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Mumbai

CRISIL Research assigns IPO grade '5/5' to Coal India Ltd

CRISIL has assigned a CRISIL IPO Grade "**5/5**" (pronounced "five on five") to the proposed initial public offer (IPO) of Coal India Ltd (Coal India). This grade indicates that the fundamentals of the IPO are **'strong'** relative to the other listed equity securities in India. However, this grade is not an opinion on whether the issue price is appropriate in relation to the issue fundamentals. The grade is not a recommendation to buy, sell or hold the graded instrument, or a comment on the graded instrument's future market price or its suitability for a particular investor.

The assigned grade reflects Coal India's dominant position (81% market share) in the Indian coal industry, catering to 53% of the country's energy requirement. The demand for coal is expected to increase at an annual rate of 11.2% over the next four years on the back of increase in thermal power plants being set up in the country. Coal India enjoys cost competitive advantage over international players since nearly 90% of its production is from open cast mines and have low stripping ratios. As a result, the notified prices of Coal India are significantly lower than imported coal prices adjusted for calorific value. The grade also takes into account the de-controlled pricing regime and Coal India's ability to increase coal prices in the past. Further, the company has been gradually increasing its mix of market-linked price sales, which has further boosted its profitability. As of March 2010, the company has a cash and bank balance of Rs 390 bn. We believe this, together with its strong cash generation and very low gearing, would enable the company to pursue growth opportunities globally and also comfortably fund its capital expenditure plans of Rs 84.5 bn over the next two years. However, ability of the management to deploy the surplus cash in productive assets would have a bearing on its return on equity. The grade also factors in a highly experienced management, credited with the successful launch of market-linked sales and turning around loss-making subsidiaries.

However, several socio-political factors limit CIL's operating flexibility. Delays in regulatory approvals, such as forest clearance, are an industry-wide concern and also remain a challenge for the company. Any adverse change in the regulatory regime on pricing regulation and restriction on mining area could have a material impact on our grade and remains a key monitorable.

About the company and the issue

Government of India-owned Coal India produces and sells coal in the country. It is the largest producer of coal in the world and has the largest resources of 64.8 bn tonnes. In FY10, it produced 431 mn tonnes of coal, which accounted for 81% of the coal production in India. The company owns and operates 471 coal mines - 163 are open cast, 273 are underground and the rest are mixed. Coal production is carried out by the seven subsidiaries of the company. Another subsidiary Central Mine Planning and Design Institute Limited (CMPDIL) carries out mine exploration and development works for the coal-producing subsidiaries.

In 2009-10, the company reported turnover of Rs 466.7 bn and net profit of Rs 98 bn. It posted EPS of Rs 15.6 during the same period. Coal India's RoE for the year was 38%.

Through the IPO, GoI plans to dilute 10% of its holding. Being an offer for sale, the corpus from the IPO would go to the government.

About CRISIL IPO Grading

CRISIL IPO (Initial Public Offering) Grading is an opinion on the fundamentals of the graded issue that reflects CRISIL's independence and expertise. This opinion is expressed as a relative assessment in relation to other listed equity securities in India. The assessment is based on a grading exercise carried out by industry specialists from CRISIL Research. A CRISIL IPO Grade 5/5 indicates strong fundamentals and a CRISIL IPO Grade 1/5 indicates poor fundamentals. CRISIL IPO Grading reflects its assessment of the graded company's equity fundamentals as distinct from an assessment of debt fundamentals. A CRISIL IPO Grade should not be construed to mean a comment on the price of the graded security nor is it a recommendation to invest or not to invest in the graded security.

Media Contact	Analytical Contact
Mitu Samar Head, Market Development & Communications CRISIL Limited Tel: +91-22- 6644 1838 Mobile: +91- 98200 61934 Fax: +91-22- 6644 1810/ 1830 E-mail: msamar@crisil.com	Tarun Bhatia Director, Capital Markets Tel: +91-22- 3342 3226 E-mail: tbhatia@crisil.com Chetan Majithia Head, CRISIL Equities Tel: +91-22- 3342 4148 E-mail: chetanmajithia@crisil.com

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