Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Coal India Ltd

Business fundamentals brighten; valuation attractive

Energy & Utilities	Sharekhan code: COALINDIA	Company 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. 155**	
Price Target: **Rs. 185**	↔

↑ Upgrade ↔ Maintain ↓ Downgrade

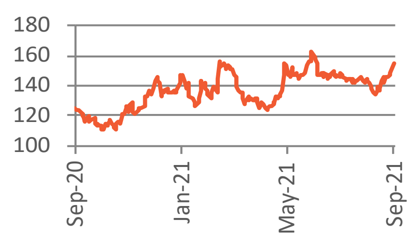
Company details

Market cap:	Rs. 95,967 cr
52-week high/low:	Rs. 165/110
NSE volume: (No of shares)	131.6 lakh
BSE code:	533278
NSE code:	COALINDIA
Free float: (No of shares)	208.7 cr

Shareholding (%)

Promoters	66.1
FII	6.6
DII	21.5
Others	5.8

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	9	-3	5	24
Relative to Sensex	4	-14	-10	-26

Sharekhan Research, Bloomberg

Summary

- Coal India is seeking government nod to hike coal prices by 10-11% under a long-term contract for power companies. For every Rs. 50/tonne price hike, Coal India's PAT would rise by 10%.
- Rising e-auction premium (46% in Aug'21) and higher coal offtake (up 24% y-o-y during April-August) would help PAT clock an 18% CAGR over FY21-24E with potential for earnings upgrade on likely rise in coal realisations.
- Management aims to lower receivables by ~40% to Rs. 12,000 crore by Mar'22. This coupled with a rise in earnings would improve cash to ~Rs. 26,000 crore in FY22 and help sustain high dividend payment ratio at ~65%.
- Improving earnings growth outlook, high RoE of ~45% and dividend yield of ~12% makes valuation attractive at 5.1x FY23E EPS (close to trough level and ~30% discount to Asian peers). Hence, we maintain a Buy on Coal India with an unchanged PT of Rs. 185.

Coal India Limited (CIL) is witnessing improvement in its operational performance with e-auction premium recovering to~ 46% in August 2021, volume growth strong at 24% y-o-y during April-August and declining receivables (management eyes receivables of Rs. 12,000 crore by March 2022). In addition, CIL is mulling a 10-11% hike (Rs. 139-153/tonne) in FSA realisations (accounts for 80% of volumes), which would further boost earnings growth over FY22E-24E.

- **Improving coal pricing environment:** Coal India's e-auction premium over notified price has increased to ~46% in August and the company is mulling an 10-11% hike in FSA coal prices on Q1FY22 level of Rs. 1,394/tonne to pass on higher operating cost and likely wage revision. For every Rs. 50/tonne increase in FSA realisations would result in incremental earnings of Rs. 1,915 crore or a ~10% rise in our FY23E PAT of Rs. 18,802 crore.
- **Volume offtake remains strong:** Coal India's volume offtake has improved markedly, rising by 24% y-o-y to 259 million tonnes during April-August 2021. Higher coal demand from the power sector, rising e-auction volumes and lower coal inventory with power plants would drive volume recovery (we expect 6% volume CAGR over FY21-24E).
- **Receivables from power sector reduce:** Coal India's receivables has declined to ~Rs. 18,330 crore in August as compared to Rs. 19,623 crore as of March 2021. The management is confident of a sharp reduction in receivables to ~Rs. 12,000 crore by March 2022 given expectation of improvement in financials of discoms/power generation companies and focus on efficient coal supplies. This would improve cash flows and help sustain high dividend payout.

Our Call

Valuation – Maintain Buy on CIL with an unchanged PT of Rs. 185: Improving earnings growth outlook (expect 18% PAT CAGR over FY21-FY24E), high RoE of ~45% and dividend yield of 12% makes the stock's valuation attractive at 5.1x FY2023E EPS (close to trough levels and at steep discount to average one-year forward PE of 7.3x for Asian peers). Potential efficient capital allocation for non-core investments (aluminium smelting and solar energy) could act as key catalysts for the stock. We maintain a Buy on Coal India with an unchanged PT of Rs. 185.

