Indbank
Merchant Banking Services Ltd
(A Subsidiary of Indian Bank)

COAL INDIA LTD

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With continuously rising coal demand, larger demand-supply gap, better pricing and improved offtake to boost CIL earnings. Moreover, with huge coal reserves, growing industry demand and the government support, coal production in the country is expected to grow at a CAGR of around 7% till FY2014. Further, improved asset base, presence in coal washeries and further expansion plans is also encouraging factor for CIL's business.

Investor's Rationale

- The largest coal producer, Coal India Ltd (CIL) has reported strong net profit at ₹28.5 billion on net sales at ₹130.9 billion for the quarter ended September 2011 and on half-yearly basis, its consolidated profit rose at ₹67.37 billion as compared with ₹40.2 billion in H1FY11. The robust rise was attributed by the price increase in February and higher-than-expected sales.

- CIL is well positioned to capitalize on the high demand for coal in India, as it is the largest coal producing company in the world, based on its raw coal production of 431.3 million tons in FY'11. It is expected that demand for non-coking coal to grow at a CAGR of 9% from 428 million tons in fiscal 2007 to approximately 651 million tons in fiscal 2012, while the demand for coking coal is likely to increase at CAGR of 8.9% in the same period.

- The Company is continuously improving its asset base acquiring new reserve base. It has set aside over ₹200,000 million in this financial year for foreign acquisitions, with planned 45 projects which would add 81mt to its portfolio. CIL has tied up with major PSU's namely SAIL,NTPC, NMDC and RINL for the acquisition of coal assets outside India specifically in Australia, the US, and Indonesia.

- CIL's higher offtake to boost revenues during FY'12. For better transportation and to create comprehensive end to end logistic solution, it tied up with Indian Railways and Shipping Corporation. Moreover, resuming of e-auction will fetch higher margins, as sales being done at close to international prices which commands higher premium over the FSA sales price.

- CIL that provides nearly 80% of the coal in India was facing obstacles to supply adequate coal to power and steel companies due to delays in environmental clearances at some of its mines. However, it received government approval for acquiring unlisted coal assets overseas, has been on the lookout for coal mines abroad.

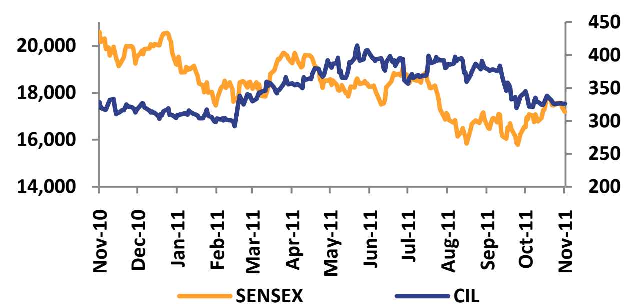
Market Data

Rating	**BUY**
CMP (₹)	326
Target (₹)	**385**
Potential Upside (%)	~18
Duration	Long Term
52 week H/L (₹)	422/287
All time High (₹)	422
Decline from 52WH (%)	22.5
Rise from 52WL (%)	13.1
Beta	0.71
Mkt. Cap (₹ bn)	2,065.4
Enterprise Val (₹ bn)	2,079.4

Fiscal Year Ended

	FY10A	FY11A	FY12E	FY13E
Revenue (₹bn)	446.1	502.3	603.8	676.6
Net Profit(₹bn)	96.5	109.2	145.8	169.0
Share Capital	63.1	63.1	63.1	63.1
EPS (₹)	15.3	17.3	23.1	26.8
PE (x)	21.4	18.9	14.2	12.2
P/BV (x)	8.0	6.2	4.6	3.5
EV/EBITDA (x)	19.8	15.4	12.8	10.8
ROE (%)	37.4	32.8	32.1	28.9
ROCE (%)	31.5	32.4	29.4	27.7

