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BUY

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NOMURA STRUCTURED FINANCE SERVICES PRIVATE LIMITED, INDIA

COMPANY QUICK COMMENT

Takeaways from our call with CIL's management on non-executive wage revision: [1] Meeting on Sep 22-23 concluded by CIL asking the trade unions to present a common set of demands [2] There is disagreement over the quantum of festival-related bonus/ex-gratia for FY12 [3] Next meeting likely post the festive period in October. Earnings sensitivity – one-day labor strike can lead to production loss of 1-1.2mt and if the demand for higher bonus is met, FY12F employee cost would be higher by 1.7%; combined impact on FY12F EPS would be ~2%. Maintain Buy; wage revision remains a near-term overhang.

Price target: 433.0 INR **Price (23 Sep 2011): 365.6 INR**

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Wage revision – negotiation to resume post October festivities

Event
We had a call with the Coal India (CIL) management to assess the progress on negotiations relating to non-executive wage revision and on news reports suggesting the labor force would be going on a country-wide strike on October 10, 2011 following the breakdown of negotiations with the trade unions on bonus/ex-gratia/coverage for contract workers for 2011.

As per media reports (Press Trust of India, Business Line) on September 23/24, 2011, the labor unions demanded Rs25,000/laborer as productivity-linked bonus (or ex-gratia) whereas CIL has promised a bonus of to Rs17,000/laborer (up YoY from Rs15,000/laborer). As per CIL, the promised increase in bonus would raise total outgo on bonus from Rs5.6bn to Rs6.2bn.

ANALYSIS

Wage revision negotiations – where do things stand?
As per our conversation with the CIL management on outcome of the September 22-23, 2011 meeting with the trade unions on wage revision, we gather – [1] Meeting broadly concluded by CIL asking the five trade unions to present a common charter of demands / expectations, [2] There was disagreement over the quantum of festival-linked bonus/ex-gratia for FY2012 (as highlighted by the news reports on this issue), [3] Next meeting is likely to be scheduled after the festive season in October (i.e. potentially in October-end / November).

Bonus/ex-gratia payment – how material is the amount involved?
Based on the data available as per the news reports, the festival-linked bonus/ex-gratia accounted for ~3% of CIL's overall employee cost in FY11; CIL's promise to raise the per laborer bonus/ex-gratia from Rs15,000/- to Rs17,000/- would imply a 11.5% YoY rise in this salary component to Rs6.2bn (~3% of our FY12F total employee cost) for CIL. If CIL management agrees to the union's demand for Rs25,000/- bonus/ex-gratia per laborer, ceteris paribus, our FY12F the incremental employee cost would rise by 1.7%.

Wage revision – sensitivity to earnings
Our earnings forecast for CIL builds-in [1] A 30% wage would increase for non-executive workers (effective July 2011), which translates into 19% / 9% YoY rise in employee cost in FY12 / FY13 respectively, [2] FY12 production/offtake at 447.5mt and 452.8mt. If the reported strike on October 10 takes place, it would lead to a loss of 1-1.2mn tons of coal production. Ceteris paribus, the potential production loss together with 1.7% increase in FY12F employee cost (if labor demand for higher bonus is met), would lower our FY12F EPS forecast by ~2%.

IMPLICATIONS
[1] Although the potential impact of the debated bonus/ex-gratia component is not very significant, we expect the impending wage negotiations (and related threat of potential production/offtake disruption) to remain an overhang on the near-term stock price performance.

Instead, we focus 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 the magnitude of wage revision as bigger downside risks to our FY12F/13F earnings forecast for the company.

Exhibit 1: Coal India – Sensitivity Analysis

Impact on EPS of 1% rise in	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%
Realization of e-auction coal	0.5%	0.5%	0.5%
Realization of washed coal	0.2%	0.2%	0.2%

Source: Nomura research

Maintain BUY as the structural growth story remains intact. Stock trades at FY12F EV/Resource and EV/reserve of 2x and 0.6x respectively.

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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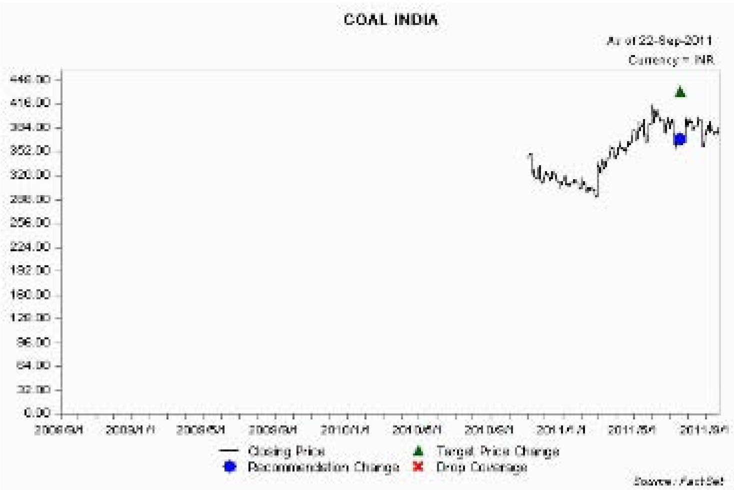
Issuer name	Ticker	Price	Price date	Stock rating	Disclosures
Coal India	COAL IN	365.6 INR	23 Sep 2011	Buy	

Previous Rating

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

Coal India (COAL IN) **365.6 INR (23 Sep 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

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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