Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Stock Update

Coal India Limited

Improving earnings outlook; Valuation attractive

Energy & Utilities	Sharekhan code: COALINDIA	Result Update

3R MATRIX	+	=	-
Right Sector (RS)	✓		
Right Quality (RQ)	✓		
Right Valuation (RV)	✓		

\+ Positive = Neutral - Negative

What has changed in 3R MATRIX

	Old		New
RS		↔	
RQ		↔	
RV		↔	

Reco/View	Change
Reco: **Buy**	↔
CMP: **Rs. 134**	
Price Target: **Rs. 160**	↔

↑ Upgrade ↔ Maintain ↓ Downgrade

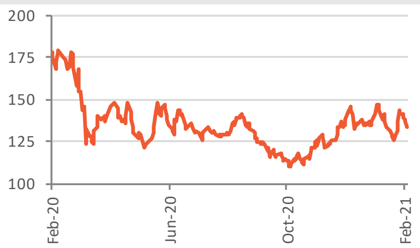
Company details

Market cap:	Rs. 83,086 cr
52-week high/low:	Rs. 182 / 110
NSE volume: (No of shares)	151.7 lakh
BSE code:	533278
NSE code:	COALINDIA
Free float: (No of shares)	208.7 cr

Shareholding (%)

Promoters	66.1
FII	6.5
DII	22.2
Others	5.2

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-7	5	2	-25
Relative to Sensex	-12	-13	-35	-49

Sharekhan Research, Bloomberg

Summary

- Q3FY21 operating profit of Rs. 5,165 crore (up 29.9% q-o-q) was 10% above our estimate as efficient cost management helped EBITDA/tonne beat expectations at Rs. 336/tonne (up 13% q-o-q). PAT at Rs. 3,085 crore was 14% below estimates due to lower other income and a high tax rate.
- Coal inventory at power plants fell to 18 days, which bodes well for higher coal offtake over Q4FY2021-Q1FY2022. Moreover, blended realisations expected to improve as e-auction premiums also improved to 25% versus 16% in 9MFY2021.
- Capital allocation for non-core investments (aluminium smelting and solar energy) would be done if there are reasonable returns. Non-core investment would be taken up in partnership with established players and Coal India will not expose itself to technology/capital risks.
- Stock trades at an attractive valuation of 4.6x its FY2023E EPS (close to trough valuation) and offers a high dividend yield of 10-12%. Hence, we maintain a Buy rating with an unchanged PT of Rs. 160.

Coal India Limited's (CIL) Q3FY2021 operating profit at Rs. 5,165 crore (up 4% y-o-y; up 29.9% q-o-q) was 10% above our estimates of Rs. 4,684 crore, led by better-than-expected EBITDA/tonne at Rs. 336/tonne (up 13% q-o-q) on the account of efficient cost management (opex/tonne declined by 6.5% y-o-y due to 5% y-o-y drop in employee cost). However, blended realisations of Rs. 1,411/ tonne (down 7.4% y-o-y; down 3% q-o-q) lagged our estimates by 3.4% and coal volume offtake at 154 million tonnes (up 8.7% y-o-y; up 14.8% q-o-q) was in line with our estimates. Fuel supply agreement (FSA) realisations declined by 4% y-o-y to Rs. 1,354/tonne while e-auction realization was down sharply by 44.1% y-o-y but improved 2% q-o-q to Rs. 1,466/tonne. PAT, at Rs. 3,085 crore (down 21.4% y-o-y; up 4.7% q-o-q), was 14% below our estimate as beat in operating profit was offset by higher depreciation, lower other income and higher effective tax rate of 35% (versus assumption of 25.2%). Coal stock at power plants declined sharply to 34 million tones, while coal inventory reached critical levels of 18 days (from 30-34 days earlier). This along with improving thermal power generation (up 8% in November 2020 to January 2021) bodes well for higher coal offtake by power plants in Q4FY2021-Q1FY2022. Additionally, e-auction premiums are also improving as it at 25% in Q4FY2021 so far versus 16% in 9MFY2021. All the above factors would drive an earnings recovery for Coal India and the management expects current high receivables to reduce from April 2021 onwards. Moreover, the management is hopeful of maintaining FY2020's dividend of Rs. 12/share in FY2021. CIL is trading at an attractive valuation of 4.6x its FY2023E EPS, which is at a steep ~63% discount to its historical average one-year forward P/E multiple of 12.5x) and the stock offers high dividend yield of 10-12%. Hence, we maintain a Buy on Coal India with an unchanged PT of Rs. 160.

