

BSE SENSEX
36,644

S&P CNX
10,848

CMP: INR195

TP: INR264 (+36%)

Buy



Stock Info

Bloomberg	COAL IN
Equity Shares (m)	6,207
M.Cap.(INRb)/(USDb)	1200.8 / 16.7
52-Week Range (INR)	288 / 178
1, 6, 12 Rel. Per (%)	-4/-17/-26
12M Avg Val (INR M)	1800
Free float (%)	29.0

Financials Snapshot (INR b)

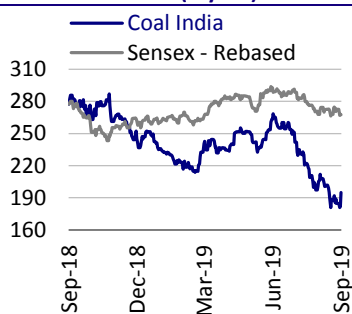
Y/E Mar	2019	2020E	2021E
Net Sales	995.5	1,004.7	1,049.5
EBITDA	300.5	295.3	314.3
PAT	174.6	158.3	164.3
EPS (INR)	28.3	25.7	26.7
Gr. (%)	47.9	-9.4	3.8
BV/Sh (INR)	42.9	44.0	49.8
RoE (%)	66.0	58.4	53.5
RoCE (%)	85.7	63.8	61.0
P/E (x)	6.9	7.6	7.3
P/BV (x)	4.5	4.4	3.9

Shareholding pattern (%)

As On	Jun-19	Mar-19	Jun-18
Promoter	71.0	71.0	78.3
DII	17.4	19.0	13.2
FII	9.0	7.1	5.4
Others	2.7	3.0	3.1

FII Includes depository receipts

Stock Performance (1-year)



A case of misplaced valuations

Attractively valued at ~3x EV/EBITDA

FY19 turned out to be a standout year for Coal India (COAL), with its adj. EBITDA increasing 48% YoY led by higher realizations. The company's ability to hike FSA prices and increase evacuation charges is a reflection of its dominant position in the industry, in our view. Moreover, even after the price hike, FSA prices are 30-40% lower than the e-auction rates (i.e., market rates). This indicates that there is still significant pricing power left with the company.

Despite the robust performance, COAL's stock price is down ~30% since end-Mar'18 (v/s BSE Sensex: +11%), with valuations at ~50% discount to its long-term average. While continuing government divestment has exerted some pressure, we note that the decline in COAL's valuation coincides with a fall in valuations of coal mining companies globally. Recent announcements of mining companies to cap/exit coal production have raised questions on the sustainability of coal.

In this report, we highlight India's divergence from other major coal-consuming economies (US, China) in terms of coal consumption. In our view, from India's standpoint, coal is here to stay, despite increasing renewable generation (unless storage technology develops). At current price, COAL's market cap = 12 years of its discounted FCF. We reiterate our Buy rating with a TP of INR264 (36% upside).

Valuations have de-rated for coal companies

Over the last 18 months, valuation multiples for coal mining companies have de-rated (Exhibit 1). While local factors (such as regulations in Indonesia and China) may have played a part, the de-rating comes at a time when questions over sustainability of thermal coal have heightened. Thermal coal consumption in the US (the third largest consumer) is now at less than two thirds of its 2010 levels, while consumption growth in China (largest consumer) has been subdued (Exhibit 2). Against this backdrop and the increasing pressure to arrest fossil fuel consumption, large global mining companies have been moving away from coal (Rio Tinto has exited, Glencore has capped production and BHP Billiton is looking to divest).

India is a different case in point

Coal consumption CAGR in India, however, has been 5% over FY10-18 (v/s China: +1%; US: -6% CAGR). Despite the increased focus on renewables, we do not expect coal demand to be impacted in the country due to the following reasons: (1) Per capita electricity consumption in India remains low (1/16th of US; 1/5th of China and 1/3rd of world average), implying significant room for coal and renewables to co-exist and grow (refer here). (2) A look at the US electricity market indicates that coal-based generation has largely been displaced by gas (Exhibit 3) on the back of favorable economics for gas-based plants. Given the lack of domestic gas supply in India, we do not foresee such a situation in the country. (3) Other conventional

sources are not in a position to displace coal. Construction of new hydro projects are marred with delays due to lengthy approval process and rehabilitation/settlement-related issues. Besides, even if India were to realize its true potential of ~150GW of hydro, this would imply incremental generation (at 40% PLF) of just 390BU – which is not sufficient to even meet incremental demand over the next five years. Nuclear generation is still at a nascent stage and accounts for ~3% of overall demand. Thus, we believe India will continue depending on coal to meet its electricity needs. Our demand-supply model for thermal coal implies demand CAGR of 6% over FY19-24 to reach 1.2bt (*Exhibit 6*).