One-year price chart



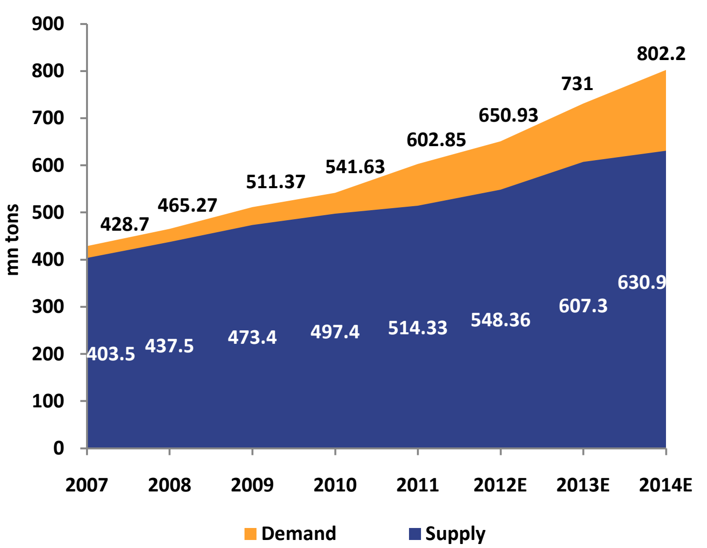
Shareholding Pattern	Sep'11	Jun'11	Diff.
Promoters	90.0%	90.0%	-
Institutional	7.9%	7.9%	-
General Public	1.5%	1.5%	-
Others	0.6%	0.6%	-

Coal demand robust; expect CILs production & offtake to improve

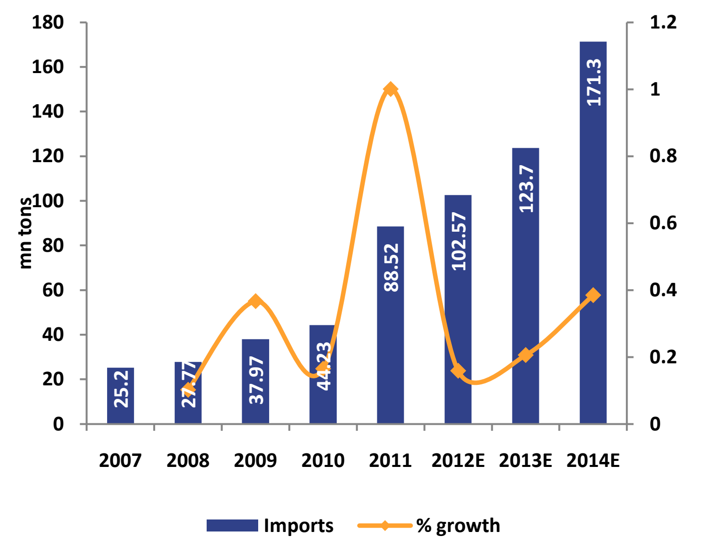
IL is well positioned to capitalize on the high demand for coal in India, particularly in the thermal power, iron and steel, cement and other manufacturing and industrial sectors. As a result of the high demand for coal in the thermal power sector and the iron and steel industry, demand for non-coking coal in India is projected to grow at a CAGR of 9% from 428 million tons in fiscal 2007 to approximately 651 million tons in fiscal 2012, while the demand for coking coal is likely to increase at CAGR of 8.9% in the same period. Most of its raw coal production is supplied for use in the thermal power sector in India. The relatively low per capita consumption of power in India compared to the world average and the continuing power deficit in India presents significant potential for growth in the demand for power in India, and demand for non-coking coal in thermal power sector is projected to grow at a CAGR of 11.3% between fiscal 2009 and fiscal 2014 Because of its pre-eminent position in the coal industry in India, the continuing dependence of the power sector on coal as a cost effective source of fuel and its long standing relationship with significant customers such as NTPC and other government owned and controlled power utilities, it plays a strategic role in the development of India's thermal power sector, which continues to be a key driver for growth in the Indian economy.

The Current deficit of thermal coal stands at 44.23mt while that of coking coal stands over 23mt. we expect the same will continue largely driven by capacity addition in both power and steel sector. Thermal coal deficit is expected to widen over 100mt by FY'12E while the same will continue for coking coal over 32mt by FY'12E. Thus, deficit in the market will enhance the imports number to bridge the demand – supply gap. In India, import is likely to grow at CAGR of ~21% to 124mn tones in FY'13E from 67mn tones in FY'10. Thus, there is huge scope for Coal India to enhance their domestic supply in the market and tap the coal driven market by reducing the level of imports. We expect CIL's production to grow at CAGR of ~5% to 495mn tones in FY'14E from 431mn tones in FY11. Besides, offtake are expected to grow at CAGR of 4% to 478mn ton in FY'14 from 424mn ton in FY'11 on the back of improved availability of rakes.

