Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Coal India Ltd

Q2 missed mark; resilient earnings outlook & high dividend yield

Energy & Utilities	Sharekhan code: COALINDIA

Reco/View: Buy	↔	CMP: **Rs. 250**	Price Target: **Rs. 280**	↔

↑ Upgrade ↔ Maintain ↓ Downgrade

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		↔	

ESG Disclosure Score NEW

ESG RISK RATING 42.47

Updated Oct 08, 2022

Severe Risk

NEGL	LOW	MED	HIGH	SEVERE
0-10	10-20	20-30	30-40	40+

Source: Morningstar

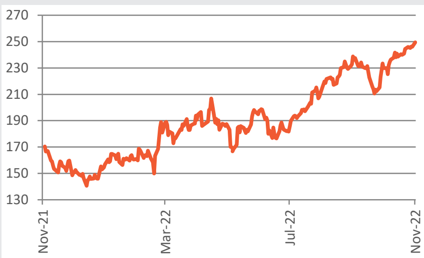
Company details

Market cap:	Rs. 1,53,760 cr
52-week high/low:	Rs. 251/139
NSE volume: (No of shares)	107.0 lakh
BSE code:	533278
NSE code:	COALINDIA
Free float: (No of shares)	208.7 cr

Shareholding (%)

Promoters	66.1
FII	6.7
DII	22.5
Others	4.6

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	8.5	19.8	33.1	45.2
Relative to Sensex	3.4	15.0	21.5	44.2

Sharekhan Research, Bloomberg

Summary

- Consolidated Q2FY23 operating profit of Rs. 7,280 crore (up 85% y-o-y) lagged our estimate as margins were impacted by higher employee costs (up 13%/8% y-o-y/q-o-q) and lower blended realisation. PAT of Rs. 6,044 crore (up 106% y-o-y) was 5% above estimates led by substantially higher other income and lower tax rate.
- E-auction realisations rose 40% q-o-q to Rs. 6,064/ tonne, with e-auction premium of 329% versus 200% in Q1FY23 while increase of 2.3% y-o-y in FSA realisations to Rs. 1414/tonne was marginally lower than estimates. Coal offtake was up by 4.8% y-o-y to 155 mt. FSA volumes surged by 22% y-o-y to 142mt but e-auction volume plunged by 62% y-o-y to only 10.4 mt.
- We have cut our FY23-24 earnings estimate to factor in lower e-auction realisations and higher costs. Despite earnings cut, the outlook remains promising given a healthy volume growth (up 6% y-o-y rise in FY23YTD) and high e-auction premium is also holding firm. We thus expect a strong 20% PAT CAGR over FY22-25E. Potential stake sale in Bharat Coking Coal Limited (BCCL) and subsequent listing would unlock value.
- The stock trades at an attractive valuation of 5.6x/5.1X its FY24E/FY25E EPS (close to trough valuation) and offers a high dividend yield of 12-13%. Hence, we maintain a Buy with an unchanged PT of Rs. 280.

Q2FY23 consolidated operating profit of Rs. 7,280 crore (up 84.7% y-o-y; down 40.6% q-o-q) was 14% below our estimate of Rs. 8,421 crore due to 14% miss in blended EBITDA margin at Rs. 471/tonne (up 76.2% y-o-y; down 31.7% q-o-q). A lower-than-expected EBITDA margins was led by a 2% miss in blended realisation of Rs. 1,782/tonne (down 2.7% q-o-q) and 13% higher-than-expected per tonne operating cost (up 13% q-o-q) due to a rise in employee costs (up 8% q-o-q to Rs. 10829 crore). Coal offtake volume of 155 million tonnes (up 4.8% y-o-y; down 12.9% q-o-q) was in line with provisional numbers announced by the company and y-o-y growth was driven by 20% y-o-y increase in FSA volumes to 142 million tonnes. However, e-auction volume declined by 62% y-o-y to 10.4 million tonnes due to elevated e-auction price. E-auction realisations surged 3.8x y-o-y and 39.7% q-o-q to Rs. 6,064/tonne (e-auction premium of 329%) while FSA realisation was up by 2.3% y-o-y (down 2% q-o-q) to Rs. 1,414/tonne. Consolidated PAT of Rs. 6,044 crore (up 105.8% y-o-y; down 31.6% q-o-q) was 5% above our estimate of Rs. 5,774 crore as miss in operating profit was more than offset by substantially higher-than-expected other income (up 2.3x y-o-y) and a lower tax rate of 21% (versus assumption of 25.2%).

Key positives

- Higher-than-expected e-auction realisation of Rs. 6,064/tonne, up 3.8x/40% y-o-y/q-o-q.
- The company declared first interim dividend of Rs. 15/share, which implies dividend yield of 6% on CMP.

Key negatives

- A sharp increase of 13%/8% q-o-q in employee cost in Q2FY23.
- Lower-than-expected e-auction volume of 10.4 million tonnes, down 62% y-o-y.

Revision in estimates – We have lowered our FY23 and FY24 earnings estimate to factor lower e-auction volume and higher operating cost. We have also introduced our FY25 earnings estimates in this report.

