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Coal India Limited

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Issue Details

- Issue Price: Rs. 225 to Rs. 245 (**5% discount for retail investors**)
- Issue Size: Rs. 14,211cr to Rs.15,475cr
- No. of Shares: 63.16cr
- Retail Reservation: 35% (19.9cr shares)
- Issue Date:
  - 18 Oct to 20 Oct (Institution)
  - **18 Oct to 21 Oct (Retail)**
- 5/5 rating from CRISIL, ICRA & CARE

Introduction

Coal India Limited (CIL), established in 1973 as a Government owned enterprise is coming out with an IPO to sell 10% stake (offer for sale) as part of the Divestment Program. CIL is the largest coal producing company (at the lowest cost) in the world and also has the highest coal reserves. CIL operates 471 mines in 21 major coalfields across 8 states in India. Out of the 471 mines, 163 are open cast mines and 273 are underground mines. However more than 90% of coal is produced from opencast mines. It's current coal production capacity is about 450 MTPA and benificiation (washing) capacity is 22 MTPA. Most of the coal produced by CIL is low grade coal which is widely used in power plants.

Revenue & Costs

- CIL sells coal by 2 means - 'Fuel Supply Agreements (FSA)' and 'e-auctions'
- FSAs are long term agreements entered with power companies and other industrial users of coal where the the price (Reserve Price) is set in consultation with the Government of India (GoI). Reserve Price is increased periodically to adjust for inflation and rise in production costs. CIL's current reserve price is around 55% lower than international coal prices. Majority (90%) of CIL's sales happen under this price mechanism
- Remaining (10%) coal is sold through e-auction, an electronic & market driven platform. Since there is supply deficit in India, coal sales in e-auctions happen at much higher price (around 66% above the reserve price)
- CIL also undertakes beneficiation (washing) of raw coal as the quality of Indian coal is not very good. Beneficiation is a process wherein the 'Grade' and 'Calorific value' of coal is improved. Gross realisations and profit margins on sale of washed coal are much higher than raw coal
- CIL employs almost 4 lakh employees and wages form single biggest cost factor (43%)

Investment Rationale

Volume driven growth:

CIL is planning to increase its production capacity to 640 MT and benificiation capacity to 300 MT by 2017. This will increase the revenue as well as margins

Margin Improvement:

- Gradually replacing natural attrition of human labour with mechanised activities to reduce employee costs
- Gradually phasing out old loss making legacy mines (mainly underground mines which have a higher cost of production) to cut losses
- Increasing sale of washed coal from 4% to 40% will increase margins. Washed coal has a higher calorific value and much higher price realisation and profit margin as compared to raw coal. Also, pay-back period for a washing plant is less than one year
- Increase in proportion of e-auction sales from 10% to 20% (still to be decided by the Government)

Monopoly Characteristics of Business:

- Revenue and earnings are more linear & less cyclical in nature, hence there is less volatility than a typical mining company
- Dominant Market Share in India (82%) which is currently facing acute coal shortage
- Lowest cost producer of coal which helps CIL to compete on pricing front
- Regulation Advantage: Ministry of Environment and Forests (MoEF) has advocated compulsory usage of washed coal if power plant is more than 1000km from the coal field for environmental reasons (going ahead, this may be reduced to 500km). There are many new power plants coming all across the country and a good proportion will be located beyond a distance of 1000km from the main coal producing regions. This regulation would ensure demand for CIL's washed coal in the future
- Favourable terms & conditions in FSA with coal consumers: Any shortfall in supply to customers to be replaced by imported coal at the customer's cost. This clause acts as a hedge if there is a shortfall in production by CIL

Good Financial Performance

- Healthy RoE (5 year average of 33%) & RoCE (5 year average of 48%)
- Consistent cash flow generation (cash on books approximately Rs. 39bn) & negligible debt
- Good dividend paying history (5 year average dividend payout ratio of 37%)

Risks & Concerns

- Sharp drop in global coal prices (by more than 50%) will put pressure on CIL's reserve price, hence impacting profitability
- Any price increase is undertaken in consultation with GoI . Power sector is the major consumer of CIL's coal (75%-80%). As cost of power is a sensitive issue, GoI may keep reserve price depressed in the future too (past 10-yr CAGR price rise is about 5%, lagging even the inflation rate)

- Production ramp-up may be constrained by Naxalism in central and eastern states and also problems of Environment clearances & land acquisitions
- Government is planning to introduce a bill wherein mining companies would have to share 26% of their profits with locals for developmental purpose

Our View

At the higher end of the price band (Rs.245), with estimated extractable coal reserves of 21.6 bn tonnes, CIL trades at an EV/ton of $1.6. CIL's EV/ton is one of the lowest in the world and such low valuations could be attributed to the discounted price at which CIL sells its coal. Also, CIL trades at a P/E of 16x and P/BV of 5.7x. Although these valuations don't appear to be very attractive, considering the monopoly nature of CIL’s business, valuations seem to be fair enough. Hence, considering the monopoly nature of business, limited downside due to coal price buffer and decent valuations, we recommend **'Subscribe'** to the issue.

Financials

Particulars (Rs Crs.)	FY2006	FY2007	FY2008	FY2009	FY2010
Total Income	34,071.6	35,043.7	39,255.2	46,095.1	52,592.3
Total Expenditure	23,848.5	25,021.5	28,838.2	38,511.3	37,157.6
Operating Profit	10,223.1	10,022.2	10,417.1	7,583.8	15,434.7
Interest	119.2	108.1	169.3	178.9	156.0
Depreciation	1,315.4	1,311.6	1,530.0	1,662.9	1,313.8
Tax	3,050.1	3,132.9	3,675.0	3,715.8	4,376.1
Net Profit	5,891.5	5,708.7	5,243.3	2,078.7	9,622.5
Extraordinary Items	38.7	72.2	533.0	6.7	14.7
Adjusted Net Profit	5,852.8	5,636.6	4,710.3	2,072.0	9,607.8
Share Capital	6,316.4	6,316.4	6,316.4	6,316.4	6,316.4
Reserves Total	7,937.3	9,896.8	10,884.3	12,691.6	19,533.0
Net Worth	14,253.6	16,213.1	17,200.7	19,008.0	25,849.4
Total Debt	2,319.0	2,143.9	1,883.9	2,148.5	2,086.9
Total Liabilities	16,572.6	18,357.0	19,084.6	21,158.4	27,959.8
Net Block	10,352.6	10,416.6	10,467.9	11,106.0	12,150.8
Capital Work in Progress	1,098.8	1,237.7	1,539.2	1,822.3	2,108.2
Investments	2,244.5	2,025.9	1,717.9	1,505.2	1,282.1
Net Current Assets	2,595.4	4,249.7	4,751.9	5,770.1	11,451.5
EPS (Rs.)	857.4	819.2	689.9	242.1	14.0
Book Value (Rs.)	2,256.6	2,566.9	2,723.2	3,009.3	40.9
Debt-Equity Ratio (x)	0.2	0.2	0.1	0.1	0.1
Current Ratio (x)	1.1	1.2	1.2	1.2	1.2
EBIDTA (%)	33.2	31.8	30.1	18.6	33.1
PAT (%)	19.2	18.1	15.2	5.1	20.6
ROCE (%)	53.8	49.9	47.5	29.4	57.5
RONW (%)	41.3	37.5	31.4	11.5	42.9

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