Key positives

- Coal offtake soared by 8.7% y-o-y and 14.8% q-o-q to 154 million tonnes given improving demand.
- Better-than-expected EBITDA/tonne at Rs. 336/tonne (up 13.1% q-o-q) versus estimate of Rs. 303/ tonne led by lower than-expected operating costs.

Key negatives

- Lower-than-expected blended realisations of Rs. 1,411/tonne (down 7.4% y-o-y; down 3% q-o-q) as FSA realisation declined by 4% y-o-y/q-o-q to Rs. 1,354/tonne.
- Receivables remain high at Rs. 21,500 crore as of December 2020 versus normal level of Rs. 5,000-6,000 crore.

Our Call

Valuation – Maintain Buy with an unchanged PT of Rs. 160: We have increased our FY2021-FY2023 earnings estimates by 4-5% to factor in higher coal volume offtake as demand from power/non-power sector expected to improve (management guidance of 12-13% overall volume growth for FY2022). Moreover, the management's focus on containing costs by cutting manpower expenses and closing loss-making mines would aid to profitability over FY2022E-FY2023E. Thus, we expect a strong recovery in CIL's earnings and expect a 19% PAT CAGR over FY2021E-FY2023E, with robust RoE of 44%. CIL's underperformance versus the benchmark index (25% decline in its stock price as compared to 24% increase in the Sensex in the past one year) makes valuation attractive at 4.6x its FY2023E EPS (close to trough level) and high dividend yield of 10-12% comforts investors. Hence, we maintain a Buy on Coal India with an unchanged PT of Rs. 160.

Key Risks

Lower-than-expected volume offtake amid any weakness in electricity demand given COVID-19 and realisations (especially for e-auction) could impact margins and earnings outlook. The government's divestment plan could act as an overhang on the stock.

Valuation (Consolidated) Rs cr

Particulars	FY19	FY20	FY21E	FY22E	FY23E
Revenues	99,547	96,080	89,744	98,833	1,04,562
OPM (%)	25.1	22.8	18.8	18.6	20.4
Adjusted PAT	17,462	16,714	12,494	14,911	17,765
% YoY growth	*21.1*	*-4.3*	*-25.3*	*19.4*	*19.1*
Adjusted EPS (Rs.)	28.3	27.1	20.3	24.2	28.8
P/E (x)	4.7	4.9	6.6	5.5	4.6
P/B (x)	3.1	2.6	2.4	2.2	2.0
EV/EBITDA (x)	2.1	2.8	4.2	3.7	3.1
RoNW (%)	75.4	57.0	37.3	40.8	44.3
RoCE (%)	87.7	60.7	36.9	40.7	45.1

Source: Company; Sharekhan estimates

Operating profit above estimates led by efficient cost management; coal offtake volume up 8.7% y-o-y

Q3FY2021 operating profit at Rs. 5,165 crore (up 4% y-o-y; up 29.9% q-o-q) was 10% above our estimates of Rs. 4,684 crore, led by better-than-expected EBITDA/tonne at Rs. 336/tonne (up 13% q-o-q) led by efficient cost management (opex/tonne declined by 6.5% y-o-y due to 5% y-o-y drop in employee cost). However, blended realisations of Rs. 1,411/tonne (down 7.4% y-o-y; down 3% q-o-q) lagged our estimates by 3.4% y-o-y and coal volume offtake stood at 154 million tonnes (up 8.7% y-o-y; up 14.8% q-o-q) was in line with our estimates. Fuel supply agreement (FSA) realisations declined by 4% y-o-y to Rs. 1,354/tonne while e-auction realization was down sharply by 44.1% y-o-y but improved 2% q-o-q to Rs. 1,466/tonne. PAT, at Rs. 3,085 crore (down 21.4% y-o-y; up 4.7% q-o-q), was 14% below our estimate as beat in operating profit was offset by higher depreciation, lower other income and higher effective tax rate of 35% (versus assumption of 25.2%).