Key Risks

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

Valuation (Consolidated) Rs cr

Particulars	FY21	FY22E	FY23E	FY24E
Revenue	90,026	1,00,402	1,05,301	1,12,462
OPM (%)	20.6	21.0	22.1	23.8
Adjusted PAT	12,700	16,539	18,802	21,124
% YoY growth	-24.0	30.2	13.7	12.4
Adjusted EPS (Rs.)	20.6	26.8	30.5	34.3
P/E (x)	7.5	5.8	5.1	4.5
P/B (x)	2.6	2.4	2.2	1.9
EV/EBITDA (x)	4.5	3.3	2.9	2.3
RoNW (%)	37.0	43.1	44.5	45.3
RoCE (%)	38.9	43.8	46.1	47.9

Source: Company; Sharekhan estimates

Coal India mulling FSA price hike of 10-11% - could result in significant earnings upgrade

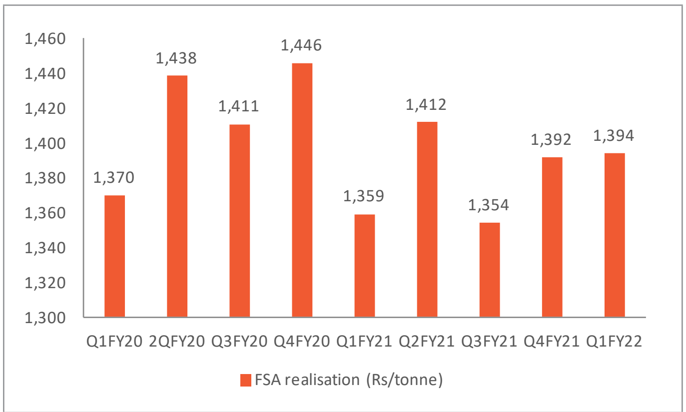
Coal India is seeking the government's approval to hike coal prices by 10-11% under long-term contracts for power companies, so as to mitigate the impact of an overall increase in the operating cost and likely wage revision in the coming months. Currently, Coal India fetches an FSA realisation of Rs. 1,394/tonne and the segment accounts for ~80% of overall volumes. We highlight here that every Rs. 50/tonne increase in FSA realisation would increase Coal India's earnings by ~Rs. 1,915 crore or 10% of our FY23E PAT of Rs. 18,802 crore. A potential increase in FSA realisation and rising e-auction premium at 46% in Aug'21 (at 20-month high level) could result in significant earnings upgrades for Coal India.

Sensitivity analysis of FSA and e-auction on FY23E PAT

	FSA realisation (Rs. /tonne)					
		1,370	1,400	**1,430**	1,480	1,530
E-auction realisation (Rs. /tonne)	1,675	15,637	16,786	17,935	19,850	21,765
	1,725	16,070	17,219	18,368	20,284	22,199
	1,775	16,504	17,653	**18,802**	20,717	22,632
	1,825	16,937	18,086	19,235	21,150	23,065
	1,875	17,370	18,519	19,668	21,584	23,499

