X FY2013E EPS adjusted for overburden removal and interest income and implies an EV/EBITDA of 7.7X on FY2013E EBITDA (adjusted for overburden removal).

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Diversion of e-auction sales – another proposed option

Media reports also indicated sustenance of e-auction sales at current levels (48 mtpa) in order to meet its FSA commitments. We currently factor e-auction sales of 50 mn tons in FY2013E and note that maintaining e-auction sales at current levels would impact our FY2013E EPS estimate by a marginal 2% though note that impact would be higher in later years as production (and hence e-auction quantum) increases. Media reports further indicate that CIL has been advised by the Government to progressively reduce e-auction quota from 10% to 7% over the XIIth Plan period.

Exhibit 1: Cut down in extant FSA quantity, delays in commissioning of capacities and ramp-up in production only way to avoid imports
Theoretical shortfall if CIL were to meet entire 80% supply through domestic supply

	2013E	2014E	2015E
Committed quantity under pre 2009 FSAs (mtpa)	316	316	316
Actual supply (%)	90	90	90
Actual supply (mtpa)	284	284	284
Committed quantity for non power sector (mtpa)	102	102	102
Actual supply (%)	60	60	60
Actual supply (mtpa)	61	61	61
Total supply through old FSAs (mtpa) [A]	**346**	**346**	**346**
Assumed e-auction quantity (mtpa) [B]	50	53	55
PLF of new plants (%)	80	80	80
Required supply through new FSAs (@80% of ACQ) [C]	104	142	177
Total required supply ([A]+[B]+[C])	**500**	**541**	**578**
Actual supply (mn tons) - KIE estimates	448	469	487
Shortfall (mn tons)	**(52)**	**(72)**	**(90)**
Import (@ 6,600 kcal/kg)	27	37	47
Shortfall in case CIL achieved stated production target			
Production target (mn tons) - MoC	464	544	576
Shortfall (mn tons)	**(36)**	**3**	**(2)**

Notes:
(1) We have assumed a scenario wherein CIL cuts supply of its extant power-FSA to 90% and non-power-FSA to 60% and capacities are delayed

Source: Kotak Institutional Equities estimates

Exhibit 2: ~20 GW of linkage-based capacity has been commissioned as of December 2011 and another 34.2 GW is under construction
Details of capacities likely to commission till March 2015 (MW)

	Plants commissioned (Post 2009)			Under construction (Upto 2015)		
	Linkage	**Captive**	**Imported**	**Linkage**	**Captive**	**Imported**
PPA (Bid/Regulated)						
NTPC	4,810	—	—	9,890	1,320	—
Others	3,275	1,250	—	3,000	1,200	—
Total central sector	**8,085**	**1,250**	**—**	**12,890**	**2,520**	**—**
Total state sector	**7,265**	**1,200**	**—**	**6,050**	**4,190**	**500**
Adani Power	1,000	—	2,138	2,912	—	—
JSW Energy	—	540	300	—	—	—
Lanco Infratech	1,500	—	600	441	—	600
Reliance Power	600	—	—	900	4,960	4,000
Tata Power	525	—	—	525	0	4,000
Others	210	250	—	6,199	4,720	2,290
Total private sector	**3,835**	**790**	**3,038**	**10,977**	**9,680**	**10,890**
Total	**19,185**	**3,240**	**3,038**	**29,917**	**16,390**	**11,390**
Merchant						
Adani Power	320	—	502	1,048	—	—
JSW Energy	—	—	1,500	—	—	—
Lanco Infratech	300	—	—	819	—	—
Reliance Power	—	—	—	300	—	—
Tata Power	—	—	—	—	—	—
Others	270	2,340	—	2,116	4,110	410
Total	**890**	**2,340**	**2,002**	**4,283**	**4,110**	**410**
Total	**20,075**	**5,580**	**5,040**	**34,200**	**20,500**	**11,800**

Source: Kotak Institutional Equities estimates

Exhibit 3: Our target price is based on 11X FY2012E adjusted EPS
Target price calculation of CIL

EBITDA (Rs bn)	**191**
OBR (Rs bn)	32
Adjusted EBITDA (Rs bn)	223
Interest income (Rs bn)	59
PAT (Rs bn)	170
Adjusted PAT (Rs bn)	**151**
EPS (Rs/share)	27
Adjusted EPS (Rs/share)	24
P/E on FY2013E adjusted PAT (X)	**11**
Value of coal business (Rs bn)	1,721
Cash (Rs bn)	681
Market Cap (Rs bn)	2,402
Target price	**380**

Notes.
(1) Adjusted EBITDA is calculated after removing the effect of OBR adjustment.
(2) Adjusted PAT is calculated after removing the effect of OBR adjustment and interest income net of taxes.

