Equities

13 November 2011 | 9 pages

# Coal India (COAL.BO)

## 2QFY12: Strong Pricing/Mix; Other Income

- Company Update

- **2QFY12 PAT above est** — CIL reported a PAT of Rs25.9bn (+74% yoy), 6% above Citi est. The outperformance was on higher than expected other income. EBITDA margin was 21% (in-line) vs 20% last year. The surge in profits was despite a 5% fall in despatches on 1) 25% higher average realization; 2) other income rising sharply.
- **Volumes fall short** — CIL's 2Q output fell 11% yoy to 80.3mt; despatches fell 5% to 93.7mt. 1H output: -5% yoy to 176.6mt; despatches flat at 200mt. Volume targets have been missed due to heavy rainfall, strikes by contract workers (Mahanadi Coalfields). Rake usage in 2Q ranged from 145-160/day (vs 168 in 1QFY12). CIL unwound ~13mt of inventory during 2Q; ~23mt in 1H (of 69mt). Citi's FY12 despatch estimate of 434mt, +2.3% yoy assumes rake availability of 180/day in 2H (despatch growth of 4.4% yoy).
- **Strong pricing/mix** — CIL's avg realization (revenues/despatches) rose 25% yoy to Rs1,403/t ($29) on higher prices (hiked in Feb11/ stronger e-auction prices). 2Q avg realisation was 3% higher than 1Q as e-auction prices rose to $50/t vs $46 in 1Q (e-auction proportion was 11.9% in 2Q vs 12.7% in 1Q) and perhaps a higher proportion of high grade coal (raw coal realization rose 3% qoq). E-auction volumes are likely to be lower in 3Q as CIL diverted 4mt of e-auction coal to the power sector in October at FSA prices. According to press reports, only 400kt (of 4mt) has been lifted so far (Telegraph). E-auction sales have resumed in November (DNA).
- **Wage hike provision** — Costs (excluding OBR adjustment) rose 24% yoy to ~22/t (of despatches) in 2Q hit by fuel and wage costs. While CIL's wage revision negotiations (due in July11) have not concluded yet, the company has made a provision in 2Q. Employee costs rose 15% yoy in 2Q to Rs57bn; and cost per employee is 20% higher yoy. We remain uncertain about the timing of the wage negotiations but expect an overall increase of 50% hike per employee (+30% yoy in FY12 and +15% in FY13).
- **Buy** — CIL trades at 11x FY13E PE (excl OBR adj) vs. global peers at 7-10x. While downside is limited, the overhang around wage/price hikes and the use of cash remains. We will review our estimates post the conference call on 14 Nov11.

| | |
|---|---|
| **Buy** | **1** |
| Price (11 Nov 11) | Rs326.30 |
| Target price | Rs418.00 |
| Expected share price return | 28.1% |
| Expected dividend yield | 1.7% |
| **Expected total return** | **29.8%** |
| Market Cap | Rs2,061,030M |
| | US$41,216M |

**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 | 21.0 | 8.0 | 43.9 | 1.1 |
| 2011A | 108,674 | 17.21 | 10.5 | 19.0 | 6.2 | 36.8 | 1.2 |
| 2012E | 147,205 | 23.31 | 35.5 | 14.0 | 4.6 | 37.8 | 1.7 |
| 2013E | 163,110 | 25.82 | 10.8 | 12.6 | 3.6 | 32.1 | 1.8 |
| 2014E | 194,467 | 30.79 | 19.2 | 10.6 | 2.9 | 30.1 | 2.1 |