Market cap implies 12 years of discounted FCF

COAL is trading at an FY20 FCF yield of ~9% and an EV/EBITDA of ~3x. This is surprising as – unlike some of its international peers – COAL is (1) in a growing demand market, (2) >75% of its revenues are under FSA and not exposed to fluctuations in global prices and (3) its FSA prices are at 30-40% discount to the market rates. Even if one were to make conservative assumptions of (1) capping COAL's production at 710mt from FY22 and (2) a fall in share for COAL in domestic coal consumption to 50% in FY31 (68% in FY19), the PV of COAL's 12-year cash flows would be equivalent to its current market cap (*Exhibit 7*). Further, such a scenario implies India's renewable capacity would reach ~310GW by FY31 (accounting for ~100% of the country's avg. demand), which is a tall order, in our view.

Commercial mining yet to kick start

We do not foresee any immediate impact on COAL from the government's recent decision to allow 100% FDI in coal mining. The move is part of the government's initiative to increase participation in commercial coal mining. However, auctioning for the same is yet to be kick started. Given procedural hurdles such as land acquisition and EC/FC clearances, we do not expect any output from commercial mines for the next 3-4 years, at least. Besides, India depends on thermal coal imports to meet its domestic needs (~130-150mt of imported coal can be substituted). As and when commercial mines come up, it would likely displace these imports.

Given the non-cyclical nature of COAL, it is perplexing to see the sharp de-rating in the stock. While lower-than-expected production and continued government divestment may be an overhang in the near-term, the longer-term story for COAL remains intact. We cut our FY20/21 PAT estimates 6/5% to factor in lower volumes given the recent decline in production. However, at ~3x FY20E EV/adj. EBITDA and ~8x P/E, the stock is attractively valued, in our view. We value COAL at 4.5x FY20 EV/adj. EBITDA and reiterate Buy with a target price of INR264/sh.

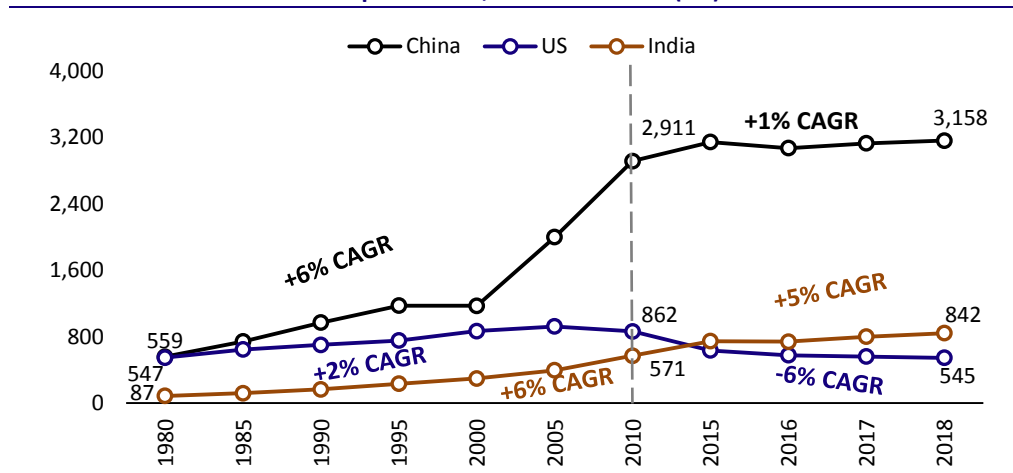
Exhibit 1: Valuation multiples for key coal mining companies have declined

