Coal India Limited

Better volumes to aid H2 recovery; Valuation attractive

Energy & Utilities | Sharekhan code: COALINDIA | Result Update

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

\+ Positive = Neutral - Negative

Reco/View	Change
Reco: **Buy**	↔
CMP: **Rs. 126**	
Price Target: **Rs. 160**	↔

↑ Upgrade ↔ Maintain ↓ Downgrade

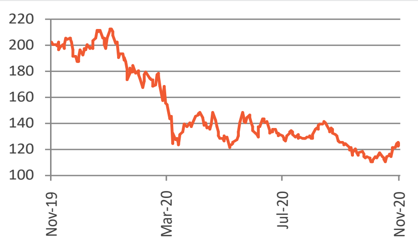
Company details

Market cap:	Rs. 78,151 cr
52-week high/low:	Rs. 215/110
NSE volume: (No of shares)	120.2 lakh
BSE code:	533278
NSE code:	COALINDIA
Free float: (No of shares)	208.7 cr

Shareholding (%)

Promoters	66.1
FII	7.2
DII	21.9
Others	4.8

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	14	-4	-2	-38
Relative to Sensex	7	-19	-42	-46

Sharekhan Research, Bloomberg

Summary

- Q2FY2021 operating profit/PAT at Rs. 3,975 crore/Rs. 2,948 crore, up 10% y-o-y and down 16.3% y-o-y was above our estimate due to Rs. 575 crore OBR write back and slight beat in FSA realisation at Rs. 1,412/tonne (up 3.9% q-o-q)
- Sharp increase in coal-based power generation by 9.5%/14.6% y-o-y in September/October bodes well for a recovery in coal offtake volume and would aid an earnings recovery (expect an 18% PAT CAGR over FY21E-FY23E with RoE of 42%).
- Management is hopeful of maintaining last fiscal's dividend of Rs. 12/share (already declared interim dividend of Rs. 7.5/share) in FY2021, which translates into high dividend yield of 10%.
- Coal India is trading at an attractive valuation of 4.6x its FY2023E EPS (~64% discount to its historical average one-year forward P/E multiple of 12.7x). Hence, we recommend a Buy rating on Coal India with PT of Rs. 160.

Coal India Limited's (CIL) Q2FY2021 operating profit/PAT at Rs. 3,975 crore/Rs. 2,948 crore, up 10% y-o-y and down 16.3% y-o-y was above our and street estimates due to write back of OBR to the tune of Rs. 575 crore and marginally higher-than-expected blended realisation at Rs. 1,454/tonne (up 3% q-o-q). Coal production was up by 10.6% y-o-y (down 5% q-o-q) to 115 million tonnes. Coal offtake increased by 9.4% y-o-y and 11.2% q-o-q to 134 million tonnes supported by recovery in demand from power sector and increase in e-auction sales volume by 44% y-o-y to 22.4 million tonnes (17% of overall volumes versus 13% in Q2FY2020). FSA realisation increased by 3.9% q-o-q to Rs. 1,412/tonne on account of premium in dispatches through linkage auction to the non-regulated sector (NRS) while e-auction realisations fell sharply by 28.8% y-o-y (down 10% q-o-q) to Rs. 1,437/tonne. A sharp increase in coal-based power generation by 9.5%/14.6% y-o-y in September/October is clearly reflected in sharp improvement in CIL's coal offtake (up 25% y-o-y in October, up 31.7% y-o-y September and up 9.3% y-o-y August) and bodes well for overall volume and earnings recovery in H2FY2021. The management aims to bring down receivables to March 2020 levels of Rs. 14,000-16,000 crore (versus Rs23300 crore in Q2FY2021) by the end of the current fiscal and indicated that it is receiving money on incremental sales volumes from October onwards. Moreover, the management is hopeful of maintaining FY2020's dividend of Rs. 12/share (already declared an interim dividend of Rs. 7.5/share) in FY2021. CIL is trading at an attractive valuation of 4.6x its FY2023E EPS, which is at a steep ~64% discount to its historical average one-year forward P/E multiple of 12.7x) and the stock offers high dividend yield of 10%. Hence, we recommend Buy on Coal India with PT of Rs. 160.