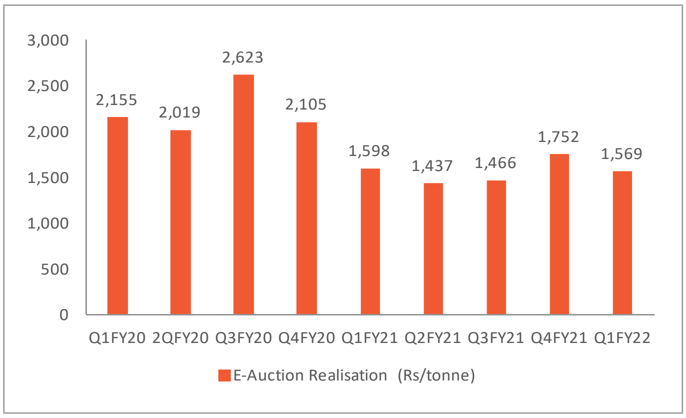
Source: Sharekhan Research

FSA realisation trend



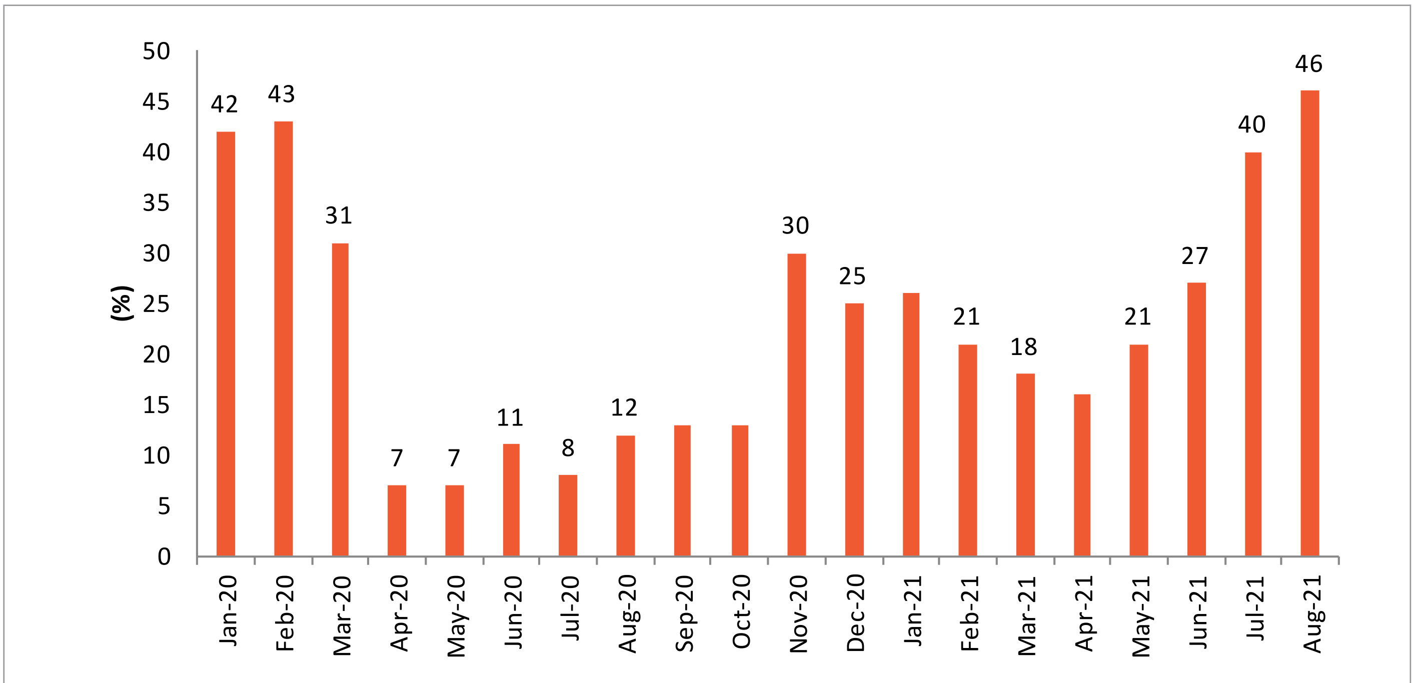
Source: Company; Sharekhan Research

E-auction realisation trend



Source: Company; Sharekhan Research

E-auction premium recovers to 46% in August 2021



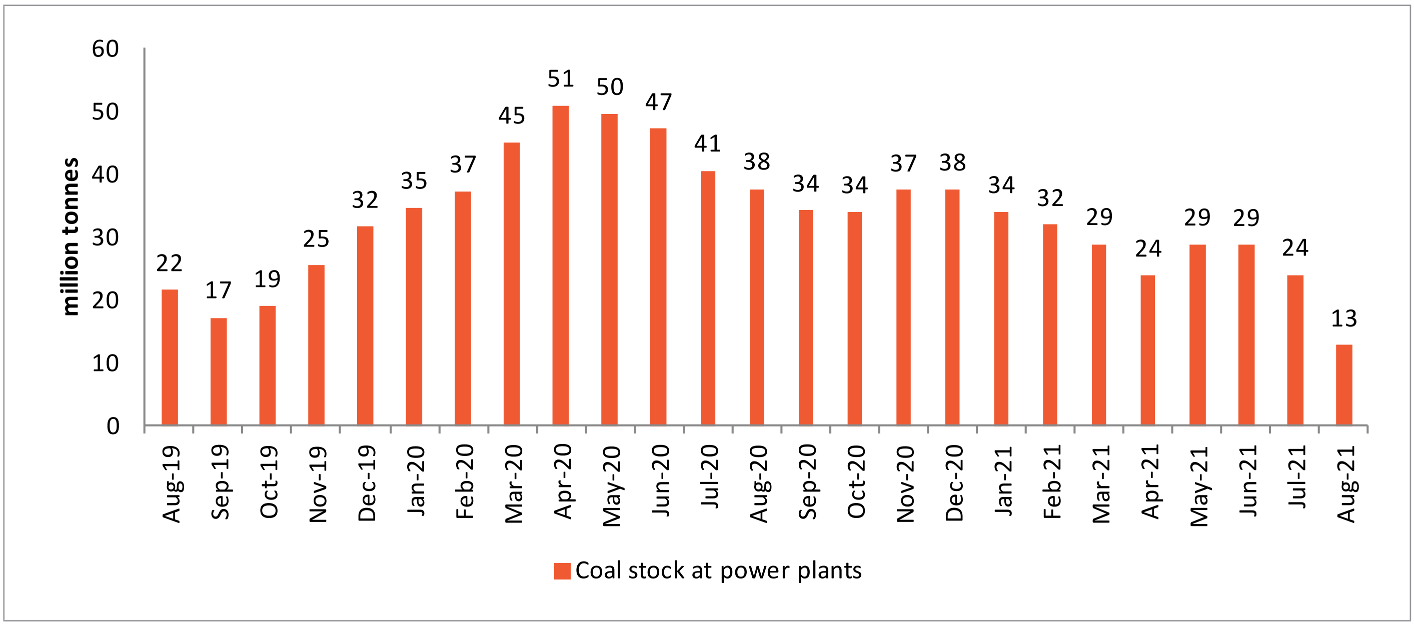
Source: Ministry of Coal; Industry reports; Sharekhan Research

Rising coal offtake gives confidence in term of volume growth – expect 6% volume CAGR over FY21-24E

Coal India's volume offtake has witnessed a strong recovery with year-on-year volume growth for six consecutive quarters since March 2021. Overall, coal offtake has witnessed strong growth of 24% y-o-y to 259 million tonnes during