Q3FY2021 conference call takeaways

- **Production guidance –** The management is indicated that current coal production run rate is at 2.2 million tonnes per day while coal off-take is at 1.8 million tonnes per day. The company is quite optimistic of crossing 600 million tonnes of coal production in FY2021E if offtake improves in Q4FY2021. The company has guided for production/offtake growth of 12-13% for FY2022E.
- **Reducing coal inventory with power plants –** The management indicated that coal stocks with power plants has reduced to 34 million tonnes from 50 million tonnes earlier. Coal stocks at power plants also declined to 18 days from 30-34 days earlier. With a sharp fall in power plants' inventories levels, the management is quite optimistic of an uptick in coal offtake from power plants given requirement to maintain minimum level of inventory.
- **Capital allocation for non-core investment –** Coal India is planning to diversify through potential investment in aluminium smelting plants (along with a PSUs) and integrated solar wafer manufacturing facility. The management's feasibility studies are going on to evaluate investment in these businessesand any decision would be taken only if there are adequate returns. Coal India would partner with established players would not take technology or capital risk. Capex plan on above would be firmed in next 1-2 quarters if investments are viable.
- **Capex guidance –** The company increased its FY2021E capex guidance to Rs. 13,000 crore and expects to spend Rs16000-17000 crore for FY2022E. Coal India has spent close to Rs. 9300 crore on capital expenditure till January 2021. Out of the total capex, Rs. 3000 crore would be spent on heavy equipment, Rs. 2,500 crore on land acquisition, some portion on moderation of evacuation system and improvement in rail connectivity.
- **E-auction premium and volume –** The management said that e-auction premium is at 25% so far in Q4FY2021 and could increase further to 30%. The average e-auction premium was at 16% for Coal India till January 2021. The management is confident blended realisation would improve as fresh coal booking is being done at higher prices. The company has achieved volume of >60 million tonnes through e-auctions and is confident of achieving the FY2021 e-auction volume target of 120 million tonnes.
- **Receivables –** The management highlighted that receivable were largely flat q-o-q at Rs. 21,500 crore as of December 2020 and expects reduction in receivables from April 2021 onwards.
- **View on competition –** The management expects that likely commencement of coal production from new mines would take at least 3-4 years given high gestation period as commercial coal mining would require lot of regulatory approvals. Thus, there is no threat to Coal India's volume offtake outlook.
- FSA realisations declined as the company has neither taken any performance incentive nor imposed any penalty on entities for lower than committed coal offtake.
- The company shut 13 under-ground loss making mines (out of the total target to close 23 mines). Additionally, seven mines are undergoing upgradation and if case there is no economical benefit these mines would also closed. The company expects cost savings of Rs. 300-400 crore from closure of unproductive underground mines.
- Provisions for Q3FY2021 jumped as the company has made provision related to the earlier receivables (> 3 years) from government companies. These provisions are expected to get reversed as the management is hopeful to receive dues.
- Coal-based power generation has increased by 8% recently.
- The company aims to maintain dividend at FY2020 level of Rs. 12/share.

Results (Consolidated) Rs cr

Particulars	Q3FY21	Q3FY20	Y-o-Y %	Q2FY21	Q-o-Q %
Net Sales	23,686	23,190	2.1	21,153	12.0
Total Expenditure	18,521	18,222	1.6	17,178	7.8
Reported operating profit	5,165	4,968	4.0	3,975	29.9
Adjusted operating profit	**5,165**	**4,968**	**4.0**	**3,975**	**29.9**
Other Income	649	1,412	-54.1	1085	-40.2
EBITDA	5,813	6,380	-8.9	5,060	14.9
Interest	155	151	2.7	147	5.5
Depreciation	916	894	2.4	852	7.5
Exceptional income/(expense)	0	0	NA	0	NA
Reported PBT	4,742	5,335	-11.1	4,060	16.8
Adjusted PBT	**4,742**	**5,335**	**-11.1**	**4,060**	**16.8**
Tax	1,658	1,414	17.3	1,109	49.5
PAT before share of profit from JVs and MI	3,084	3,921	-21.3	2,951	4.5
Share of profit from JVs	0	1		1	
Minority interest	-1	-2		3	
RPAT	3,085	3,924	-21.4	2,948	4.7
Adjusted PAT	**3,085**	**3,924**	**-21.4**	**2,948**	**4.7**
O/S Shares (cr)	616	616		616	
Reported EPS (Rs)	5.0	6.4	-21.4	4.8	4.7
Adjusted EPS (Rs)	5.0	6.4	-21.4	4.8	4.7
Margins (%)			***BPS***		***BPS***
Adjusted OPM	21.8	21.4	38.1	18.8	301.4
Adjusted NPM	13.0	16.9	-389.4	13.9	-91.1