Source: Kotak Institutional Equities estimates

Exhibit 4: Profit model, balance sheet, cash model of CIL, March fiscal year-ends, 2009-15E (Rs mn)

	2009	2010	2011	2012E	2013E	2014E	2015E
Profit model							
Net sales	**387,888**	**446,153**	**502,336**	**604,484**	**651,482**	**710,550**	**767,446**
Coal issued for other purpose	20,220	20,690	23,826	29,464	32,880	35,656	38,507
Transport and loading recovery	14,698	12,260	12,182	12,380	12,838	13,473	14,038
Total income	**424,142**	**485,774**	**550,877**	**642,627**	**698,746**	**761,294**	**820,934**
EBITDA	**39,309**	**114,735**	**146,973**	**177,979**	**190,935**	**221,061**	**247,193**
Interest income	28,447	26,940	29,660	39,074	59,108	75,730	96,277
Other Income (ex transport, interest)	8,051	13,209	6,121	15,775	15,775	15,775	15,775
Interest expense	(1,789)	(1,560)	(791)	(546)	(434)	(377)	(360)
Depreciation	(16,909)	(13,138)	(16,729)	(20,490)	(22,422)	(23,927)	(25,131)
Pretax profits	**57,110**	**140,186**	**165,234**	**211,792**	**242,961**	**288,263**	**333,753**
Tax	(36,336)	(43,996)	(55,959)	(64,127)	(73,354)	(84,838)	(103,855)
Net income	**20,774**	**96,190**	**109,275**	**147,665**	**169,607**	**203,425**	**229,897**
Extraordinary items	13	35	(602)	—	—	—	—
Reported profit	20,787	96,224	108,674	147,665	169,607	203,425	229,897
Earnings per share (Rs)	**3**	**15**	**17**	**23**	**27**	**32**	**36**
Balance sheet							
Paid-up common stock	63,164	63,164	63,164	63,164	63,164	63,164	63,164
Total shareholders' equity	**191,651**	**257,952**	**333,172**	**423,248**	**526,708**	**650,797**	**791,035**
Minority interest	19	236	326	326	326	326	326
Total borrowings	21,485	20,869	15,536	13,536	11,615	11,007	10,607
Shifting and rehab fund	12,238	14,774	16,214	19,967	24,472	29,645	35,849
Total liabilities and equity	**225,393**	**293,831**	**365,247**	**457,076**	**563,121**	**691,775**	**837,816**
Net fixed assets	110,212	120,354	128,429	153,721	168,722	173,721	167,664
Capital work-in progress	19,195	22,107	22,181	26,716	27,592	24,073	20,546
Investments	15,052	12,823	10,637	10,637	10,637	10,637	10,637
Cash	296,950	390,778	458,623	557,008	680,806	844,623	1,040,312
Current assets (excl. cash)	174,009	152,466	185,337	213,514	228,127	247,423	265,589
Current liabilities and provisions	399,293	414,316	448,725	513,558	562,292	618,517	677,071
Deferred tax asset	9,268	9,604	8,732	9,038	9,529	9,813	10,139
Misc. expenditure	—	15	34	—	—	—	—
Total assets	**225,393**	**293,831**	**365,248**	**457,076**	**563,121**	**691,775**	**837,816**
Free cash flow							
Operating cash flow, excl. working capital	39,616	106,073	125,299	167,849	191,539	227,067	254,703
Working capital changes	77,708	22,856	1,538	36,656	34,122	36,928	40,388
Capital expenditure	(18,758)	(19,804)	(17,832)	(50,317)	(38,299)	(25,408)	(15,547)
Free cash flow	**98,567**	**109,125**	**109,005**	**154,188**	**187,362**	**238,588**	**279,544**
Ratios							
Net debt/equity (%)	(143.7)	(143.4)	(133.0)	(128.4)	(127.1)	(128.1)	(130.2)
Return on equity (%)	11	43	37	39	36	35	32
Book value per share (Rs)	30	41	53	67	83	103	125
ROCE (%)	**11**	**43**	**36**	**40**	**37**	**36**	**33**

Source: Company, Kotak Institutional Equities estimates

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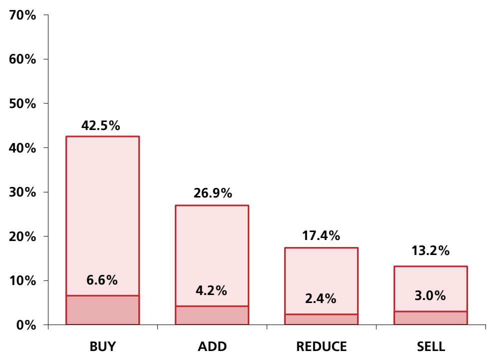

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Source: Kotak Institutional Equities

As of December 31, 2011

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