Initiation of Coverage
7 August 2013

Wescoal Holdings Ltd
Overlooked Coal Junior With Exciting Prospects

Share Code: WSL – Market Cap: R239m – PE: 11.1x – DY: 2.2%

12m Target Price	**246cps**
Share Price	**138cps**
Implied Return	**78%**

Coal Mining & Trading | South Africa

Business Overview: Coal Miner with Strong Coal Trading Operations

- Built out of long-established coal-trading operations, Wescoal has moved into thermal coal mining for supply to Eskom.
- The Group has built a portfolio of valuable short- to medium-life coal deposits that are mostly either in or near to production.
- Khanyisa was previously the only producing mine, but Intibane began production during June 2013 and will contribute to FY 14E. The larger, longer-life mine, Elandspruit, is planned for FY 15E.
- The Group has also recently conditionally acquired a large competitor in the coal trading space.

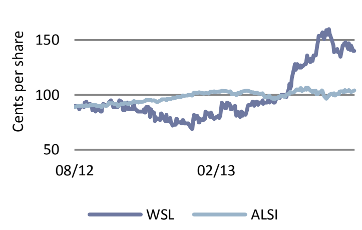
Key Issues: Inland Coal Price and Inland Coal Market Dynamics

- The inland coal tends to track international coal prices, which have been under short-term spot pressure as softer global markets attempt to absorb increasing USA exports.
- A looming 2015 supply deficit to Eskom creates risks of regulatory intervention in South Africa's inland coal market.

Forecast, Valuation and Implied Return: Highly Sensitive to Coal Price

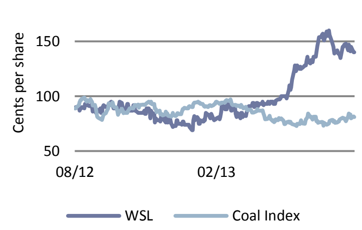
- Our forecasts are heavily influenced by the assumptions underpinning the timing, efficiency and rate of Wescoal's new coal mines; critically, Intibane in the short term (from FY 14E) and Elandspruit in the medium term (from FY 15E).
- Our SOTPs on Wescoal arrives at a fair value of R367m or 213cps, 54% more than the current share price on an implied PE of 18.6x of historical earnings. This implies a fair value of c.R10 per ton of *in situ* coal for the Group's mining assets (c.218cps per WSL share) with a further R56m or 33cps fair value from the Group's Coal Trading segment. We have taken out a 20% Group discount for overheads and corporate costs.
- Rolling forward all the fair values at our Cost of Equity (19.2%), we arrive at our 12m TP of 246cps for Wescoal on an Exit PE of 10.6x, implying an attractive 78% return.
- As a junior coal miner, our valuation of Wescoal is based on the assumption of a flat spot coal price. A sensitivity analysis of our models sees our fair value changing by between 10cps to 13cps for every 1% change in the assumed coal price.

Share Price against the ALSI



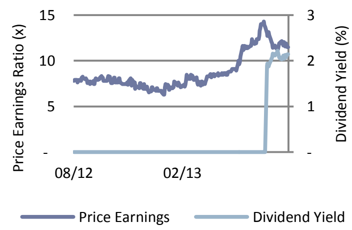
Sources: I-Net Bridge, Blue Gem Research

Share Price against the Coal Mining Index



Sources: I-Net Bridge, Blue Gem Research

Price Earnings (x) and Dividend Yield (%)



Sources: I-Net Bridge, Blue Gem Research

Key Forecasts (Rm)	Mar 11A	Mar 12A	YoY %	Mar 13A	YoY %	Mar 14E	YoY %	Mar 15E	YoY %
Revenue	**558**	**631**	**13%**	**677**	**7%**	**1420**	**110%**	**1872**	**32%**
Net Profit	**-43.6**	**20.6**	**-147%**	**19.7**	**-4%**	**40.1**	**104%**	**132.8**	**231%**
HEPS (Cont. Ops.)	**-8.1**	**13.0**	**-260%**	**12.4**	**-5%**	**23.8**	**92%**	**77.1**	**224%**
Return on Equity (%)	*-31.9%*	*13.1%*	-	*11.1%*	-	*19.3%*	-	*43.2%*	-
Price Earnings ratio (x)	-17.0	10.6	-	11.1	-	5.8	-	1.8	-
Price-to-Book ratio (x)	1.5	1.4	-	1.2	-	1.1	-	0.8	-