Demand Will Out play Supply (mn ton)



Imports to cross 100mt mark by 2012



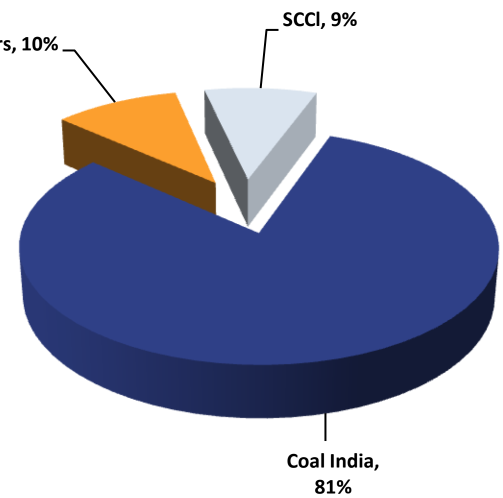
Robust Q2FY12 earnings despite lower productivity

The dominant miner of the country recorded a significant increase of 73.56% in its Q2FY12 net profits at ₹259.3 million against prior year's ₹149.4 million. On a half-yearly basis, its consolidated profit rose to ₹67 billion in Apr-Sept'11 as compared with ₹40.2 billion a year earlier. However, the net earnings of the company were spurred mainly due to interest income earned over an investment of ~₹450 billion rather than its operational efficiency. Profit growth from operations was hit due to nearly 10 million tonnes (11%) of shortfall in production compared to last year. Off-take was down by 5% to 94 mt. Despite lower sales volume, the company reported sales revenue growth of 18% due to higher realization of coal against same period of 2010. The operating profit of the miner also suffered due to higher employee cost increase of ₹7000 per employee. Overburden removal cost has also gone up. Going further, the company's revenue is expected to reach ₹676.6 billion in the coming two years, backed by its consistent efforts to bring its coal prices near to global standards.

Dominance in the Indian Coal Industry

Coal India is the largest coal producing company in the world, based on its raw coal production of 431.3 million tons in FY'11. CIL alone accounts for over 80% of the total coal production in India and offtake plans in the coming years is likely to enhance more market share. The company also poses the largest coal reserves in the world based on its reserve base of 18,862.9 million tons of Total Reserves as of April 1, 2010 the next biggest player is China Senhua Energy whose reserve base is 7,562 million tons lesser than that of CIL . With its cost efficiency, it provides coal at a very low price to coal consuming company; we expect the company will continue to serve over 80% of domestic market despite increased captive mining by major clients.