	Mar-18			Mar-19			Current		
	M Cap (USD b)	1 yr fwd		M Cap (USD b)	1 yr fwd		M Cap (USD b)	1 yr fwd	
		P/E	EV/EBITDA		P/E	EV/EBITDA		P/E	EV/EBITDA
Coal mining cos									
India									
Coal India	27.0	10.0	5.8	21.2	8.6	5.0	16.8	7.0	3.6
China									
China Shenua	62.8	10.8	6.3	55.9	10.4	4.6	50.0	9.4	4.2
China Coal	9.0	13.9	10.6	8.7	14.5	8.6	7.7	10.9	7.6
Yanzhou	8.5	9.2	10.4	6.6	8.2	8.6	5.5	6.2	7.9
Indonesia									
Adaro	4.7	11.3	4.5	3.0	6.6	3.5	2.5	5.8	3.2
Indo Tambangaya	2.3	7.9	3.9	1.9	7.2	3.4	1.0	5.7	2.2
US									
Arch Coal	1.9	15.0	5.3	1.6	8.6	4.2	1.2	4.6	2.8
Peabody	4.7	45.1	5.3	3.1	22.1	4.1	1.8	16.6	2.9
Others									
Exxaro	3.2	8.4	6.1	4.1	7.4	6.6	3.1	6.1	7.3
Avg. coal mining cos.	124.1	14.6	6.5	106.1	10.4	5.4	89.6	8.0	4.6
Global miners with exposure to coal									
BHP Billiton	111.6	18.3	7.7	131.2	18.4	8.9	114.6	16.1	7.6
Glencore	71.9	8.3	4.3	57.2	7.6	4.2	37.4	9.0	4.4
Avg. global mining cos.	183.5	13.3	6.0	188.4	13.0	6.5	152.0	12.5	6.0

Source: MOFSL, Bloomberg

Slowing thermal coal consumption in key economies such as US and China has led to sustainability concerns.

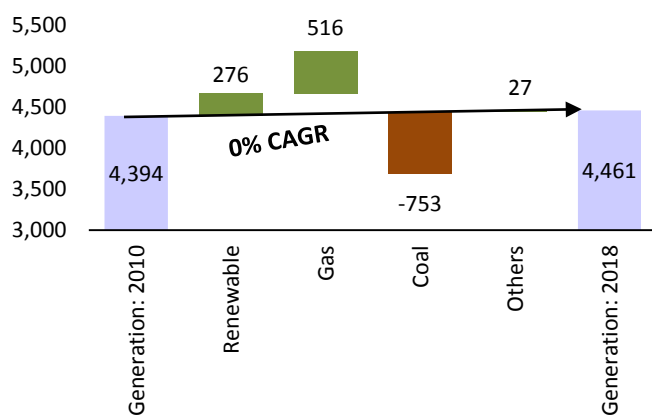
Exhibit 2: Thermal coal consumption in US, China and India (mt)



Source: IEA, MOFSL

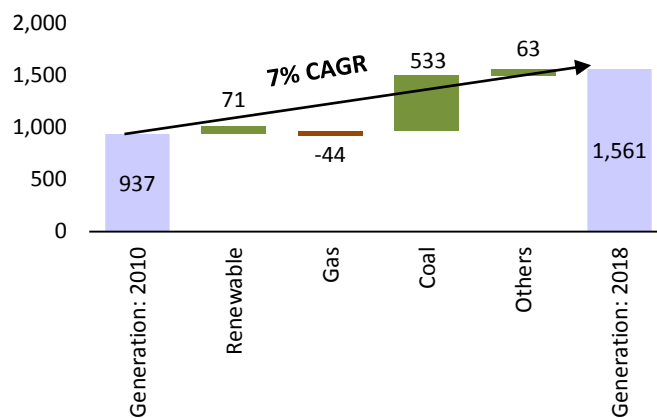
US & India on divergent paths

Exhibit 3: Electricity generation in US: 2010-18 (b kWh)



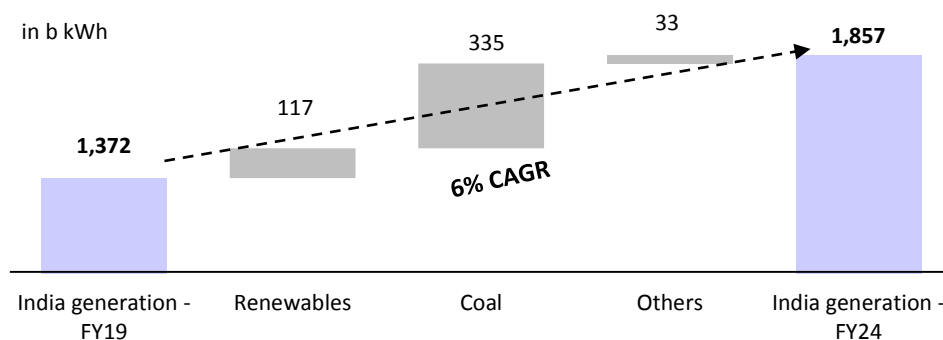
Source: BP Review, MOFSL

Exhibit 4: Electricity generation in India: 2010-18 (b kWh)