Sources: Wescoal, I-Net Bridge, Blue Gem Research

Keith McLachlan*

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Key Forecasts (Rm)	**Mar 11A**	**Mar 12A**	**YoY %**	**Mar 13A**	**YoY %**	**Mar 14E**	**YoY %**	**Mar 15E**	**YoY %**
Revenue	**558**	**631**	**13%**	**677**	**7%**	**1420**	**110%**	**1872**	**32%**
- Coal Trading	315	359	14%	359	0%	1020	184%	1040	2%
- Coal Mining	243	274	13%	328	20%	400	22%	832	108%
- Khanyisa	243	274	13%	274	20%	325	19%	325	0%
- Khanyisa (mtpa)	*1.39*	*1.18*	*-15%*	*1.31*	*11%*	*1.30*	*-1%*	*1.30*	*0%*
- Intibane	-	-	-	-	-	175	>100%	240	37%
- Intibane (mtpa)	-	-	-	-	-	*0.70*	>100%	*0.96*	37%
- Elandspruit	-	-	-	-	-	-	-	475	>100%
- Elandspruit (mtpa)	-	-	-	-	-	-	-	*1.90*	*>100%*
- Inter-Group	-	-2	>100%	-9	298%	-	-100%	-	-
Gross Profit	**28.4**	**64.1**	**126%**	**72.7**	**13%**	**194.4**	**167%**	**392.2**	**102%**
GP Margin (%)	*5.1%*	*10.2%*	-	*10.7%*	-	*13.7%*	-	*20.9%*	-
Operating Costs	-50.4	-40.9	-19%	-48.8	20%	-100.2	105%	-133.4	33%
EBITDA	**-6.2**	**30.5**	-592%	**27.7**	-9%	**123.2**	344%	**348.3**	183%
EBITDA Margin (%)	*-1.1%*	*4.8%*	-	*4.1%*	-	*8.7%*	-	*18.6%*	-
Operating Profit	-21.4	30.5	-243%	27.7	-9%	94.2	240%	258.8	175%
Operating Profit Margin (%)	*-3.8%*	*4.8%*	-	*4.1%*	-	*6.6%*	-	*13.8%*	-
Net Profit (Att. Parents)	**-43.6**	**20.6**	-147%	**19.7**	-4%	**40.1**	104%	**132.8**	231%
Net Profit Margin (%)	*-7.8%*	*3.3%*	-	*2.9%*	-	*2.8%*	-	*7.1%*	-
Issued Shares (millions)	157.9	157.9	0%	157.9	0%	172.2	9%	172.2	0%
Weighted Shares (millions)	150.3	157.9	5%	157.9	0%	168.6	7%	172.2	2%
EPS (Cont. Ops.)	-11.3	13.1	-216%	12.5	-5%	23.8	91%	77.1	224%
HEPS	-26.2	13.0	-150%	12.4	-5%	23.8	92%	77.1	224%
HEPS (Cont. Ops.)	-8.1	13.0	-260%	12.4	-5%	23.8	92%	77.1	224%
DPS (cps)	**-**	**-**	**-**	**3**	**>100%**	**6**	**94%**	**19**	**231%**
Assets	275	282	3%	289	3%	427	48%	598	40%
Return on Assets (%)	*-15.9%*	*7.3%*	-	*6.8%*	-	*9.4%*	-	*22.2%*	-
Liabilities	279	282	1%	289	3%	427	48%	598	40%
Equity (Parent)	136	157	15%	177	13%	208	17%	307	48%
Return on Equity (%)	*-31.9%*	*13.1%*	-	*11.1%*	-	*19.3%*	-	*43.2%*	-
NAV (cps)	90.8	99.5	10%	112.4	13%	120.5	7%	178.4	48%
Tangible NAV (cps)	46.5	56.1	21%	63.2	13%	33.8	-47%	91.6	171%
Cash flow from operations	17	12	-29%	38	214%	178	364%	317	78%
Cash conversion ratio (%)	*-277.7%*	*40.1%*	-	*138.8%*	-	*144.9%*	-	*91.2%*	-
Cash flow from investing	-25	-4	-82%	-25	473%	-127	407%	-116	-9%
Change in cash for the year	20	-11	-157%	1	87%	29	1899%	112	-484%
Cash	31	20	-36%	21	7%	50	136%	162	222%
Net cash	30	19	-37%	21	9%	50	142%	162	222%
Price Earnings ratio (x)	-17.0	10.6	-	11.1	-	5.8	-	1.8	-
Price-to-Book ratio (x)	1.5	1.4	-	1.2	-	1.1	-	0.8	-
Price-to-Tangible-Book ratio (x)	3.0	2.5	-	2.2	-	4.1	-	1.5	-
EV/EBITDA ratio (x)	-35.1	7.1	-	7.9	-	1.8	-	0.6	-
Dividend Yield (%)	-	-	-	2%	-	4%	-	14%	-