CIL accounts for 81% of coal production in India



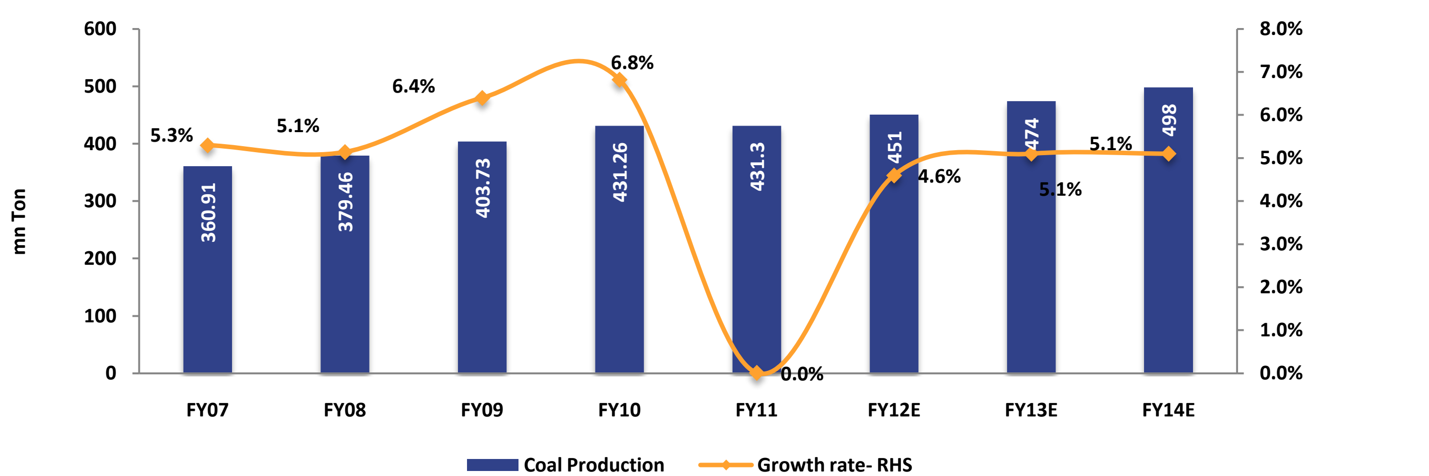
Persistent improvement in asset base

Demand for non-coking coal in India is projected at approximately 651 million tons in fiscal 2012, while the demand for coking coal is also likely to increase at same pace. Taking the increasing demand and lagging supply into consideration the company is acquiring new reserve base and also taking initiatives for overseas acquisitions in the near term. The company has obtained prospecting license for the coal blocks in Mozambique through its wholly owned subsidiary. It is also planning to make equity investments in strategic brown field and Greenfield coal assets and enter into long-term off take arrangements for the import of coal into India. They have also established a strategic joint venture ICVL with four large Indian PSUs namely SAIL,NTPC, NMDC and RINL for the acquisition of coal assets outside India specifically in Australia, the US, and Indonesia.

The company has set aside over ₹200,000mn in this financial year for foreign acquisitions. To meet the increasing target, CIL has planned 45 projects (comprising 22 capacity expansion projects for existing mines with an aggregate expected capacity of 47.51mt and 23 new mine projects with an aggregate expected capacity of 33.27mt) were in various stages of mine planning and development. This expansion will add 81mt mining capacity to CIL. The management has various other expansion plans to ram up its production to extent is dominance in Indian coal industry. There are 149 ongoing projects in CIL has been sanctioned with capacity of over 400mt.

The company currently operates 17 coal beneficiation facilities having capacity of 39.4mn tons and it is expected to develop 20 more beneficiation facilities comprising of 14 non coking coal facilities and 6 coking coal facilities with the capacity of 111.10mtpa as the management has planned to raise the level of washed coal to 40% of total production by 2017 from the current 3% by FY'17E.

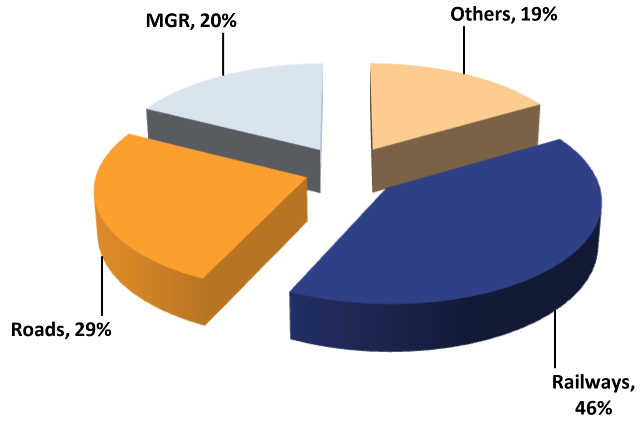
Coal Production Growth Rate (%)



Higher offtake to boost revenue

CIL has set an internal target of ~477 mt of coal sales for FY'12, backed by ~452 mt of production and ~25 mt of inventory liquidation. The company has over ~70 mt of inventory in the beginning FY'12 primarily due to inadequate transportation facilities, and has liquidated ~17.5 mt YTD. As, the company has planned to dispatch additional ~25mt inventory, the requirement of rail rakes would go up by 20 rakes/day. The company has also entered into agreement with Indian Railways according to which CIL will be able to avail on an average 190 rakes/day during peak season and will avail 175rakes/day in a year. With better transportation facility offtake numbers will improve which was impacted last year in July, August and September due to the inadequate availability of rakes as the severe law and order concerns in Jharkhand disrupting operation. Recently, CIL has entered into MOU with the shipping corporation to create comprehensive end to end logistic solution from load port to consuming end with the minimization of the logistic issues. The company has also offered to supply 447mn tons during current year to the power sector subject to the availability of 190rakes per day on an average.