Source: BP Review, MOFSL

- A look into the US electricity market reveals that coal substitution has been achieved through higher gas-based generation on the back of increased fuel availability (post shale gas development) and subsequent lower prices. We note that **~70% of coal-based generation displaced in the US (over 2010-18) has been through gas-based generation**. Given a stable demand scenario in the US (0% CAGR over 2010-18), the move to phase out coal-based capacities was possible, as gas-based plants (1) became economically favorable and (2) have the ability to manage peak demand and grid frequency (due to faster ramp up/down). Renewables, on the other hand, have made their way into the system slowly.
- Electricity demand in India continues growing at >5%. In such a scenario, replacing coal-based capacities is difficult as other generation sources would have to not just replace the existing generation but also cater to incremental demand.
- The shift toward lower-emission gas-based generation in the US coincided with a decline in natural gas prices. Generation cost for gas-based plants in the US is <INR2/kWh and is highly competitive with the coal-based plants. Compared to this, generation cost for gas-based plants in India is still ~INR3.5/kWh (at currently low global prices). Further, the lack of domestic gas supply within the country exposes it to fluctuating global prices and raises concerns about its viability over a long period.
- From India's perspective, we do not see gas displacing coal in the current scenario. Besides, while the share of renewables in generation mix would continue rising (estimated at 13% in 2024 v/s 9% in FY19), it would not be sufficient to meet the country's incremental demand (refer Exhibit 5).

Exhibit 5: India electricity generation growth over FY19-24 (b kWh)

Source: CEA, MOFSL

Thermal coal demand to reach 1.2bt in FY24

Our demand-supply model estimates a 6% CAGR in coal-based generation in the country over FY19-24. This, along with demand from the non-power sector, is expected to drive a 6% CAGR in thermal coal demand to 1.2bt by FY24.

Exhibit 6: India's thermal coal demand

	FY16	FY17	FY18	FY19	FY20E	FY21E	FY22E	FY23E	FY24E	FY19-24E CAGR
Power Generation	1,169	1,236	1,303	1,372	1,457	1,548	1,645	1,748	1,857	6.3%
YoY (%)	4.5%	5.8%	5.4%	5.2%	6.3%	6.3%	6.3%	6.3%	6.3%	
Coal based gen. (b kwh)	862	910	953	989	1,047	1,104	1,169	1,242	1,324	6.0%
YoY (%)	7.8%	5.6%	4.7%	3.7%	5.9%	5.4%	5.9%	6.2%	6.6%	
Specific Cons.(kg/kwh)	0.633	0.630	0.638	0.636	0.636	0.635	0.634	0.632	0.631	
Power (mt)	546	574	608	629	665	701	741	785	836	5.9%
YoY (%)	2.7	5.1	6.0	3.4	5.9	5.3	5.7	6.0	6.4	
Non-power [apparent] (mt)	243	233	251	266	282	298	315	338	364	6.5%
Total Consumption (mt)	789	807	859	894	947	999	1,056	1,124	1,200	6.0%

Source: CEA, MOFSL

COAL's market cap = 12 years of discounted FCF

If one were to make conservative assumptions of (1) capping COAL's production at 710mt in FY22 and (2) decline in its share of domestic coal consumption to 50% in FY31 (68% in FY19), the PV of COAL's 12-year cash flows would be equivalent to its current market cap. We note that such a scenario also implies India's renewable capacity would reach ~310GW by FY31 (~100% of the country's avg. demand), which is a tough task.