Source: Powered by dataCentral

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| Fiscal year end 31-Mar | 2010 | 2011 | 2012E | 2013E | 2014E |
|---|---|---|---|---|---|
| **Valuation Ratios** | | | | | |
| P/E adjusted (x) | 21.0 | 19.0 | 14.0 | 12.6 | 10.6 |
| EV/EBITDA adjusted (x) | 15.3 | 11.5 | 8.9 | 7.3 | 5.4 |
| P/BV (x) | 8.0 | 6.2 | 4.6 | 3.6 | 2.9 |
| Dividend yield (%) | 1.1 | 1.2 | 1.7 | 1.8 | 2.1 |
| **Per Share Data (Rs)** | | | | | |
| EPS adjusted | 15.57 | 17.21 | 23.31 | 25.82 | 30.79 |
| EPS reported | 15.57 | 17.21 | 23.31 | 25.82 | 30.79 |
| BVPS | 40.84 | 52.75 | 70.55 | 90.38 | 114.16 |
| DPS | 3.50 | 3.90 | 5.50 | 6.00 | 7.00 |
| **Profit & Loss (RsM)** | | | | | |
| Net sales | 466,843 | 526,162 | 607,163 | 671,936 | 744,699 |
| Operating expenses | -362,481 | -395,918 | -443,924 | -489,344 | -520,467 |
| **EBIT** | **104,362** | **130,244** | **163,239** | **182,592** | **224,232** |
| Net interest expense | -886 | -791 | -466 | -466 | -466 |
| Non-operating/exceptionals | 36,711 | 35,781 | 50,568 | 55,991 | 62,215 |
| **Pre-tax profit** | **140,186** | **165,234** | **213,341** | **238,117** | **285,981** |
| Tax | -43,425 | -55,959 | -66,136 | -75,007 | -91,514 |
| Extraord./Min.Int./Pref.div. | 1,576 | -602 | 0 | 0 | 0 |
| **Reported net income** | **98,337** | **108,674** | **147,205** | **163,110** | **194,467** |
| Adjusted earnings | 98,337 | 108,674 | 147,205 | 163,110 | 194,467 |
| Adjusted EBITDA | 117,656 | 146,973 | 180,683 | 200,902 | 242,900 |
| **Growth Rates (%)** | | | | | |
| Sales | 14.4 | 12.7 | 15.4 | 10.7 | 10.8 |
| EBIT adjusted | 365.9 | 24.8 | 25.3 | 11.9 | 22.8 |
| EBITDA adjusted | 199.3 | 24.9 | 22.9 | 11.2 | 20.9 |
| EPS adjusted | 142.1 | 10.5 | 35.5 | 10.8 | 19.2 |
| **Cash Flow (RsM)** | | | | | |
| **Operating cash flow** | **105,956** | **89,974** | **212,758** | **228,630** | **263,951** |
| Depreciation/amortization | 13,295 | 16,729 | 17,444 | 18,310 | 18,668 |
| Net working capital | 63,910 | -12,081 | 21,216 | 37,873 | 33,843 |
| **Investing cash flow** | **9,497** | **6,975** | **-36,500** | **-37,000** | **-39,500** |
| Capital expenditure | -19,815 | -17,832 | -36,500 | -37,000 | -39,500 |
| Acquisitions/disposals | 2,230 | 2,185 | 0 | 0 | 0 |
| **Financing cash flow** | **-21,621** | **-29,108** | **-33,706** | **-36,864** | **-43,181** |
| Borrowings | -1,853 | -4,096 | 0 | 0 | 0 |
| Dividends paid | -22,100 | -24,634 | -34,740 | -37,898 | -44,215 |
| **Change in cash** | **93,832** | **67,841** | **142,552** | **154,766** | **181,271** |
| **Balance Sheet (RsM)** | | | | | |
| **Total assets** | **708,151** | **813,973** | **993,330** | **1,174,215** | **1,389,452** |
| Cash & cash equivalent | 390,782 | 458,623 | 601,175 | 755,941 | 937,212 |
| Accounts receivable | 21,686 | 30,256 | 33,269 | 36,818 | 40,805 |
| Net fixed assets | 142,461 | 150,610 | 169,666 | 188,356 | 209,188 |
| **Total liabilities** | **449,963** | **480,475** | **547,366** | **603,040** | **668,025** |
| Accounts payable | 43,358 | 52,828 | 52,890 | 58,374 | 63,844 |
| Total Debt | 19,631 | 15,536 | 15,536 | 15,536 | 15,536 |
| **Shareholders' funds** | **258,188** | **333,498** | **445,963** | **571,175** | **721,427** |
| **Profitability/Solvency Ratios (%)** | | | | | |
| EBITDA margin adjusted | 25.2 | 27.9 | 29.8 | 29.9 | 32.6 |
| ROE adjusted | 43.9 | 36.8 | 37.8 | 32.1 | 30.1 |
| ROIC adjusted | na | na | na | na | na |
| Net debt to equity | -143.8 | -132.9 | -131.3 | -129.6 | -127.8 |
| Total debt to capital | 7.1 | 4.5 | 3.4 | 2.6 | 2.1 |

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## 2Q FY12 Results

**Figure 1. Coal India - 2QFY12 Results**

| | 2QFY12A | 2QFY11A | % chg |
|---|---|---|---|
| Net sales | 131,481 | 111,023 | 18% |
| Total operating expenses | 104,207 | 88,686 | 18% |
| **EBITDA** | **27,274** | **22,337** | **22%** |
| **EBITDA margin (%)** | **20.7%** | **20.1%** | |
| Other income (excluding transportation charges recovered)* | 15,487 | 7,929 | 95% |
| Depreciation | 5,734 | 3,869 | 48% |
| EBIT | 37,027 | 26,397 | 40% |
| Interest expenses | 128 | 114 | 12% |
| PBT for the year | 36,898 | 26,283 | 40% |
| Exceptional items | 92 | -503 | |
| Total Tax | 11,132 | 10,839 | 3% |
| -Tax rate (%) | 30.2% | 41.2% | |
| Reported PAT | 25,858 | 14,941 | 73% |
| Extraordinary items (net of tax) | 73 | 4 | |
| **PAT** | **25,931** | **14,945** | **74%** |
| | | | |
| Production( m tonnes) | 80.32 | 90.52 | -11.3% |
| Despatches ( m tonnes) | 93.73 | 98.89 | -5.2% |

Source: Company Reports and Citi Investment Research and Analysis. * Transportation charges recovered are an estimate.

