Coal India Limited

CRISIL IPO Grade 5/5 (Strong)

September 03, 2010

Grading summary

CRISIL has assigned a CRISIL IPO Grade **'5/5'** (pronounced "five on five") to the proposed 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 offer price for the issue may be higher or lower than the level justified by its fundamentals. The grade is not a recommendation to buy, sell or hold the graded instrument, its future market price or suitability for a particular investor. To arrive at the overall grade, amongst various other parameters, CRISIL has considered the company's business prospects, its financial performance, management capabilities and corporate governance practices.

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. Further, 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.

Contacts:

Media

Mitu Samar

Head, Market Development & Communications

CRISIL Limited

Phone: +91-22-3342 1838

Mobile: +91-9820061934

Fax: +91-22-3342 3001

Email: msamar@crisil.com

Analytical

Chetan Majithia

Head, Equities

CRISIL Limited

Phone: +91-22-3342 4148

Fax: +91-22-3342 3501

Email: chetanmajithia@crisil.com

Client - servicing

Client servicing

Phone: +91-22-3342 3561

Email: clientservicing@crisil.com

About the company

Coal India was incorporated in 1973 as Coal Mines Authority Limited pursuant to the nationalisation of coal mines. The company underwent a corporate reorganisation wherein Bharat Coking Coal, Central Coalfield Limited, Coal Mines Planning and Development Institute, Eastern Coalfields limited and Western Coalfield Limited became its subsidiaries. Post the reorganisation, the company was freshly incorporated in 1975 and the name was changed to Coal India Limited. In 1985, National Coalfields Limited and South Eastern Coalfields Limited were made subsidiaries. The company was conferred 'Navratna' status by the GoI (Government of India) in October 2008, which provides it with certain operational and financial autonomy. Additionally, its six wholly-owned subsidiaries out of nine have been accorded 'mini-Navratna' status leading to decentralisation of operations and decision making. The company is the largest coal producer in the country with a market share of 81% in domestic coal production. Around 90% of coal is produced from open cast mines and the balance from underground mines.

Issue details

Shares offered to public	631,636,440
As per cent of post issue equity	10%
Object of the Issue	Offer for sale by GoI
Amount proposed to be raised	Not available at the time of grading
Price band	Not available at the time of grading
Lead managers	Citigroup Global Markets India Private Limited, Deutsche Equities (India) Private Limited, DSP Merrill Lynch Limited, Enam Securities Private Limited, Kotak Mahindra Capital Company Limited, Morgan Stanley India Company Private Limited.

Detailed Grading Rationale

A. Business Prospects

- ### *Strong growth in domestic demand for coal, but supply growth lagging*

Coal is the primary source of energy, accounting for nearly 53% of the total energy consumption in India. Since India has huge coal resources (276 bn tonnes as of March 2010), the Integrated Energy Policy 2006 expects coal to remain the prime source of energy, accounting for 50% of the primary commerical energy requirement of India. CRISIL Research expects the demand for coal in India to grow at 11.2% CAGR to 933 MT (million tonnes) in FY14. Under the Eleventh Five-Year Plan, India plans to add power generation capacity of 78 GW. Nearly 67% of this capacity is coal-based, indicating that the demand for coal would primarily come from the power sector. The demand for non-coking coal is expected to grow at CAGR of 11.3% whereas that for coking coal is expected to grow at 9.7% CAGR over FY09-14 (CRISIL Research estimates). The overall domestic production is, however, estimated to grow at 7.2% CAGR over FY09-14 to 672 MT resulting in an acute shortage of coal in the domestic market. CRISIL Research expects imports of coal to treble to 180 MT in FY14 from 59 MT in FY10 to meet the shortage.

- ### *Largest producer of coal in the world, dominant position in India*

Coal India is the largest producer of coal in the world. It owns 48% of India's proven reserves and contributes over 81% of the total coal production in India. Given India's abundant coal reserves and the absence of other sustainable fuel sources, the company plays a strategic role in meeting India's energy requirements. CRISIL Research estimates Coal India to contribute 80% of the Indian coal production in FY12 and, thus, maintain its dominant position. Nearly 90% of the company's production is from open cast mines. Moreover most of these open cast mines have low stripping ratios, which provides the company with a significant cost advantage.

- ### *Established capabilities of mine exploration, development and operations*

Coal India has developed strong skills for exploration, development and production from coal mines. The company's wholly-owned subsidiary Central Mine Planning and Design Institute Limited (CMPDIL) carries out exploration, mine development and design work for Coal India. CMPDIL has explored over 500 coal projects and has been able to prove 80 bn tonnes of coal reserves. It has carried out planning for open cast mines for capacity up to 25 MTPA and depth of 480 meters, and underground mines for capacity up to 3.5 MTPA and depth of 600 meters. The company is currently operating 163 open cast and 273 underground mines. The capabilities have helped the company grow its production at a CAGR of 5.2% from 260 MT in FY00 to 431 MT in FY10.