Exhibit 7: Coal India: Free cash flows (FY20-31)

		FY19	FY20E	FY21E	FY22E	FY23E	FY24E	FY25E	FY26E	FY27E	FY28E	FY29E	FY30E	FY31E
Vols.	mt	608	635	670	710	710	710	710	710	710	710	710	710	710
Adj. EBITDA	INR/t	494	465	469	483	466	449	430	423	415	407	398	389	380
EBITDA	INR b	300	295	314	343	331	319	305	300	294	289	283	276	270
Operating cash flow*	INR b	212	196	243	260	258	249	239	234	229	224	219	214	209
Capex	INR b	73	80	80	80	50	50	50	50	50	50	50	50	50
Loan repayment	INR b	0	0	0	22	0	0	0	0	0	0	0	0	0
FCFE	INR b	139	116	163	158	208	199	189	184	179	174	169	164	159
Discount rate	%	12												
NPV of FCFE over FY20-31	INR b	1,173												

*includes net other income

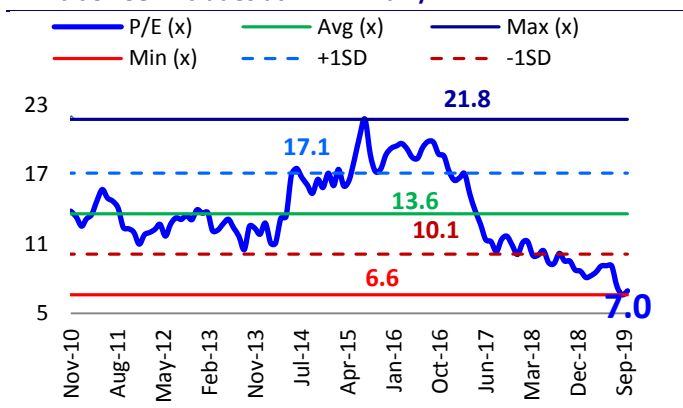
Source: MOFSL, Company

Exhibit 8: Key assumptions for the above discounting model

		FY19	FY20E	FY21E	FY22E	FY23E	FY24E	FY25E	FY26E	FY27E	FY28E	FY29E	FY30E	FY31E
Coal India's share in coal demand	%	68	67	67	67	63	59	58	56	55	54	53	51	50
India's coal consumption	mt	894	947	999	1,056	1,124	1,200	1,229	1,259	1,289	1,320	1,352	1,384	1,417
Conventional power generation	b kWh	1,245	1,311	1,378	1,450	1,528	1,613	1,686	1,762	1,841	1,924	2,010	2,101	2,195
<i>growth</i>	%		5.3	5.1	5.3	5.4	5.6	4.5	4.5	4.5	4.5	4.5	4.5	4.5
All-India generation (incl. RE)	b kWh	1,372	1,457	1,548	1,645	1,748	1,857	1,969	2,087	2,212	2,345	2,485	2,634	2,792
<i>growth</i>			6.3	6.3	6.3	6.3	6.2	6.0	6.0	6.0	6.0	6.0	6.0	6.0
Implied RE generation	b kWh	127	146	171	195	220	244	283	325	371	421	475	534	597
<i>growth</i>	%		15.5	16.6	14.3	12.5	11.1	15.9	14.9	14.1	13.4	12.9	12.4	11.9
Implied RE capacity	GW	66	76	89	101	114	127	147	169	192	218	246	277	310

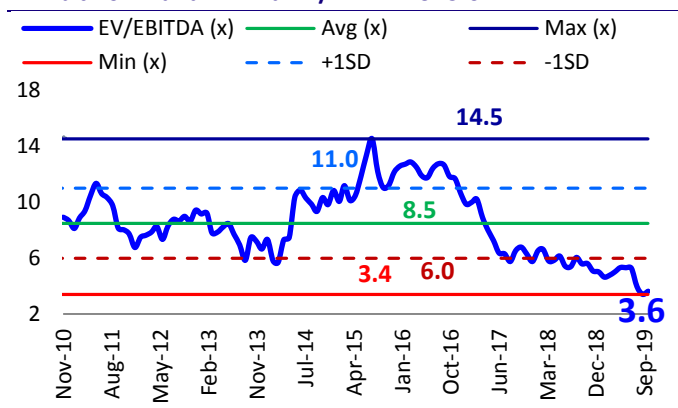
Source: MOFSL, Company

Exhibit 9: COAL trades at 7x 1Y fwd P/E...