# 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 accounted for ~80% of India's coal production. Power generation accounts for ~75-80% of CIL's volumes. NTPC is its largest customer and accounted for 27% of its raw coal despatches in FY10. ~90% of CIL's production is from open-cast mines, where production cost ($12/t) is significantly cheaper than underground mines ($62/t). CIL had ~384k permanent employees as of 31 Mar 11.

## Investment strategy

We rate CIL as Buy (1) with a target price of Rs418. We believe CIL has significant opportunities: 1) Huge resources (64.2bn tonnes); 2) India's growing demand with CIL (431mt in FY10) controlling 80%+ of India's output; 3) Coal pricing at a discount to global prices; 4) Increasing value addition through washing/market-driven pricing; 5) High return, structurally low-cost operations (average cost ~$17/t); and 6) >US$10bn net cash. We see the 13% stock price correction over the last 3 months (underperforming the Sensex by 1%) as largely discounting volume disappointment and uncertainty on wage hikes/price revisions/ impact of the draft mining bill. We believe CIL will continue to be supported by structural upsides on pricing, margins, with limited downside to our volumes and a further de-rating as unlikely.

## Valuation

Our TP incorporates a 30% wage hike per employee in FY12, 15% hike in FY13 and 2% raw coal price hike in FY13. We believe the proposed 26% profit-sharing burden is likely to be lower but unlikely to be zero. Hence our TP is derived using a combination of two scenarios: #1 assumes no profit sharing - derived price Rs456; #2 assumes 26% profit sharing in FY13 and beyond - derived price Rs360; with a 60:40 weighting. CIL does not have a long valuation history since it listed in Nov 2010. We arrive at our TP of Rs418 using: (1) a valuation based on DCF+30% premium (Rs541) and (2) 10x Sep12 PE based valuation (Rs232); with a 60/40 weighting. The 10x PE multiple used is at the upper end of the PE band for Indonesian and Chinese producers, which currently trade in a PE band of 5.5-10.5x.

## 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; higher wages than anticipated; disruption of operations in politically unstable areas; auction for future reserves; and non-availability of critical equipment. If any of these risk factors has a greater downside impact than we anticipate, the share price will likely have difficulty attaining our target price.

# Appendix A-1

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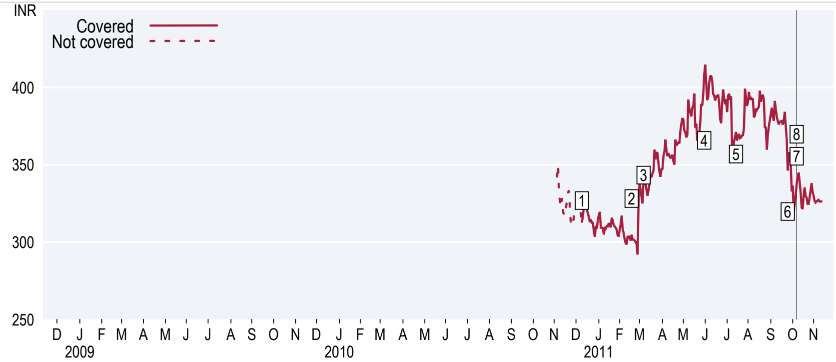
**Fundamental Research**

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 |

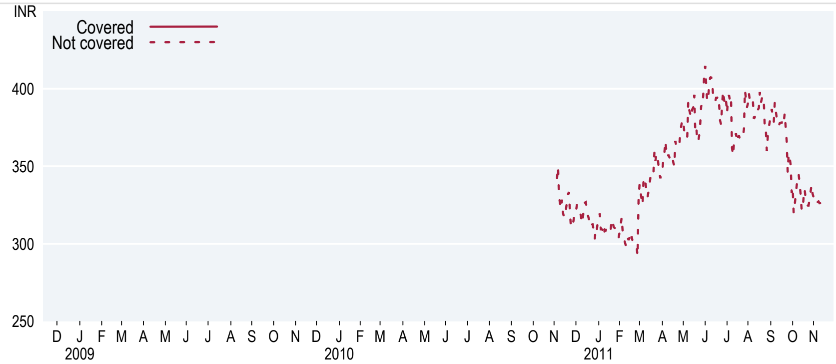
* Indicates change

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




* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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|---|---|---|---|---|---|---|
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