- ### *Deregulation of pricing - Coal India increases prices to cover rise in production costs*

The company supplies coal to its customers through Fuel Supply Agreement (FSA) at prices which it notifies from time to time. As a result of the deregulation of coal pricing in India, Coal India is able to increase its notified prices to cover any rise in production, thereby protecting its profitability. The dominant position of the company helps it to pass on the rise in production and transportation costs, and changes in statutory levies to its customers. The company has announced four price increases since FY00; the average price has increased at 4.9% CAGR over FY00-10. However, the notified prices of the company are still significantly below the international prices, giving it a competitive advantage.

- ***Shift in sales mix towards market-linked pricing***

Apart from the sale of coal under FSA at notified prices, the company supplies certain portion of its production at market-linked prices through E-Auctions and specific MoUs. Under E-Auction, the company sells around 10% of its production at market-determined rates. It also sells certain quantity of higher grade non-coking coal (A, B, C grades) and beneficiated coal through specific MoUs with its customers at prices which are 15% below the import parity prices for similar grade coal. The company plans to set up 20 coal beneficiation facilities with a capacity of 111 MT; they are expected to come on stream by FY17. The increasing sale of beneficiated coal would thus increase the contribution of sales at market-linked prices to overall sales of the company leading to increase in profitability.

- ***Improving productivity due to natural attrition in manpower and mechanisation***

Post nationalisation of coal mines, Coal India was burdened with excess manpower which acted as a drag on its financials. However, the number of employees has been declining by around 12,000-15,000 every year due to natural attrition. The company has now started introducing advanced mining equipments, especially for underground operations. These measures have increased productivity; output has risen from 3.05 tonnes per man shift in FY05 to 4.47 tonnes per man shift in FY10.

- ***New projects and utilisation of cash to drive growth***

The company has identified 45 coal mining projects which are under various stages of planning and development for implementation in Eleventh and Twelfth five-year plans. Of these, 25 projects with estimated production of 47.51 MTPA and capex requirement of Rs 33.9 bn are expected to become operational by end-FY12. Whereas 20 projects with estimated production of 33.27 MTPA and capex requirement of Rs 25.8 bn would become operational during the Twelfth Five-Year Plan. Additionally, the company intends to develop 20 coal beneficiation facilities with a capacity of 111 MTPA at a capex of Rs 23.3 bn, which would come on stream between FY14 and FY17. The company has a strong cash balance of Rs 390 bn as of FY10. Utilisation of this cash for mining projects and overseas acquisitions planned by the company would drive the company’s growth going ahead.

- ***Delay in regulatory approvals a key hurdle to production***

The coal sector in India is riddled with delays in securing regulatory approvals, especially for forest clearances. Forest clearances take between three and eight years, which could affect the growth plans of the company. Land acquisition and environmental clearances also are a cumbersome process.

- ***Impending policy changes a key monitorable***

  The impending policy changes involving forest clearances and setting up of an independent coal regulator are key monitorables. The proposal for categorising forest areas into ‘go’ and ‘no-go’ areas for coal mining is currently under discussion with the GoI, Ministry of Environment and Forests, and Ministry of Coal. Also, the proposal to set up a coal regulating body is under discussion at the government level. Any adverse changes in the regulatory regime due to aforementioned changes could materially impact our grading.

B. Financial Performance

Coal India's revenues grew at a two-year CAGR of 17.0% to Rs 467 bn in FY10 primarily on account of 5.5% CAGR in sales volumes and 10.8% CAGR in average realisations over FY08-10. The increase in notified prices and sale of coal under market-linked prices through E-Auction and MoUs has resulted in increase in the average realisation. The company had announced an average rise of 10% and 11% in December 2007 and October 2009, respectively, for the notified prices. It has sold 8.1%, 12.9% and 11.6% of its total sales volumes in FY08, FY09 and FY10, respectively, at market-linked prices through E-Auctions.

The company's EBITDA margins dipped to 15.7% in FY09 as a result of increase in employee costs. The upward revision in wages under National Coal Wage Agreement VIII and the executive pay revision led to a 51.7% increase in overall employee cost in FY09. The increase in prices in October 2009 to offset the rise in costs and, higher sales at market linked prices resulted in margin increase to 27.6% in FY10.

The EPS of the company grew at a two-year CAGR of 51% to Rs 15.6 in FY10. The RoE increased to 38.0% in FY10, in line with higher profitability. As on FY10, the company has cash and bank balance of Rs 390 bn and net worth of Rs 258 bn.