Our Call

Valuation – Maintain Buy on CIL with an unchanged PT of Rs. 280: Improving earnings growth outlook (expect a 20% PAT CAGR over FY2022-FY2025E), a high RoE of ~51%, and dividend yield of 12-13% make CIL's valuation attractive at 5.6x/5.1x its FY2024E/FY2025E EPS (close to trough levels). The board has given in-principle approval to divest a 25% stake in Bharat Coking Coal Limited (BCCL) and awaits approval from the government. Stake sale and a potential listing could help unlock value. We maintain a Buy recommendation on CIL with an unchanged price target (PT) of Rs. 280.

Key Risks

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

Valuation (Consolidated) Rs cr

Particulars	FY22	FY23E	FY24E	FY25E
Revenue	1,09,714	1,27,056	1,27,733	1,37,426
OPM (%)	22.5	29.7	28.0	28.7
Adjusted PAT	17,358	29,306	27,551	30,018
% YoY growth	36.7	68.8	-6.0	9.0
Adjusted EPS (Rs.)	28.2	47.6	44.7	48.7
P/E (x)	8.9	5.2	5.6	5.1
P/B (x)	3.6	3.1	2.8	2.5
EV/EBITDA (x)	5.2	2.9	3.0	2.5
RoNW (%)	43.6	63.2	52.4	50.9
RoCE (%)	45.1	66.0	56.3	55.9

Source: Company; Sharekhan estimates

Q2 operating profit lags estimate; in-line PAT on higher other income and lower tax rate

Q2FY23 consolidated operating profit of Rs. 7,280 crore (up 84.7% y-o-y; down 40.6% q-o-q) was 14% below our estimate of Rs. 8,421 crore due to 14% miss in blended EBITDA margin at Rs. 471/tonne (up 76.2% y-o-y; down 31.7% q-o-q). A lower-than-expected EBITDA margins was led by a 2% miss in blended realisation of Rs. 1,782/tonne (down 2.7% q-o-q) and 13% higher-than-expected per tonne operating cost (up 13% q-o-q) due to a rise in employee costs (up 8% q-o-q to Rs. 10829 crore). Coal offtake volume of 155 million tonnes (up 4.8% y-o-y; down 12.9% q-o-q) was in line with provisional numbers announced by the company and y-o-y growth was driven by a 20% y-o-y increase in FSA volumes to 142 million tonnes. However, e-auction volume declined by 62% y-o-y to 10.4 million tonnes due to elevated e-auction price. E-auction realisations surged 3.8x y-o-y and 39.7% q-o-q to Rs. 6,064/tonne (e-auction premium of 329%) while FSA realisation was up by 2.3% y-o-y (down 2% q-o-q) to Rs. 1,414/tonne. Consolidated PAT of Rs. 6,044 crore (up 105.8% y-o-y; down 31.6% q-o-q) was 5% above our estimate of Rs. 5,774 crore as miss in operating profit was more than offset by substantially higher-than-expected other income (up 2.3x y-o-y) and a lower tax rate of 21% (versus assumption of 25.2%).

Results (Consolidated) Rs cr

Particulars	Q2FY23	Q2FY22	YoY (%)	Q1FY23	QoQ (%)
Revenue	**29,838**	**23,291**	**28.1**	**35,092**	**-15.0**
Total Expenditure	22,558	19,349	16.6	22,841	-1.2
Reported operating profit	**7,280**	**3,942**	**84.7**	**12,251**	**-40.6**
Other Income	1761	782	125.3	995	77.1
Interest	135	141	-4.4	150	-10.0
Depreciation	1,077	934	15.3	994	8.4
Reported PBT	**7,829**	**3,648**	**114.6**	**12,101**	**-35.3**
Tax	1,643	711	131.3	3,243	-49.3
PAT before share of profit from JVs and MI	6,186	2,938	110.6	8,858	-30.2
Share of profit from JVs	-142	-5		-24	490.4
Minority interest	0	-4		1	-67.6
Reported PAT	**6,044**	**2,937**	**105.8**	**8,833**	**-31.6**
O/S Shares (cr)	616	616		616	
Reported EPS (Rs.)	9.8	4.8	105.8	14.3	-31.6
Margins (%)			**BPS**		**BPS**
OPM	24.4	16.9	747.3	34.9	-1,051.2
NPM	20.3	12.6	764.5	25.2	-491.6
Tax rate	21.0	19.5	151.7	26.8	-580.8

Source: Company; Sharekhan Research

Key operating performance

Particulars	Q2FY23	Q2FY22	YoY (%)	Q1FY23	QoQ (%)
Coal production (mt)	139	126	10.6	160	-12.8
Coal offtake (mt)	155	147	4.8	177	-12.9
Blended realisation (Rs. /tonne)	1,782	1,444	23.4	1,831	-2.7
FSA realisation (Rs. /tonne)	1,414	1,382	2.3	1,443	-2.0
E-auction realisation (Rs. /tonne)	6,064	1,594	280.5	4,340	39.7
Adjusted EBITDA excluding OBR (Rs. /tonne)	519	282	84.4	719	-27.7

Source: Company; Sharekhan Research

Outlook and Valuation

■ Sector View – India's coal demand expected to reach 1,250-1,500 million tonne with increased 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 suggest that India's coal demand could reach 1,250-1,500 million tonnes by FY2030, assuming a 6-8% growth in power demand and despite considering growth in renewable energy capacity to 450 GW by FY20230 (from 123 GW in FY2019).