Sources: Wescoal, I-Net Bridge, Blue Gem Research workings, assumptions and forecasts

Investment Case

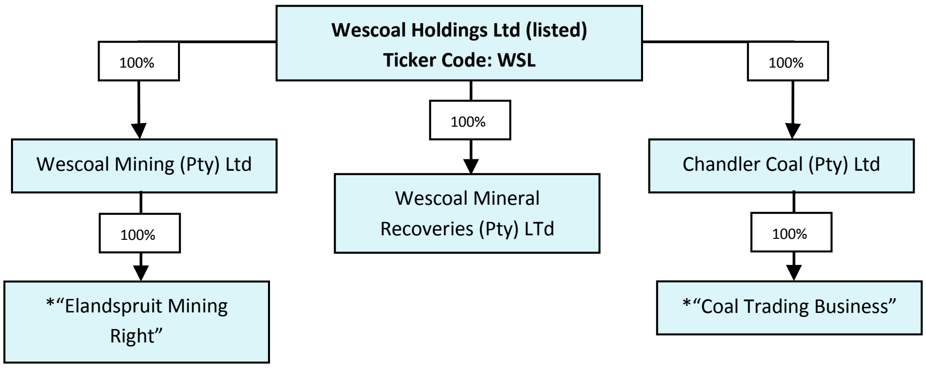
Wescoal Holdings Ltd has built a small portfolio of thermal coal assets in South Africa's inland coal market, supplying into a rising demand from Eskom that underpin positive local coal market dynamics. The Group also owns Chandler Coal, a long-running coal-trading operation, and has recently (conditionally) acquired another coal-trading operation as the Group moves to consolidate the sector.

Our fair value for the Group's Coal Trading segment is R135m or 79cps, implying a (pro-forma) PE of 8.6x. We do assume, though, that the outstanding conditions remaining on the Coal Business Acquisition will be fulfilled and that the acquisition will become unconditional. Valuing each of the Group's mines separately, we arrive at a SOTP fair value of R376m or 218cps for the Coal Mining segment, or c.R10/t for our estimated *in situ* coal resource. Adjusting for net cash and a 20% Group overhead discount, the SOTP of the Group places its fair value at R367m or 213cps. In other words, Wescoal's intrinsic value appears to be 54% more than the current share price on an implied PE of 18.6x of historical earnings, albeit on a much lower Forward PE of 8.9x.

Overall, Wescoal's shares appear quite discounted against its current assets, while we believe the Group has positioned itself to benefit from the positive prospects of the local coal market.

Group Overview

Figure 1: Summarised Group Structure (after the Elandspruit and "Coal Trading Business" transactions have become unconditional)



Sources: Wescoal and Blue Gem Research

** New acquisitions may still be dependent on certain conditions; implicit assumption in this report is that the conditions are fulfilled and the acquisitions become unconditional.*

Table 1: Summarised Corporate Governance Checklist

Corporate Governance Aspect	Is it in place at Group-level?	Comment
External auditors?	Yes	PriceWaterhouseCoopers Inc.
Internal audit function?	No	Currently under review.
Appropriate management incentives?	Yes	Performance-based remuneration framework implemented via a duly constituted Remuneration Committee.
Independent non-executive Chairman?	Partially	Non-Executive Chairman, but not independent due to his large BEE stake in the Group (c.34%).
Balance of independent, non-executives on the Group Board?	Yes	The Board has a balance of Non-Executive Directors with a balance of these being Independent.

Sources: Wescoal and Blue Gem Research

Wescoal's CEO, André Boje, became involved in the inland coal industry in 1997 when he took a stake in Chandler Coal, a long-running inland coal trading business that still forms a key segment of the Group.

Boje was instrumental in Wescoal Holdings Ltd being formed, listing the Group on the AltX during 2005, and subsequently guiding the Group as it became involved in primary production of coal through a series of acquisitions. During 2010 the Group moved its listing to the JSE Main Board, "Coal", located under "Mining".