Key positives

- Coal offtake increased sharply by 9.4% y-o-y and 11.2% q-o-q to 134 million tonnes given improving demand from power sector.
- Better-than-expected EBITDA/tonne at Rs. 297/tonne versus estimate of Rs. 262/tonne led higher FSA realisation (up 3.9% q-o-q).

Key negatives

- Continued pressure on e-auction prices (down 28.8% y-o-y; down 10% q-o-q).
- Receivables remain high at Rs. 23,300 crore versus Rs. 23,349 crore as of June 2020.

Our Call

Valuation – Recommend Buy on Coal India with PT of Rs. 160: We have lowered our FY2021-FY2023 earnings estimates to factor in lower e-auction realisations, partially offset by higher coal offtake assumption. CIL's coal offtake has shown tremendous improvement in the last three months given improving demand and a low base of last year. Hence, we expect a strong recovery in coal offtake volume as electricity demand has recovered to pre-COVID-19 level and management is confident of containing costs with a reduction in manpower costs. Thus, we expect a strong recovery in CIL's earnings and expect an 18% PAT CAGR over FY2021E-FY2023E, with robust RoE of 42%. CIL is trading at an attractive valuation of 4.6x its FY2023E EPS, which is at a steep ~64% discount to its historical average one-year forward P/E multiple of 12.7x) and the stock offers a high dividend yield of 10%. Hence, we recommend Buy on Coal India with 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 margin 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	88,187	95,621	1,01,601
OPM (%)	25.1	22.8	15.5	17.2	19.8
Adjusted PAT	17,462	16,714	12,071	14,224	16,856
% YoY growth	21.1	-4.3	-27.8	17.8	18.5
Adjusted EPS (Rs.)	28.3	27.1	19.6	23.1	27.4
P/E (x)	4.4	4.6	6.4	5.5	4.6
P/B (x)	2.9	2.4	2.2	2.0	1.9
EV/EBITDA (x)	1.9	2.5	4.9	3.9	3.1
RoNW (%)	75.4	57.0	36.0	39.1	42.4
RoCE (%)	87.7	60.7	35.3	39.0	43.1

Source: Company; Sharekhan estimates
Note: We now convert Coal India into a Stock Update; it was earlier a 'Viewpoint' under our coverage

OBR write-back and marginally higher blended realisation help PAT beat estimate; coal offtake volume up 9.4% y-o-y

Q2FY2021 operating profit at Rs. 3,975 crore (up 10% y-o-y; up 30.3% q-o-q) was above our estimates of Rs. 3,521 crore due to write-back of OBR to the tune of Rs. 575 crore and marginally higher-than-expected blended realisation at Rs. 1,454/tonne (up 3% q-o-q) As a result, EBITDA/tonne was better-than-expected at Rs. 297/tonne (up 17.1% q-o-q). FSA realization increased by 3.9% q-o-q to Rs. 1,412/tonne while e-Auction realisation fell sharply by 28.8% y-o-y (down 10% q-o-q) to Rs. 1,437/tonne. Coal production was up by 10.6% y-o-y (down 5% q-o-q) to 115 million tonnes. Coal offtake increased by 9.4% y-o-y and 11.2% q-o-q to 134 million tonnes supported by recovery in power demand and increase in e-auction sales volume by 44% y-o-y to 22.4 million tonnes (17% of overall volumes versus 13% in Q2FY2020). PAT at Rs. 2,948 crore (down 16.3% y-o-y; up 41.8% q-o-q) was also above our estimate of Rs. 2,438 crore due to a beat in operating profit, lower-than-expected depreciation cost and higher-than-expected other income (up 38.2% q-o-q).