April-August 2021 led by rising coal demand from power companies (CIL's volume dispatches to power sector increased sharply by 27.2% y-o-y to 206 million tonnes during April-August 2021) as electricity consumption has recovered sharply.

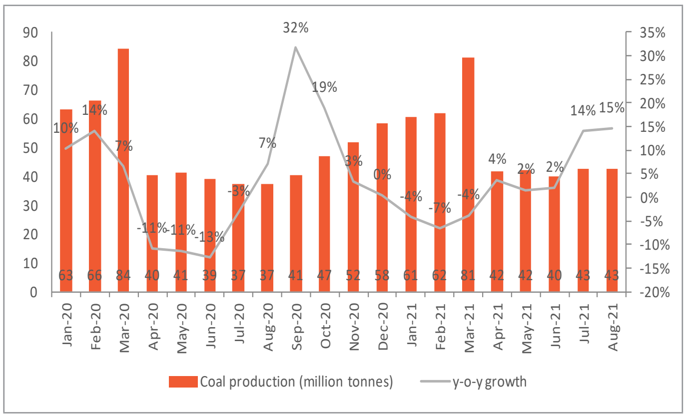
Rising international coal prices dragged down coal imports by power plants, which are solely dependent upon overseas coal. This created a shortage of coal for power generation and stocks with power plants slumped to 13 million tonnes in August 2021 from 29 million tonnes in June 2021. Thus, we believe that CIL's coal dispatches would remain strong and expect 9%/3%/5% y-o-y growth in its coal offtake in FY2022E/FY2023E/FY2024E to 625mt/643mt/676mt.