Source: Company; Sharekhan Research

Key operating performance

Particulars	Q3FY21	Q3FY20	Y-o-Y %	Q2FY21	Q-o-Q %
Coal production (mt)	157	148	6.3	115	36.4
Coal offtake (mt)	154	142	8.7	134	14.8
Blended realisation (Rs/tonne)	1,411	1,523	-7.4	1,454	-3.0
FSA realisation (Rs/tonne)	**1,354**	**1,411**	**-4.0**	**1,412**	**-4.1**
E-auction realisation (Rs/tonne)	1,466	2,623	-44.1	1,437	2.0
Adjusted EBITDA excluding OBR (Rs/tonne)	413	437	-5.4	280	47.4

Source: Company; Sharekhan Research

Outlook and Valuation

■ Sector view - India's coal demand expected to reach 1250-1500 million tonne with rise in power generation

Coal accounts for 55% of India's total commercial energy production. Although its share in overall energy mix of India is expected to go down over next decade but it would continue to remain as primary energy and source and absolute coal demand is expected to improve given higher demand from sectors such as power and steel. The industry estimates suggests that India's coal demand could reach 1,250-1,500 million tonnes by FY2030 assuming 6-8% growth in power demand and despite considering growth in renewable energy capacity to 450 GW by FY20230 (from 123 GW in FY2019). Additionally, coal offtake also improved recently as coal-based power generation increased sharply by 9.5%/14.6% y-o-y in September/October 2020.

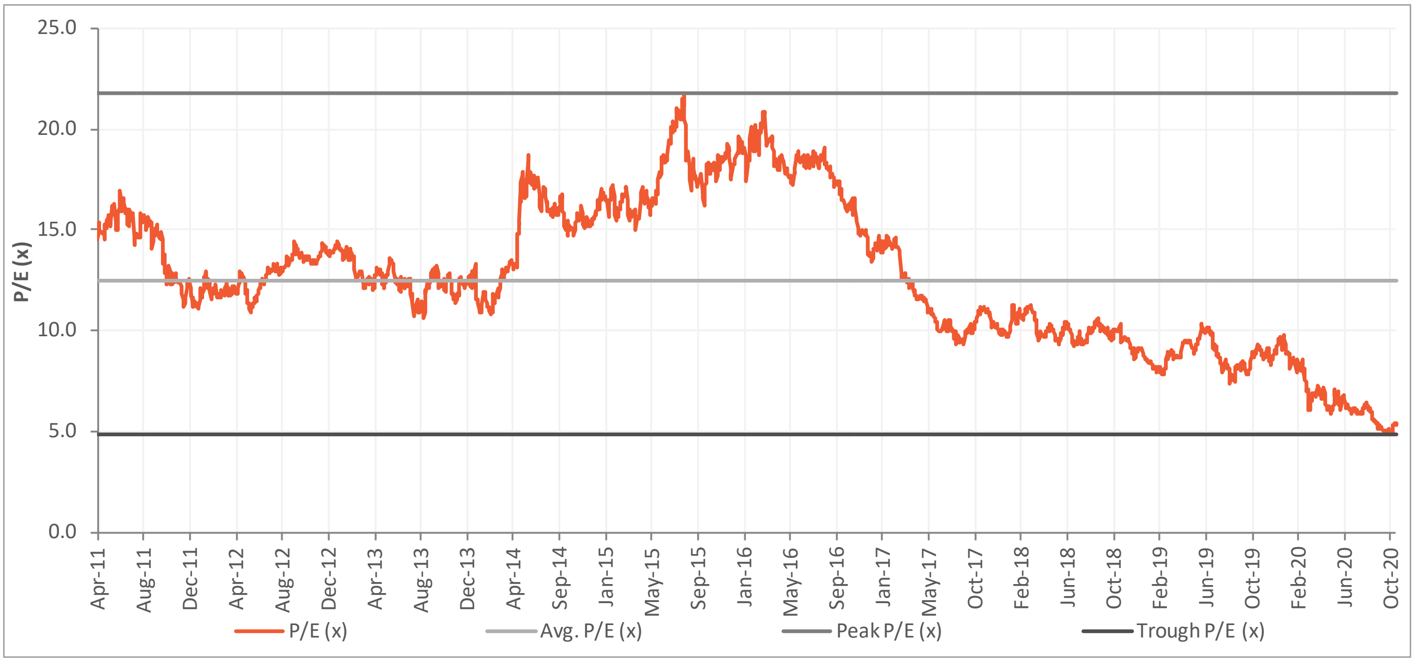
■ Company outlook - Improving volume and earnings outlook