Source: MOFSL, Company

Exhibit 10: ... and 1Y fwd EV/EBITDA of 3.6x



Source: MOFSL, Company

Exhibit 11: Coal India - Target price derivation

	FY18	FY19	FY20E	FY21E	FY22E
Adjusted EBIDTA	203,089	300,483	295,257	314,305	343,017
Target EV/EBITDA (x)			4.5	4.5	4.5
Target EV			1,328,657	1,414,371	1,543,574
Net debt	-311,085	-316,302	-301,064	-357,426	-417,551
Target Equity value			1,629,721	1,771,797	1,961,126
TP (INR/share)			264		

Source: MOFSL, Company

Financials and Valuations

Income Statement						(INR Million)		
Y/E Mar	2015	2016	2017	2018	2019	2020E	2021E	2022E
Net Sales	741,201	780,073	783,719	858,624	995,469	1,004,703	1,049,468	1,111,990
Change (%)	5.0	5.2	0.5	9.6	15.9	0.9	4.5	-2.2
EBITDA	211,621	211,148	150,634	203,089	300,483	295,257	314,305	343,017
EBITDA Margin (%)	28.6	27.1	19.2	23.7	30.2	29.4	29.9	30.8
Depreciation	61,465	56,373	55,823	64,246	85,216	98,340	105,634	112,789
EBIT	150,156	154,775	94,811	138,843	215,268	196,917	208,671	230,228
Interest	73	3,862	4,117	4,318	2,750	2,778	2,806	2,834
Other Income	65,706	59,406	55,156	46,583	58,737	42,076	39,324	42,674
Extraordinary items	50	0	0	-73,844	0	0	0	0
PBT	215,839	210,319	145,850	107,264	271,255	236,215	245,190	270,068
Tax	78,573	71,719	51,660	37,067	96,625	77,951	80,913	89,122
Tax Rate (%)	36.4	34.1	35.4	34.6	35.6	33.0	33.0	33.0
Min. Int. & Assoc. Share	0	0	0	0	0	0	0	0
Reported PAT	137,266	138,601	94,190	70,198	174,630	158,264	164,277	180,946
Adjusted PAT	137,266	138,601	94,190	118,942	174,630	158,264	164,277	180,946
Change (%)	-14.1	1.0	-32.0	26.3	46.8	-9.4	3.8	1.7

Balance Sheet						(INR Million)		
Y/E Mar	2015	2016	2017	2018	2019	2020E	2021E	2022E
Share Capital	63,164	63,164	62,074	62,074	61,627	61,627	61,627	61,627
Reserves	340,367	285,168	183,194	136,392	202,912	209,242	245,383	281,826
Net Worth	403,531	348,332	245,268	198,466	264,539	270,870	307,011	343,453
Debt	4,019	11,921	30,078	15,309	22,027	22,027	22,027	22,027
Deferred Tax	-19,591	-20,445	-27,328	-53,551	-42,692	-42,692	-42,692	-42,692
Total Capital Employed	388,617	340,855	251,477	163,849	247,943	254,273	290,414	326,857
Gross Fixed Assets	448,080	234,137	276,883	325,733	401,631	481,631	561,631	641,631
Less: Acc Depreciation	286,929	26,824	55,984	84,805	115,888	152,792	192,096	231,399
Net Fixed Assets	161,150	207,314	220,900	240,928	285,742	328,839	369,535	410,232
Capital WIP	51,594	59,044	103,078	137,710	136,984	136,984	136,984	136,984
Investments	0	73	106	3,443	4,622	4,622	4,622	4,622
Current Assets	873,074	841,406	809,377	839,286	857,149	868,716	936,960	1,012,086
Inventory	61,838	75,692	89,453	64,439	55,839	68,815	71,881	76,164
Debtors	85,219	114,476	107,359	86,892	54,986	68,815	77,632	88,350
Cash & Bank	559,060	409,137	327,021	326,394	338,330	323,091	379,453	439,579
Loans & Adv, Others	166,958	242,102	285,545	361,561	407,994	407,994	407,994	407,994
Curr Liabs & Provns	697,201	766,982	881,984	1,057,518	1,036,554	1,084,887	1,157,687	1,237,067
Curr. Liabilities	697,201	766,982	881,984	1,057,518	1,036,554	1,084,887	1,157,687	1,237,067
Provisions	0	0	0	0	0	0	0	0
Net Current Assets	175,873	74,425	-72,607	-218,232	-179,405	-216,171	-220,727	-224,981
Total Assets	388,617	340,855	251,477	163,849	247,943	254,273	290,414	326,857