Declining coal stocks at power plants to fuel coal demand



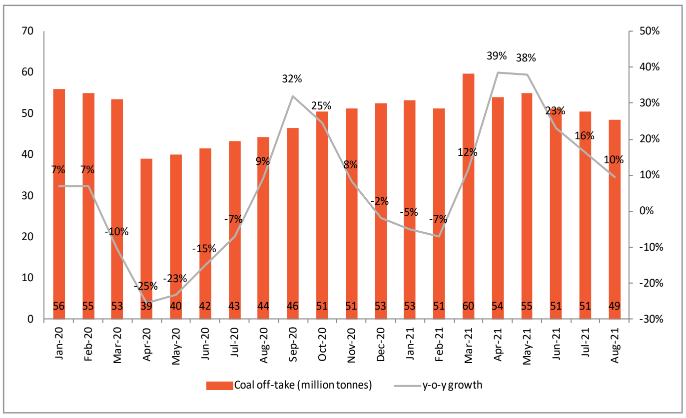
Source: National Power Portal; Sharekhan Research

Monthly coal production trend



Source: Company; Sharekhan Research

Monthly coal off-take growth remains strong

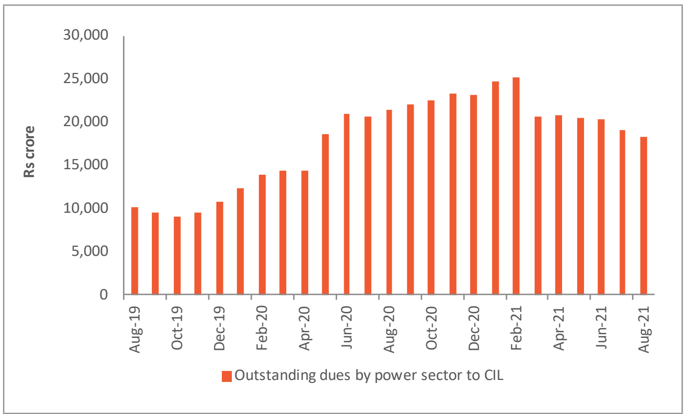


Source: Company; Sharekhan Research

Reducing receivables level to improve cash position and help sustain high dividend payout

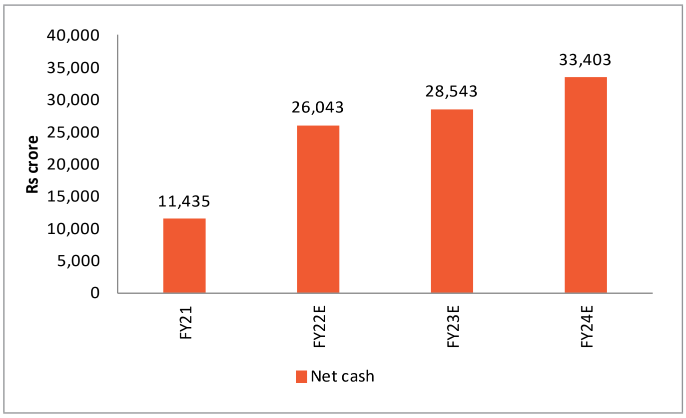
Coal India's receivables spiked to a peak level of ~Rs. 25,000 crore in February 2021 and were higher by 162%/36% y-o-y to Rs. 14408 crore/Rs. 19,623 crore in FY2020/FY2021 due to delayed payments from power generation companies given weak financial position of state discoms. However, with improving financials of state discoms, rising power demand and efficient supply management by Coal India, the company's receivable level has decline to Rs. 18,330 crore as of August 2021 and the management expects the same to reduce further to Rs. 12,000-13,000 crore by March 2022. This would free-up cash stuck in working capital and higher earnings would considerably improve Coal India's cash position over FY2022E-FY2023E. Thus, we expect dividend payout ratio to remain high at 65% with dividend yield in excess of ~12%.