Transportation break-up

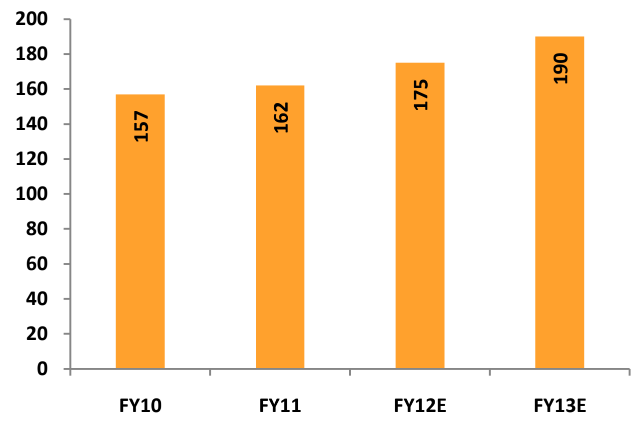


Lowest cost producer ~ tag attached

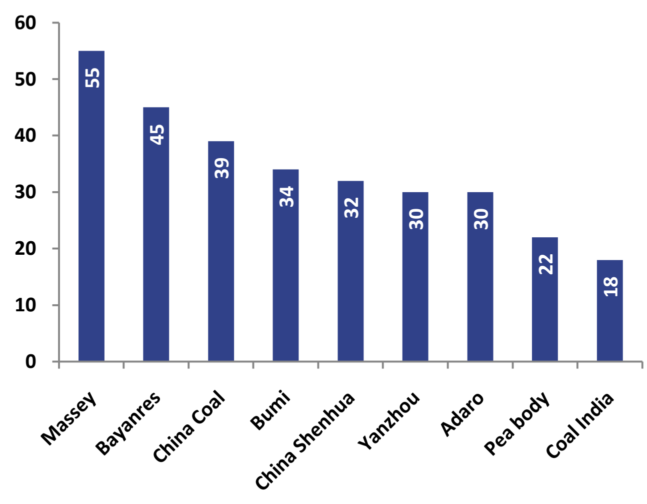
CIL benefitted highly as it is the lowest cost producer of coal at an average rate of $18/ton compared to the global average of $30/ton down by 66.67%. It was mainly on account of higher productivity per man shift which provides economies of scale to the company and also most of their productions are from open pit which is highly cost efficient helped the company to become competitive in the world by providing coal at low price. The company operates nearly 90% of its mines through open cast mining thereby able to reduce both employee and cost of equipment, coupled with strategically located open cast mines. However the benefits of operating through open cast mines could be condensed as CIL poses 279 loss making mines which accounts for nearly 13% of production. The company plans to re-start its operations at 18 underground mines that were abandoned earlier because of safety reasons.

The company is focused on increasing the contribution from underground mines, including reserve below 300meters depth by deploying advanced production equipments and technologies. CIL has able to operate at higher level of margins, as the company's employees remuneration as a % of revenue saw an improvement, its net employee cost stood at 36% for FY'11, as against 31.7% in FY'10, 48.9% in FY'09 and 41.4% during FY'08. The company currently poses 383347 employees against 397138 in FY'10, 412350 in FY'09 and 439343 during FY'07. The pricing strategy of CIL uptil now has been limited to covering rise in production costs which have not been offset by productivity and efficiency improvements. CIL offers Hefty discount of 62-63% on notified prices of coal, which is likely to narrow over the next decade.

Higher availability of Rail rakes/day would boost revenues



Lowest cost producer (US$/ton)