Boje is backed by an experienced and capable team. The Chief Financial Officer, Petrus Janse van Rensburg, joined Chandler Coal in 2004. Representing the strategic 34% BEE shareholder in the Group, Non-Executive

Chairman, Muthanyi Robinson Ramaite, currently sits on a number of other Boards, including Adcorp Holdings, and was previously the Director-General of the Department of Public Service and Administration.

Coal Mining

Table 2: Segment Key Forecasts (consolidated)

Mining Segment (Rm)	FY 11A	FY 12A	FY 13A	FY 14E	FY 15E	FY 16E	FY 17E	FY 18E
Revenue	243	274	328	400	832	730	476	456
Cost of production	278	244	224	287	523	484	272	254
Average Revenue per ton (Rand/t)*	R225/t	R243/t	R250/t	R250/t	R250/t	R250/t	R250/t	R250/t
Average Cost per ton (Rand/ton)**	R200/t	R207/t	R250/t	R144/t**	R126/t	R133/t	R114/t	R112/t
Operating Profit	-	30	35	84	219	161	142	130

Sources: Wescoal (various), Blue Gem Research workings, assumptions and forecasts

** This price per ton differs (i.e. is below) thermal coal export prices predominantly due to its lower-grade. Our forecast assumes a flat average spot of R250/t.*

*** Significant drop in the Rand/ton cost of production is due to the low Stripping Ratio at Intibane, which begins contributing product from FY 14E.*

Wescoal's main coal mining assets are:

- **Khanyisa**: A short-life, open cast thermal coal mine currently supplying Eskom with an off-take agreement.
- **Intibane**: A short-life, open cast thermal coal mine with a potentially very attractive Stripping Ratio. The mine began operations in June 2013 and started to supply Eskom from July 2013.
- **Elandspruit**: A medium-life, open cast thermal coal mine expected to go into production during March/April 2014 and then also supply Eskom.
- **Other**: The Group does hold two other coal assets, Silverbank and Verblyden, but neither has a defined reserve, therefore we exclude these assets from our review of the Group's Coal Mining segment and our valuation thereof. While we have given these assets a nil value, they certainly have some value (even just "optionality value") and this creates upside risk to our valuation of the Group.

The three major coal assets are all located within South Africa, lying in the Witbank geography (Figure 2), with Khanyisa and Intibane extremely near to each other and Elandspruit just outside of the Middelburg town.

Figure 2: Geographic Location of Wescoal's Mining Operations

Sources: Wescoal, Google Maps and Blue Gem Research estimations

Table 3 summarises the key operating characteristics of each of the three major coal mining assets owned by Wescoal. Many of these variables are key both in building our forecasts for the Group's financial results and as inputs into our Discounted Free Cash Flow (DCF) valuations of each respective mine (see the Valuation section later in this report for more details).

Table 3: Key Segmental Metrics (Per Producing Mine)

Metric / Assumption	Khanyisa	Intibane	Elandspruit
Measured reserves (mt)	1.32 mt	1.73 mt	28.50 mt
Our estimated reserves (mt)*	4.00 mt	1.73 mt	28.50 mt
Start of production (FY)	Already in production	FY 14E (June 2013)	FY 15E (March/April 2014)
Steady-state production (mtpa)	1.30 mtpa	0.96 mtpa (Reached in FY 15E)	2.28 mtpa (reached in FY 16E)
Life of Mine (years)**	3 to 4 years	3 to 4 years	12 to 15 years
Major product type***	Eskom-grade thermal coal	Eskom-grade thermal coal	Eskom-grade thermal coal
Off-take agreement	Eskom	Eskom	Eskom
Stripping ratio (x)	3.5x - 4.0x, may rise beyond this as mining starts to go underground	1.5x - 2.0x	1.9x for the first 18m tons, 3.5x average over the Life of Mine.
Sales price (flat)****	R250/t	R250/t	R250/t
Cost per ton (flat)*****	R215/t	R115/t*****	R140/t

Sources: Wescoal (various), Blue Gem Research workings, assumptions and forecasts

** Measured reserves are only the formally declared reserves. This metric is our attempt to capture a realistic estimate of total mineable coal in each mine.*

*** Our estimated reserves divided by the steady-state production, rounded to the nearest year. Extension of mine projects could make these conservative.*