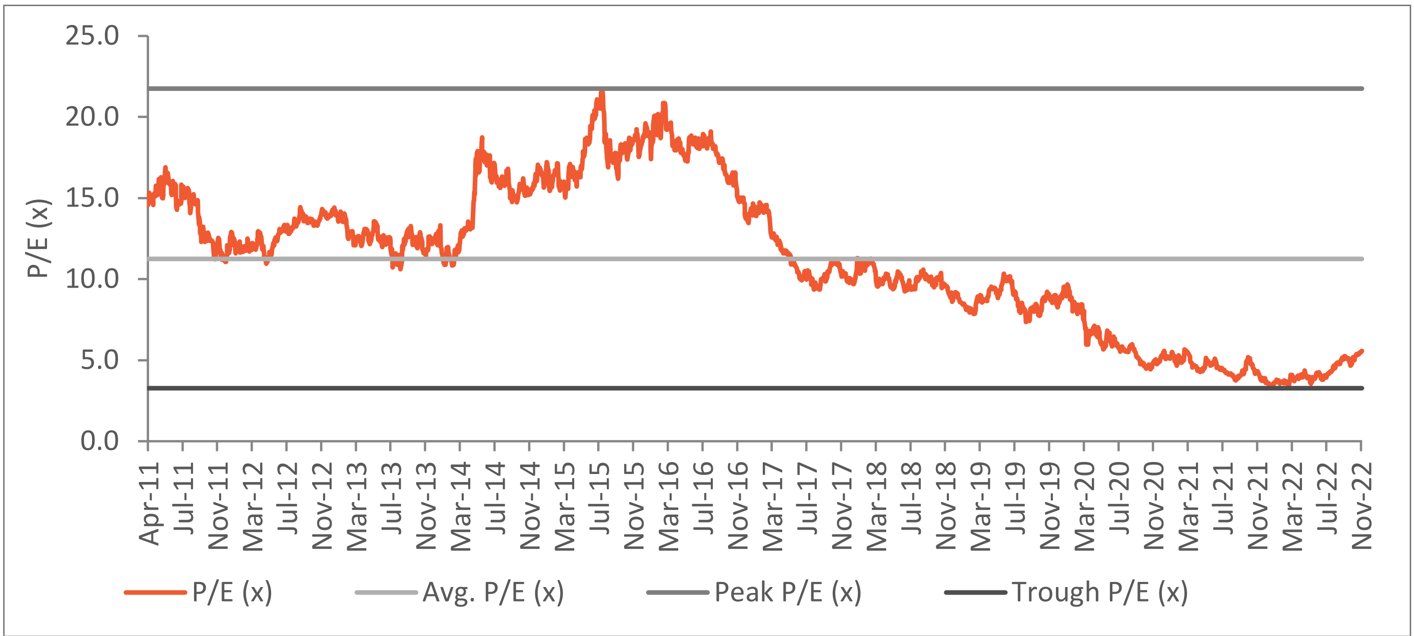
■ Company outlook – Improving volume and likely higher realisation to drive earnings recovery

CIL's earnings outlook has improved considerably as coal shortage bodes well for volume growth while improving e-auction realisation as high international coal prices would improve the company's earnings profile. Thus, we expect a strong 20% PAT CAGR over FY2022-FY2025E.

■ Valuation – Maintain Buy on CIL with an unchanged PT of Rs. 280

Improving earnings growth outlook (expect a 20% PAT CAGR over FY2022-FY2025E), a high RoE of ~51%, and dividend yield of 12-13% make CIL's valuation attractive at 5.6x/5.1x its FY2024E/FY2025E EPS (close to trough levels). CIL's board has given in-principle approval to divest a 25% stake in Bharat Coking Coal Limited (BCCL) and awaits approval from the government. Stake sale and a potential listing could help unlock value. We maintain a Buy recommendation on CIL with an unchanged price target (PT) of Rs. 280.

One-year forward P/E (x) band



Source: Company, Sharekhan Research

About the 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, fertiliser, glass, ceramic, paper, and chemical), and washed and beneficiated coal (manufacturing of hard coke for steel making, power generation, cement, and sponge iron).

Investment theme

The government's plans to increase coal production to substitute imports (stands at 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 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	11.0
2	HDFC Asset Manangement Co. Ltd	4.2
3	Nippon Life India Asset Management Ltd	2.4
4	Vanguard Group Inc./The	1.1
5	Bharat 22	1.1
6	BlackRock Inc.	0.9
7	ICICI Prudential Asset Management Co. Ltd/India	0.9
8	SBI Funds Management Pvt. Ltd	0.7
9	Aditya Birla Sun Life Asset Management Co. Ltd	0.4
10	Lazard Ltd.	0.3

Source: Bloomberg (old data)

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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