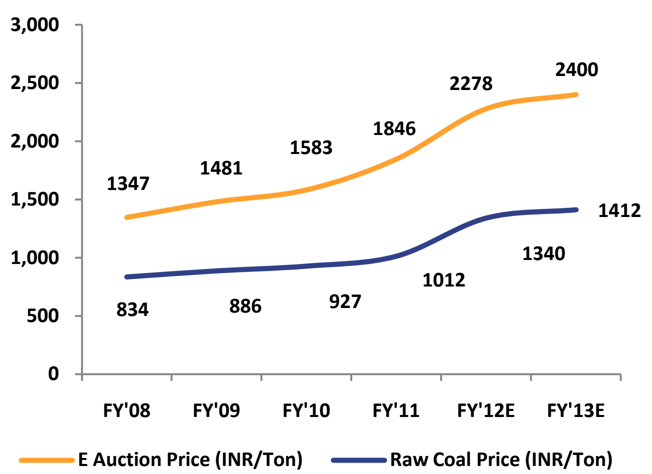


E-auction to increase the margins

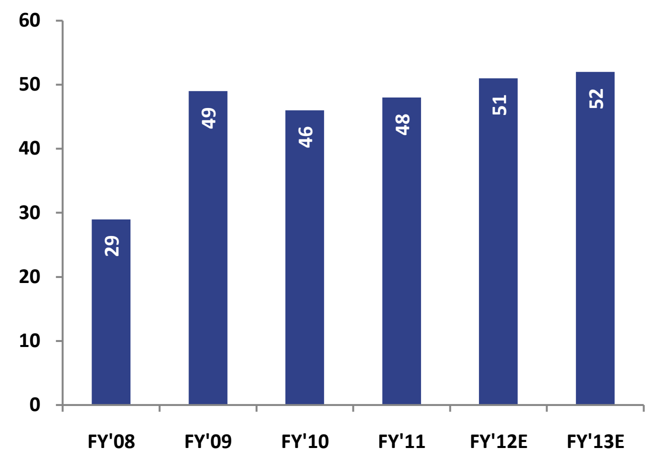
E-auction contributes 26% of CIL EBIDTA based on Q1 figures and 11-12% of volumes, sales being done at close to international prices. The price of coal is expected to remain firm over next one year impacting CIL's profitability positively over coming quarters. Further, the price increase of around 10% is expected during this year. Company sells around 11% of total sales, through e-Auction with a premium to domestic linkage coal, which has raised from 60% in FY'10 to 80% levels during FY'11. Currently the premiums are running at 90%, with international coal prices expected to raise the premium to remain firm and would benefit the CIL.

Coal India is back on the e-auction route and resumed auctioning on Nov 1, 2011, after staying away for a month following the government's push to divert supplies to fuel-starved power plants. According to Coal India officials, North Eastern Coalfields, the Assam-based subsidiary of Coal India, went for the e-auction for 20,000 tonnes of coal — 10,000 tonnes each from its Tilak and Ledo open cast mines — at a booking price of ₹4,535 a tonne. Other subsidiaries like South Eastern Coalfields, Eastern Coalfields and Western Coalfields will follow suit, according to the schedule drawn up by the Kolkata-headquartered holding company. It has already scheduled for 923,370 tonne of e-auction of coal, including auction of above 20,000 tonnes.

CIL Comparative Coal Prices



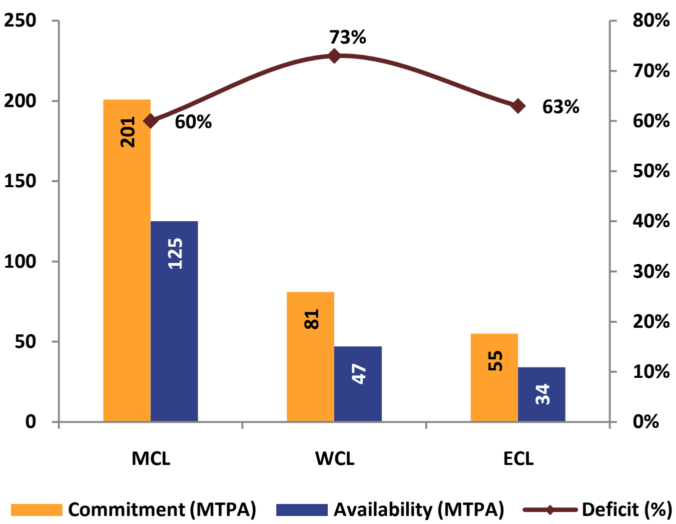
CIL Coal E-auction Sale (mn tons)



Washeries to augment future growth

Coal India operates 17 coal beneficiation facilities comprising 5 non-coking coal beneficiation facilities with capacity of 17.22 millon tons and 12 coking coal beneficiation facilities with an aggregate deigned feedstock capacity of 22.18 million tons as of March 31, 2011. Further, the company wants to develop 20 more beneficiation facilities comprising of 14 non coking coal facilities and 6 coking coal facilities with the capacity of 111.10mtpa as the management has planned to raise the level of washed coal to 40% of total production by 2017 from the current 3% by 2017E. Planned capex for the project is estimated around ₹23,275 million. The company pricing for beneficiated coal is comparatively higher at an average rate of ₹2,100/ton compared to ₹1000/ton of raw material sold at an FSA. Thus, once the facilities will be set up, Coal India revenue is likely to inch higher. The company has also planned up to integrate its facilities with open cast mines having capacities of more than 2.5 million tones.