Declining receivables to improve cash position



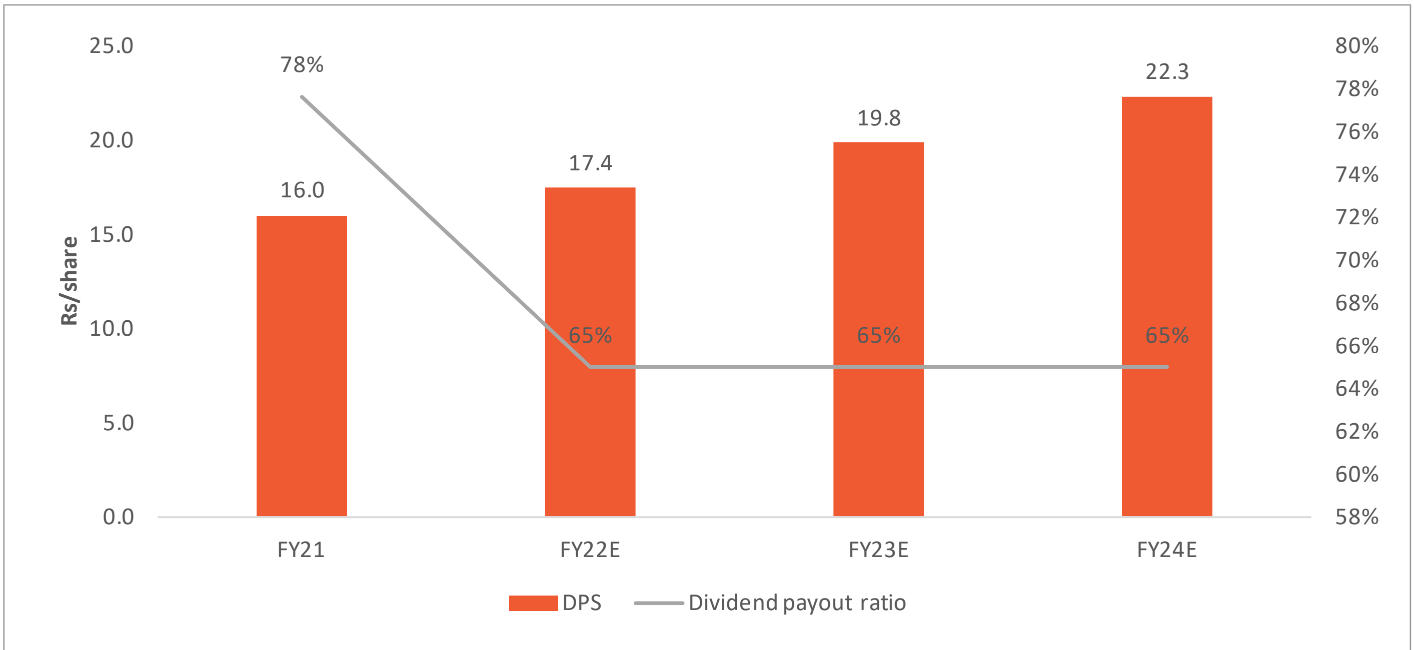
Source: Company; Sharekhan Research

Cash position to improve sharply over FY22E-24E



Source: Company; Sharekhan Research

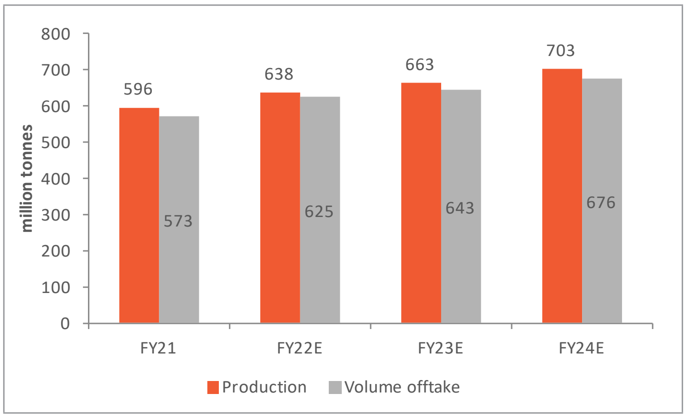
Dividend payout and DPS to remain high



Source: Company; Sharekhan Research

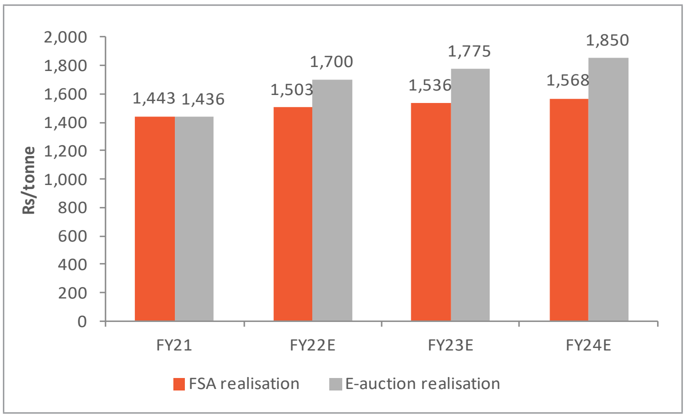
Financials in charts

Decent volume growth outlook



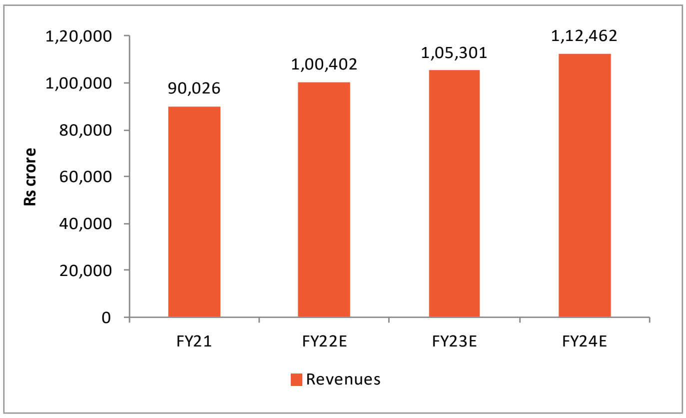
Source: Company; Sharekhan Research

Rising FSA/e-auction realisations bode well for earnings



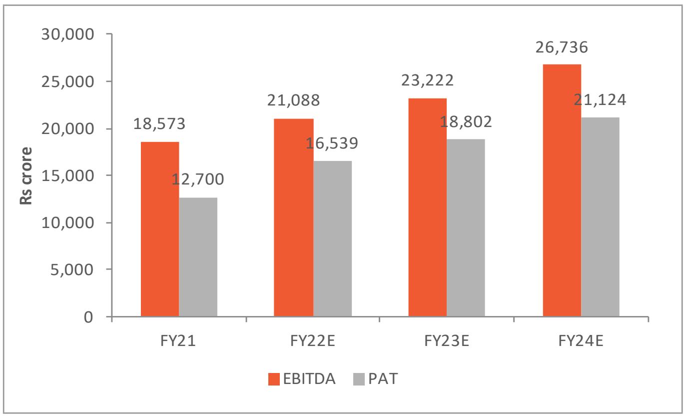
Source: Company; Sharekhan Research

Revenue trend



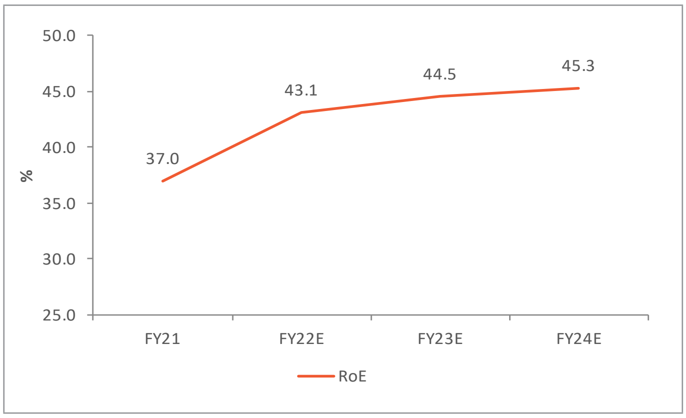
Source: Company; Sharekhan Research

PAT/EBITDA to grow strongly over FY22E-24



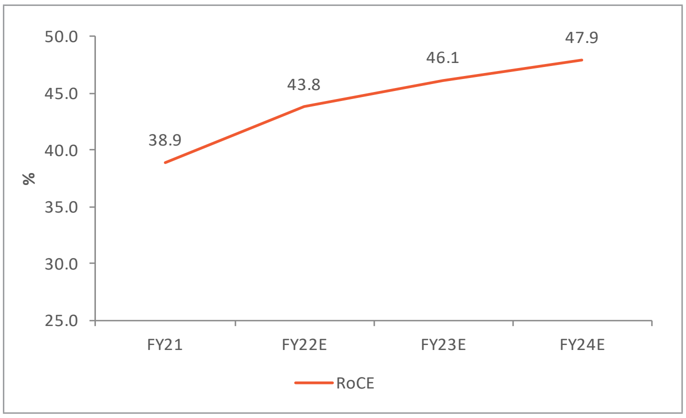
Source: Company; Sharekhan Research

RoE trend



Source: Company; Sharekhan Research

RoCE trend



Source: Company; Sharekhan Research

Outlook and Valuation