Since this is an offer for sale by GoI, the company would not receive any proceeds from the IPO and there would be no change in equity of the company.

Restated Financial performance snapshot

		FY08 Actual	FY09 Actual	FY10 Actual
Operating income	Rs mn	341,875	410,175	466,703
EBITDA margins	%	19.5	15.7	27.6
Net profits	Rs mn	42,850	40,628	98,294
RONW	%	24.9%	21.4%	38.0%
Basic EPS	Rs	6.8.	6.4	15.6
Diluted EPS	Rs	6.8.	6.4	15.6
No. of equity shares	Mn	6,316	6,316	6,316
Net worth	Rs mn	172,007	190,081	258,437
Book value (FV Rs 10)	Rs	27.2	30.1	40.9
Current ratio	Times	1.21	1.20	1.34

**Note: Numbers have been reclassified as per CRISIL standards*

Source: DRHP

C. Management Capabilities and Corporate Governance

Coal India's top management is well qualified and highly experienced. Most of the directors started their careers with the company. The senior management has been instrumental in making the shift towards market-linked pricing for coal and in turning around the loss-making subsidiaries like Eastern Coalfields Limited and Bharat Coking Coal Limited. However, the management has been unable to deploy the huge cash balance with the company. Ability of the management to deploy the surplus cash in productive assets would have a bearing on its future return on equity.

Coal India was accorded the 'Navratna' status in 2008, which has given it autonomy in functioning. Moreover, six of its nine subsidiaries have won the 'mini-Navratna' status which entails quicker decisions at the subsidiary level.

The 14-member board is highly experienced and diversified. It is chaired by the current Managing Director Mr. Partha Bhattacharya, who is due to retire in February 2011. The company and the Ministry of Coal have initiated the process of finding his successor. The board has seven independent directors; four have been on the board since August 2007 while the others were inducted recently. Based on our interaction with the independent directors, we believe they are fairly conversant with the business of the company.

Post the issue, the GoI would continue to remain the majority shareholder with a 90% stake in the company. By virtue of its dominant shareholding, GoI enjoys rights which can place the minority shareholders at a potential disadvantage with regard to having a say in broader corporate affairs.

Annexure I

Business Profile

Introduction

Government of India-owned Coal India produces and sells coal in the country. It is the largest coal reserve holder in the world. It is also the largest producer of coal in the world. 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; two of them - Mahanadi Coalfields and South Eastern Coalfields - together contribute 50% of the company's production. Another subsidiary - CMPDIL - carries out mine exploration and development works for the coal-producing subsidiaries.

Production

Coal production of the company has grown at a CAGR of 5.9% from 323 MT in FY05 to 431 MT in FY10. The company produces mainly low grade coal. The D, E and F grades of non-coking coal constitute 75% of the total production of the company.

Key clients

The customers of Coal India include government-owned and private companies from power, steel, cement and other sectors. The top five customers of the company are power utility companies; NTPC leads the rank with 26.7% of sales.

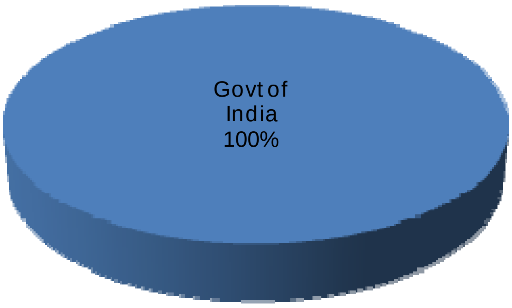
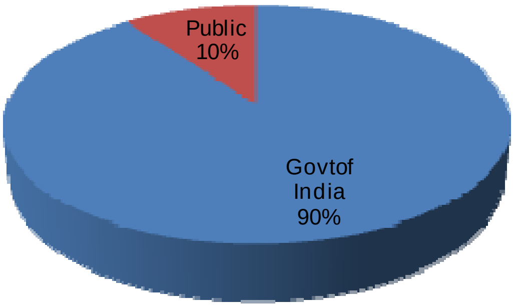
Sales mechanisms

Fuel supply agreement (FSA): Post the implementation of New Coal Distribution Policy (NCDP) in 2007, Coal India issues Letter of Assurance (LOA) on the basis of recommendations made by the inter-ministerial Standing Linkage Committee for supply of coal. After meeting certain project milestone criteria, the LOA is converted into a legally enforceable FSA. The pricing of coal under FSA is notified by Coal India from time to time.

E-Auction route: Coal India can sell around 10% of its production through E-Auctions at market-determined prices. The percentage of coal allotted under the E-Auction route is reviewed by the Ministry of Coal from time to time.