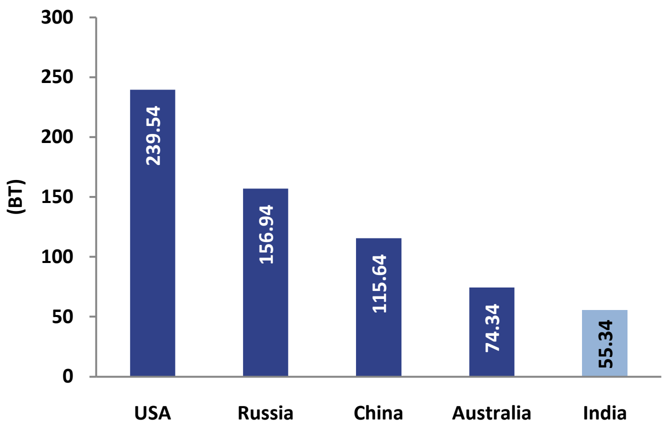
Coal Linkage Commitment vs Availability (FY12E)



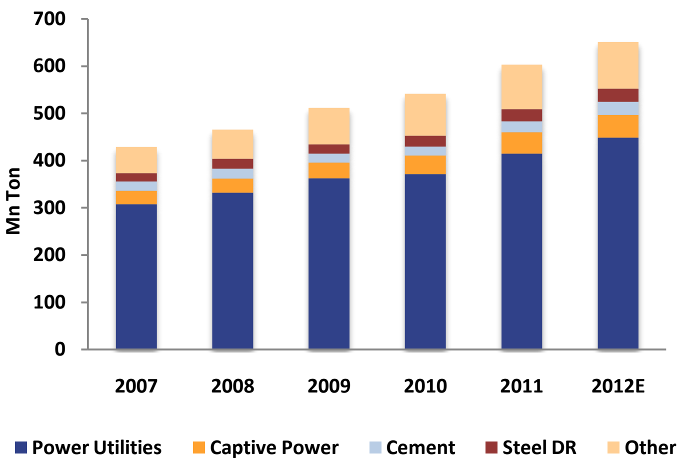
The Coal Industry

Coal is the one of the prime fuels in India and has met approximately 52 % of India's total energy needs and will continue to be crucial to India's future energy needs. According to the International Energy outlook, the world's extractable coal reserves are estimated at 826bt sufficient for next 119 years. The United States has the largest proved coal reserves, followed by Russia, China, Australia and India. Nearly 82% of the world's coal reserves are located in US (29%), Russia (19%), China (14%), certain non-OECD countries in Europe and Eurasia (primarily former Soviet countries) (10.0%), and Australia and New Zealand (9.0%). India alone account for 6.7% of the world's recoverable reserves. In India, coal is the prime fuel used to fire thermal power plants due to its availability and affordability. It also stands out to be the dominant source of energy and meets 52.4%, while oil and natural gas meets approximately 41.6% of the total primary energy requirement of the country.

World's Extractable Coal Reserves



Break-Up of Non- Coking Coal Demand (mn ton)



Indian Scenario

The Indian coal industry stands as the third largest in the world in terms of production and fourth largest in terms of reserves. Despite having one of the largest reserves, the industry does not hold a position in the league of global energy suppliers, mainly due to its soaring domestic demand. Indian coal demand is continuously rising on the back of high demand from major coal consuming sectors including Power, Cement, and Steel.

Global Scenario

China is the dominant player in global coal industry with its share in coal production accounts over 3bt or 44% of global coal production, followed by US with total production stands at .97bt, India is the third largest producers of coal accounting for 8% of coal produced globally at .56bt.

On consumption front, Asia account for more than 60% of global demand, largely driven by China while India is the third largest consumer. As, both China and India are writing the growth story of the world, the consumption seems to be obvious with India largely accelerating due to the infrastructural development.

Outlook

According to GSI and GoI outlook, the India's geological coal resources stand over 276.81bt out of which India holds~110bt of proved reserves. Coal is the dominant source of energy and met 52.4% of primary energy requirements, while the rest of the demand is fulfilled by Oil & Natural gas and other sources of energy. The coal as a source of energy derive its demand from power sector which stood over 77%, while rest demand comes from steel, cement, fertilizers, bricks, and chemicals. PSUs hold the major coal sources in India by accounting over 90% of coal production. Coal India is the leader coal producer in India accounting over 81% to total coal production, followed by Singareni Collieries Company (SCCL) accounting nearly 10% to India's coal production. Currently, the country is facing serve shortage of coal supply, during FY'11 the country remains net importer of coal to the tune of 88.5mt or over 15% of the total coal production in India. Moreover, with huge coal reserves, growing industry demand and the government support, coal production in the country is expected to grow at a CAGR of around 7% during 2011-12 to 2013-14. India aims to generate at least 400,000 MW of power by 2030 through coal-fired power plants. Hence the necessity of the mineral cannot be emphasized enough.