Financials and Valuations

Ratios

Y/E Mar	2015	2016	2017	2018	2019	2020E	2021E	2022E
Basic (INR)								
EPS	21.7	22.6	15.2	19.2	28.3	25.7	26.7	29.4
Cash EPS	31.5	31.5	24.2	29.5	42.2	41.6	43.8	47.7
Book Value	63.9	55.1	39.5	32.0	42.9	44.0	49.8	55.7
DPS	20.7	27.4	19.9	16.5	13.1	20.5	17.3	19.4
Payout (incl. Div. Tax.)	112.9	145.5	160.3	103.3	55.5	96.0	78.0	79.9
Valuation(x)								
P/E	16.7	12.9	19.3	14.8	6.9	7.6	7.3	6.6
Price / Book Value	5.7	5.3	7.4	8.9	4.5	4.4	3.9	3.5
EV/EBITDA	8.2	6.7	10.1	7.1	2.9	3.0	2.7	2.3
Dividend Yield (%)	5.7	9.4	6.8	5.8	6.7	10.5	8.9	9.9
EV /ton of Reserves	79.7	66.6	69.9	66.6	40.7	41.4	38.8	36.0
Profitability Ratios (%)								
RoE	34.0	41.0	38.4	35.4	66.0	58.4	53.5	52.7
RoCE	34.5	39.9	32.7	58.4	85.7	63.8	61.0	59.2
RoIC	-45.5	-60.6	-40.0	-37.7	-51.7	-59.6	-63.4	-63.6
Turnover Ratios (%)								
Asset Turnover (x)	1.9	2.3	3.1	5.2	4.0	4.0	3.6	3.4
Debtors (No. of Days)	42	54	50	37	20	25	27	29
Inventory (No. of Days)	30	35	42	27	20	25	25	25
Creditors (No. of Days)	5	15	18	19	25	20	21	22
Leverage Ratios (%)								
Net Debt/Equity (x)	-1.4	-1.1	-1.2	-1.6	-1.2	-1.1	-1.2	-1.2

Cash Flow Statement

(INR Million)

Y/E Mar	2015	2016	2017	2018	2019	2020E	2021E	2022E
Adjusted EBITDA	211,621	211,148	150,634	203,089	300,483	295,257	314,305	343,017
Non cash opr. exp (inc)	21,428	25,840	37,046	-54,587	10,718	10,735	10,930	11,129
(Inc)/Dec in Wkg. Cap.	6,487	-26,697	60,216	138,450	-48,918	-39,909	-5,413	-9,105
Tax Paid	-95,721	-78,754	-89,427	-74,329	-95,329	-77,951	-80,913	-89,122
Other operating activities	0	0	0	0	0	0	0	0
CF from Op. Activity	143,815	131,538	158,469	212,623	166,955	188,133	238,909	255,917
(Inc)/Dec in FA & CWIP	-49,014	-57,857	-86,761	-85,293	-73,393	-80,000	-80,000	-80,000
Free cash flows	94,801	73,681	71,707	127,330	93,561	108,133	158,909	175,917
(Pur)/Sale of Invt	9,615	-1	-50	-3,332	-1,184	0	0	0
Others	43,256	47,005	34,433	23,747	40,464	31,340	28,394	31,545
CF from Inv. Activity	3,857	-10,852	-52,379	-64,878	-34,114	-48,660	-51,606	-48,455
Inc/(Dec) in Net Worth	0	0	-45,531	0	0	0	0	0
Inc / (Dec) in Debt	1,935	9,902	18,169	-14,778	6,718	0	0	0
Interest Paid	-73	-207	-306	-370	-96	-2,778	-2,806	-2,834
Divd Paid (incl Tax) & Others	-152,119	-205,569	-148,311	-120,725	-108,138	-151,934	-128,136	-144,503
CF from Fin. Activity	-150,257	-195,874	-175,980	-135,873	-101,516	-154,712	-130,942	-147,337
Inc/(Dec) in Cash	-2,585	-75,188	-69,890	11,872	31,325	-15,238	56,362	60,126
Add: Opening Balance	561,644	559,060	409,137	327,021	326,394	338,330	323,091	379,453
Closing Balance	559,060	483,872	339,247	338,893	357,719	323,091	379,453	439,579

Explanation of Investment Rating	
Investment Rating	Expected return (over 12-month)
BUY	>=15%
SELL	< - 10%
NEUTRAL	< - 10 % to 15%
UNDER REVIEW	Rating may undergo a change
NOT RATED	We have forward looking estimates for the stock but we refrain from assigning recommendation

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