Q2FY2021 conference call takeaways

- **Production guidance** – The company has guided for coal production of 660 million tonnes for FY2021E. This implies a 17% y-o-y growth in production (75 million tonnes monthly run-rate) for November-March 2021. E-auction volume target of 100 million tonnes for FY2021E versus 65 million in FY2020. The company targets to achieve coal production of 1 billion tonnes by FY2023-FY2024.
- **Subsidiary-wise production target** - South Eastern Coalfields Limited (SECL) - 172mn tonnes, Eastern Coalfields Limited (ECL) -52 million tonnes, Bharat Coking Coal Limited (BCCL) - 29 million tonnes, Central Coalfields Limited (CCL) - 74 million tonnes, Mahanadi Coalfields Limited (MCL) - 113 million tonnes, Western Coalfields Limited (WCL) - 60 million tonnes and Northern Coalfields Limited (NCL) - 160 million tonnes.
- **Capex guidance** – Rs10,000 crore for FY2021E and already spent Rs. 5,000 crore in H2FY2021. Out of the total capex, ~30% would be spent on land acquisition and 25-30% on equipment and machines. The management expects that FY2021 capex could be higher by 10% at Rs11000 crore
- **E-auction premium** - The company has given freedom to all the subsidiaries to fix their own floor price from October for e-auction. E-auction premium stood at 13% in October.
- **Receivables position** – The management said that receivables were at ~Rs. 23,300 crore as on September 2020 versus Rs. 23,349 crore as of June 2020. The management targets to bring down receivables to March 2020 level of Rs. 14000-16000 crore by the end of current fiscal. The management indicated that CIL is receiving money on incremental sales volumes from October onwards and would put pressure on state government to recover dues from state power companies.
- Increase in FSA realisations by 4% q-o-q was on account of premium in dispatches through linkage auction to non-regulated sector (NRS).
- The company aims to maintain dividend at FY2020 level of Rs. 12/share, which translates into a dividend yield of 10%.

Results Rs cr

Particulars	Q2FY21	Q2FY20	YoY %	Q1FY21	QoQ %
Net Sales	21,153	20,383	3.8	18,487	14.4
Total Expenditure	17,178	16,771	2.4	15,435	11.3
Reported operating profit	3,975	3,611	10.1	3,052	30.3
Adjusted operating profit	**3,975**	**3,611**	**10.1**	**3,052**	**30.3**
Other Income	1085	1,630	-33.5	785	38.2
EBITDA	5,060	5,241	-3.5	3,837	31.9
Interest	147	170	-13.3	183	-19.5
Depreciation	852	793	7.5	853	0.0
Exceptional income/(expense)	0	0	NA	0	NA
Reported PBT	**4,060**	**4,279**	**-5.1**	**2,801**	**44.9**
Adjusted PBT	4,060	4,279	-5.1	2,801	44.9
Tax	1,109	754	47.1	723	53.5
PAT before share of profit from JVs and MI	2,951	3,524	-16.3	2,079	42.0
Share of profit from JVs	1	-1		-1	
Minority interest	3	0		-2	
RPAT	2,948	3,523	-16.3	2,080	41.8
Adjusted PAT	**2,948**	**3,523**	**-16.3**	**2,080**	**41.8**
O/S Shares (cr)	616	616		616	
Reported EPS (Rs)	4.8	5.7	-16.3	3.4	41.8
Adjusted EPS (Rs)	4.8	5.7	-16.3	3.4	41.8
Margins (%)			**BPS**		**BPS**
Adjusted OPM	18.8	17.7	107.4	16.5	228.4
Adjusted NPM	13.9	17.3	-334.6	11.2	268.8

Source: Company; Sharekhan Research

Key operating performance

Particulars	Q2FY21	Q2FY20	YoY %	Q1FY21	QoQ %
Coal production (mt)	115	104	10.6	121	-5.0
Coal offtake (mt)	134	122	9.4	120	11.2
Blended realisation (Rs/tonne)	1,454	1,551	-6.2	1,412	3.0
FSA realisation (Rs/tonne)	1,412	1,438	-1.8	1,359	3.9
E-auction realisation (Rs/tonne)	1,437	2,019	-28.8	1,598	-10.0
Adjusted EBITDA excluding OBR (Rs/tonne)	280	347	-19.3	236	18.6

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 450GW by FY20230 (from 123GW 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.