- **Sector outlook – 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 India's overall energy mix is expected to fall over the next decade, it would remain a primary energy source and absolute coal offtake is expected to improve given higher demand from sectors such as power and steel. 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).
- **Company outlook – Improving volume and likely higher realisation to drive earnings recovery:** Coal India's earnings outlook has improved considerably, led by a sharp 24% y-o-y jump in coal volume offtake during April-August 2021 and expectation of improvement in e-auction realisations on a likely rise in coal demand and elevated international coal prices. We thus expect a strong earnings revival for Coal India with likely PAT growth of 30.2%/13.7%/12.4% y-o-y for FY2022E/FY2023E/FY2024E.
- **Valuation – Maintain Buy on Coal India with an unchanged PT of Rs. 185:** Improving earnings growth outlook (expect 18% PAT CAGR over FY21-FY24E), high RoE of ~45% and dividend yield of 12% makes the stock's valuation attractive at 5.1x FY2023E EPS (close to trough levels and at steep discount to average one-year forward PE of 7.3x for Asian peers). Potential efficient capital allocation for non-core investments (aluminium smelting and solar energy) could act as key catalysts for the stock. We maintain a Buy on Coal India with an unchanged PT of Rs. 185.

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
Samiran Dutta	Director – Finance
Binay Dayal	Director – Technical

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Life Insurance Corp of India	11.0
2	HDFC Asset Management Company Limited	4.2
3	Nippon Life India Asset Management Limited	2.2
4	ICICI Prudential Asset Management Company Ltd/India	1.2
5	Bharat 22	1.0
6	Vanguard Group Inc.	0.9
7	BlackRock Inc.	0.9
8	SBI Funds Management Pvt. Ltd	0.7
9	Aditya Birla Sun Life Asset Management Company Limited	0.4
10	Lazard Limited	0.3

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;