Coal stock at power plants has declined sharply to 34 million tones and coal inventory has reached critical level of 18 days (from 30-34 day earlier). This coupled with improving thermal power generation (up 8% in November 2020 to January 2021) bodes well for higher coal offtake by power plants in Q4FY2021-Q1FY2022. Additionally, e-auction premium is also improving as it at 25% in Q4FY2021 so fat versus 16% in 9MFY2021. All the above factors would drive earnings recovery for Coal India and management expect current high receivables to reduce from April 2021 onwards.

■ Valuation - Maintain Buy on Coal India with an unchanged PT of Rs. 160

We have increased our FY2021-FY2023 earnings estimates by 4-5% to factor in higher coal volume offtake as demand from power/non-power sector expected to improve (management guidance of 12-13% overall volume growth for FY2022). Moreover, the management's focus on containing costs by cutting manpower expenses and closing loss-making mines would aid to profitability over FY2022E-FY2023E. Thus, we expect a strong recovery in CIL's earnings and expect a 19% PAT CAGR over FY2021E-FY2023E, with robust RoE of 44%. CIL's underperformance versus the benchmark index (25% decline in its stock price as compared to 24% increase in the Sensex in the past one year) makes valuation attractive at 4.6x its FY2023E EPS (close to trough level) and high dividend yield of 10-12% comforts investors. Hence, we maintain a Buy on Coal India with an unchanged PT of Rs. 160.

One-year forward P/E (x) band



Source: Sharekhan Research

About company

CIL is engaged in the production and sale of coal. The company operates through ~82 mining areas across eight states and contributes to 82% of India's coal production. The company's products include coking coal (used in steel making and metallurgical industries), semi-coking coal (used in steel making, merchant coke manufacturing, and other metallurgical industries), non-coking coal (mainly used in power generation; also used for cement, fertilizer, glass, ceramic, paper and chemical), and washed and beneficiated coal (manufacturing of hard coke for steel making, used in power generation, cement and sponge iron).

Investment theme

The government's plans to increase coal production to substitute imports (stands more than 200 million tonne) would help CIL to register sustainable volume growth over the next couple of years. Moreover, cost-control initiatives such as reduction of manpower (employee cost accounts for 53-54% of overall cost) would cushion margins. Moreover, valuations are at a steep discount to historical averages and the stock also offers high dividend yield.

Key Risks

- Lower-than-expected volume offtake and realisation (especially e-auction) could impact margin and earnings outlook.
- The government's divestment plan could act as an overhang on the stock.

Additional Data

Key management personnel

Pramod Agrawal	Chairman and Managing Director
S. Sarkar	Director – Finance
Binay Dayal	Director – Technical

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Life Insurance Corp of India	11.1
2	HDFC Asset Management Co Ltd	3.9
3	CPSE ETF	2.9
4	Nippon Life India Asset Management	2.8
5	BHARAT 22	1.1
6	ICICI Prudential Asset Management	1.0
7	Vanguard Group Inc/The	0.9
8	SBI Funds Management Pvt Ltd	0.7
9	BlackRock Inc	0.6
10	Aditya Birla Sun Life Asset Management	0.4

Source: Bloomberg

Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and detoriating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research

Sharekhan

by BNP PARIBAS

Know more about our products and services

For Private Circulation only

Compliance Officer: Mr. Joby John Meledan; Tel: 022-61150000; email id: compliance@sharekhan.com;

For any queries or grievances kindly email igc@sharekhan.com or contact: myaccount@sharekhan.com

Registered Office: Sharekhan Limited, 10th Floor, Beta Building, Lodha iThink Techno Campus, Off. JVLR, Opp. Kanjurmarg Railway Station, Kanjurmarg (East), Mumbai – 400042, Maharashtra. Tel: 022 - 61150000. Sharekhan Ltd.: SEBI Regn. Nos.: BSE / NSE / MSEI (CASH / F&O / CD) / MCX - Commodity: INZ000171337; DP: NSDL/CDSL-IN-DP-365-2018; PMS: INP000005786; Mutual Fund: ARN 20669; Research Analyst: INH000006183;