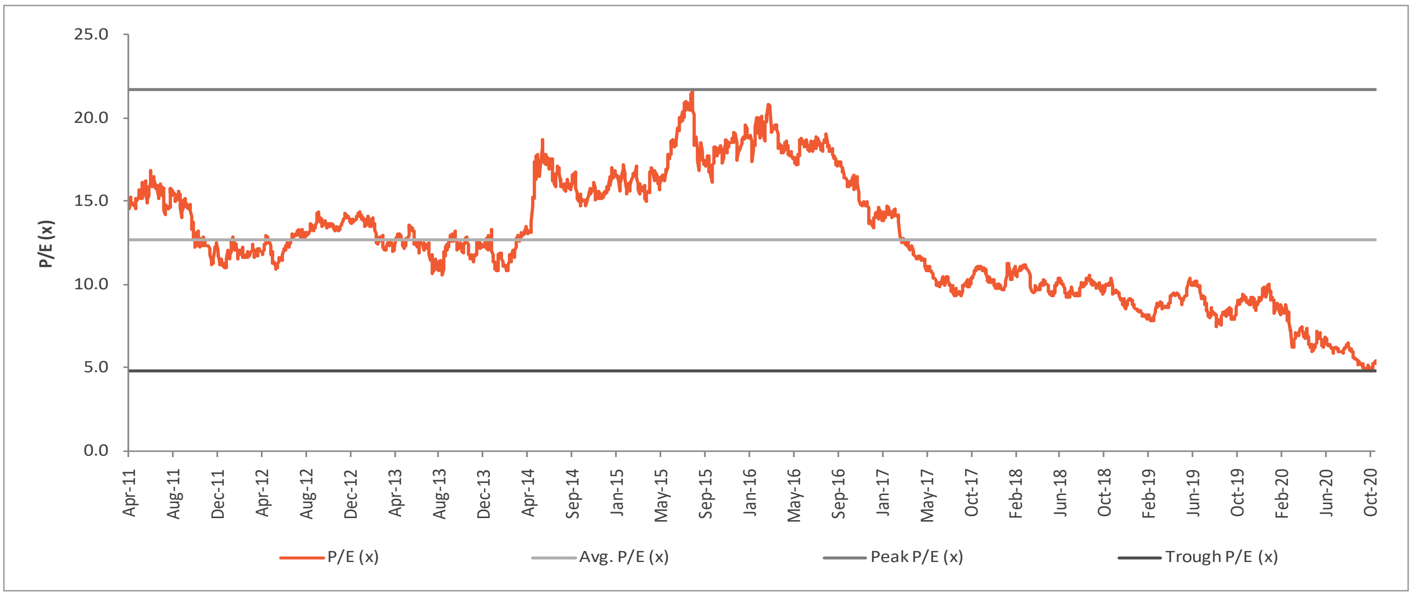
■ Company outlook - Improving earnings outlook given higher coal offtake

Coal offtake has been improving with three consecutive months of y-o-y increase (25% y-o-y in October, 31.7% y-o-y September and 9.3% y-o-y August) for Coal India due to an increase in demand from power sector and higher e-auction sales. With recent sharp improvement in coal offtake, a decline in coal sales volumes has narrowed down significantly to 3.4% y-o-y during April-October 2020 (versus a decline of 7.6% y-o-y in H1FY2021). The company is witnessing double digit growth in offtake in November and the company is targeting to achieve e-auction volume of 100mt in FY2021 given higher sales to non-regulated sector. We thus expect coal offtake to improve significantly in H2FY2021E, while premium on e-auction prices (13% currently) has also started from October 2020. Hence, we expect CIL's earnings outlook to improve considerably in H2FY2021E.

■ Valuation - Recommend Buy on Coal India with PT of Rs. 160

We have lowered our FY2021-FY2023 earnings estimates to factor in lower e-auction realisations, partially offset by higher coal offtake assumption. CIL's coal offtake has shown tremendous improvement in the last three months given improving demand and a low base of last year. Hence, we expect a strong recovery in coal offtake volume as electricity demand has recovered to pre-COVID-19 level and management is confident of containing costs with a reduction in manpower costs. Thus, we expect a strong recovery in CIL's earnings and expect an 18% PAT CAGR over FY2021E-FY2023E, with robust RoE of 42%. CIL is trading at an attractive valuation of 4.6x its FY2023E EPS, which is at a steep ~64% discount to its historical average one-year forward P/E multiple of 12.7x) and the stock offers a high dividend yield of 10%. Hence, we recommend Buy on Coal India with 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 healthy 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: Bloomberg

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Life Insurance Corporation of India	11.1
2	HDFC Asset Management Co. Ltd.	3.7
3	Reliance Capital Trustee Co. Ltd.	3.1
4	CPSE ETF	3.1
5	ICICI Prudential Asset Management	1.2
6	BHARAT 22	1.1
7	GIC Pte. Ltd.	1.0
8	Vanguard Group Inc/The	0.8
9	SBI Fund Management Pvt. Ltd.	0.7
10	BlackRock Inc.	0.6

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

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