Balance Sheet (Consolidated)

(₹million)	FY10A	FY11A	FY12E	FY13E
Share Capital	63,163.6	63,163.6	63,163.6	63,163.6
Reserve and surplus	194,788.5	270,008.4	390,588.9	521,776.3
Net Worth	257,952.1	333,172.0	453,752.5	584,939.9
Minority Interest	236.0	326.0	326.0	326.0
Loan funds	19,431.4	15,535.7	14,500.0	14,500.0
Other Liability	14,774.3	16,213.7	20,900.0	25,335.0
Capital Employed	**292,393.8**	**365,247.4**	**489,478.5**	**625,100.9**
Gross fixed assets	349,453.2	367,211.0	498,574.0	511,369.0
Less: acc. depreciation	229,139.8	238,782.0	256,465.0	275,727.4
Net Fixed assets	120,313.4	128,429.0	242,109.0	235,641.6
Capital WIP	22,106.7	22,180.5	20,000.0	25,000.0
Total Fixed Assets	142,420.1	150,609.5	262,109.0	260,641.6
Investment	12,823.0	10,637.0	10,637.0	10,637.0
Net Current Assets	127,691.1	195,235.0	207,966.6	345,056.4
Deferred Tax	9,444.6	8,732.0	8,732.0	8,732.0
Misc. Expenses	15.0	33.9	33.9	33.9
Capital Deployed	**292,393.8**	**365,247.4**	**489,478.5**	**625,100.9**

Profit & Loss Account (Consolidated)

(₹million)	FY10A	FY11A	FY12E	FY13E
Operating Income	446,153.0	502,336.0	603,865.0	676,657.0
Operating Expenses	340,793.0	367,545.0	442,080.7	484,120.1
EBITDA	105,360.0	134,791.0	161,784.3	192,536.9
EBITDA Margin (%)	23.6	26.8	26.8	28.5
Depreciation	13,138.0	16,462.0	17,683.0	19,262.4
EBIT	92,222.0	118,329.0	144,101.3	173,274.5
EBIT Margins (%)	20.7	23.6	23.9	25.6
Interest	886.0	791.0	750.0	723.7
Other Income	48,626.0	47,628.0	65,000.0	69,000.0
PBT	139,962.0	165,166.0	208,351.3	241,550.8
Tax	43,425.0	55,959.0	62,505.4	72,465.2
Net Profit	96,537.0	109,207.0	145,845.9	169,085.6
Net Profit Margin (%)	21.6	21.7	24.2	25.0

Key Ratios

	FY10A	FY11A	FY12E	FY13E
EBITDA Margin (%)	23.6	26.8	26.8	28.5
EBIT Margin (%)	20.7	23.6	23.9	25.6
NPM (%)	21.6	21.7	24.2	25.0
ROCE (%)	31.5	32.4	29.4	27.7
ROE (%)	37.4	32.8	32.1	28.9
EPS (₹)	15.3	17.3	23.1	26.8
CEPS(₹)	17.4	19.9	25.9	29.8
P/E (x)	21.4	18.9	14.2	12.2
BVPS	40.8	52.7	71.8	92.6
P/BVPS (x)	8.0	6.2	4.6	3.5
EV/Operating Income (x)	4.7	4.1	3.4	3.1
EV/EBITDA (x)	19.8	15.4	12.8	10.8

Valuation and View

Coal India is well poised for continuous growth driven by its positioning as the largest coal producer in world and improved demand on the back of higher need for power supported by higher pricing. Its earnings are expected to grow at a CAGR of 16% during FY11-13, despite substantial escalation in wage cost, uncertain regulatory environment.

CIL is attractively placed at P/E of ~ 12.2x FY13E given the long term prospects of the company. Considering the above aspects, we rate the stock as 'BUY' at the current market price of ₹326, with the target price of ₹385.

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