MOUs: The company sells higher grade non-coking coal (A, B, C grade) and beneficiated coking and non-coking coal under specific MOUs with the clients. The pricing under this mechanism is negotiated with the customer and is usually at a 15% discount to the import parity prices of similar grade of coal.

Shareholding Pattern

Pre-IPO	Post-IPO
	

Source: DRHP ** Assuming offer is fully subscribed #nominee of the President of India

Annexure II: Profile of the Directors

Name of Directors	Designation	Age	Qualification	Directorships / partnership in other entities/Past Experience
Mr. Partha S Bhattacharyya	Chairman & Managing Director	59	Postgraduate degree in Physics from Jadavpur University, Kolkata; Diploma in Finance from ICFAI Hyderabad; Fellow of ICWAI and World Academy of Productive Science	NIL
Mr. N. C. Jha	Director (Technical)	58	Masters Degree from Indian School of Mines, Dhanbad, First Class Mine Managers Certificate (coal)	Bharat Coking Coal Limited, South Eastern Coalfields Limited, Central Mine Planning & Design Institute Limited, International Coal Ventures Private Limited
Mr. R. Mohan Das	Director (Personnel & Industrial Relations)	53	Postgraduate degree in social work from Madurai University, Advanced Management program from Queens College UK, Management Development Program from Wharton School, US	Western Coalfields Limited, Central Coalfields Limited
Mr. A. K. Sarkar	Director (Marketing)	59	PhD in Physics from Calcutta University	Northern Coalfields Limited, Mahanadi Coalfields Limited
Mr. A. K. Sinha	Director (Finance)	57	Graduated in honors in Physics from Belur Ramkrishna Vidyamandir, Kolkata, Member of ICAI, Bachelors in Law from Calcutta University, Advance Management programme from Queens College UK	Eastern Coalfields Limited, South Eastern Coalfields Limited
Mr. Alok Perti	Nominee Director of GoI	57	Masters degree in Physics from University of Allahabad, Masters Course in Social Planning from London School of Economics, IAS	Neyveli Lignite Corporation
Mr. Sanjiv Kumar Mittal	Nominee Director of GoI	47	Bachelors in Electrical Engineering from IIT Delhi, IAS	Hindustan Copper Limited, Bharat Aluminium Company Limited, Hindustan Zinc Limited
Dr. A. K. Rath	Independent Director	61	Masters in Physics from Delhi University, Doctorate in Business Administration from KIIT, IAS	Mangalore Refinery & Petrochemical Limited
Mr. R.N. Trivedi	Independent Director	52	Bachelors in Technology from IIT (K), M.A. (Eco), Ph.D. (Eco),D.Sc (Agri Eco.)	Served as Principal Secretary to Govt.
Mr. Sachi Chaudhuri	Independent Director	60	B.A.(Eco),Post Graduate Studies in Economics	Retired Civil Servant
Prof. S. K. Barua	Independent Director	58	Masters in Technology from IIT Kanpur, PhD From IIM, Ahmedabad	Bharat Petroleum Company Limited, Securities Trading Corporation Limited, Paras Pharmaceuticals Limited, Torrent Power Limited
Mohd. Anis Ansari	Independent Director	51	B.A.,LL.M and LL.B	Served as Principal Secretary for various govt. departments in Uttar Pradesh
Ms. Sheela Bhide	Independent Director	62	Doctorate in International Trade form Institute of International Studies Geneva, Masters in Economics from US, Masters in Public Policy from Harvard University, IAS	NIL
Mr. Kamal R Gupta	Independent Director	56	Bachelors in Science from CSJM University Kanpur, Member of ICAI	Corporate Consultants Private Limited, Govind Polymers Private Limited

Source: DRHP, Company

Disclaimer

A CRISIL IPO grading is a one-time assessment and reflects CRISIL's current opinion on the fundamentals of the graded equity issue in relation to other listed equity securities in India. A CRISIL IPO grading is neither an audit of the issuer by CRISIL nor is it a credit rating. Every CRISIL IPO grading is based on the information provided by the issuer or obtained by CRISIL from sources it considers reliable. CRISIL does not guarantee the completeness or accuracy of the information on which the grading is based. A CRISIL IPO grading is not a recommendation to buy / sell or hold the graded instrument; it does not comment on the issue price, future market price or suitability for a particular investor.

CRISIL is not responsible for any errors and especially states that it has no financial liability whatsoever to the subscribers / users / transmitters / distributors of CRISIL IPO gradings. For information on any IPO grading assigned by CRISIL, please contact 'Client Servicing' at +91-22-33423561, or via email: clientservicing@crisil.com.

For more information on CRISIL IPO gradings, please visit http://www.crisil.com/ipo-gradings