**** Predominantly low-grade bituminous, thermal coal for Eskom consumption*

***** Based on a flat inland coal price. R250/t based off a steady R/Gj, at current estimated Eskom prices. These will differ greatly from export pricing of higher-grade thermal and metallurgic coal.*

****** No inflation has been taken into account. For valuation purposes, inflation is assumed to be captured by our Cost of Equity being nominal in nature. Note Intibane's extremely low Stripping Ratio affects our averages during its period of production.*

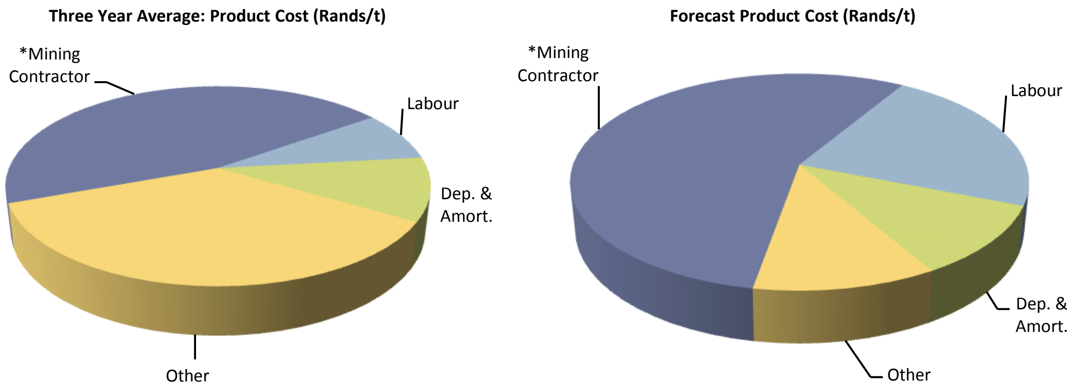
Wescoal has been operating Khanyisa since 2010 as a low-cost, open cast thermal coal operation. The Group has been selling the mine's Eskom-grade thermal coal to Eskom as feed into the surrounding Witbank power stations of the electricity utility. While only 1.32Mt of coal is declared as a reserve, the Group is beginning underground mining and various other projects aimed at extending the Life of Mine of the operation. We estimated that at a steady-state production of c.1.3mtpa, the operation has between three and four more years of economic resources remaining.

Intibane is located near to Khanyisa in Witbank. It has declared reserves of 1.73mt of Eskom-grade thermal coal with a potentially very attractive Stripping Ratio (c.1.5x). Intibane is therefore likely to be a high-margin operation, albeit one with a short three to four year Life of Mine. There is an off-take agreement with Eskom and, like Khanyisa, management sees opportunities to extend the Life of Mine. The mine began production during June 2013 and started supplying Eskom during July 2013 c.80 000t per month. It will therefore contribute c.0.7mtpa to Wescoal's FY 14E.

Elandspruit was recently acquired in an effective asset swap of a similarly sized deposit with Xstrata. The asset swapped by Wescoal for Elandspruit is located advantageously adjacent to an existing coal mining operation of Xstrata. Elandspruit has declared reserves of 28.50mt of thermal coal with an average Stripping Ratio of c.3.5x. Management estimates that the first 18mt are likely to be mined at a Stripping Ratio of c.1.9x, but the lowest estimated Stripping Ratio is c.1.0x in the western section of the property and it then rises to a maximum of c.8.0x in the south and southeast. Elandspruit has an estimated Life of Mine of 12 years (management feels that this may realistically be as high as 15 years) at a steady-state production of 2.28mtpa being supplied predominantly to Eskom.

Wescoal's approach to mining these small coal deposits is a rolling open cast operation utilising blasting and contract mining for bulk earth moving (Figure 3). Rehabilitation takes place on a rolling basis as the sections are cut, mined out and thereafter filled. Any coal sorting, washing and blending is done within the Group or even utilises the Coal Trading segment. One of the Group's key approaches to extracting these small coal deposits economically involves minimal upfront capex, utilising Instalment Sales Agreements as an initial financing mechanism and then funding most of the operation's capex modularly from the producing mine's free cash flows.

Figure 3: Approximate Cost Breakdown for Wescoal's Mining Approach



Sources: Wescoal and Blue Gem Research workings, assumptions and forecasts

** The Mining Contractor is paid per ton of earth moved, thus this cost varies depending on the Stripping Ratio. This example cost breakdown assumes a 1.0x Stripping Ratio.*

We have assumed that Wescoal has full rights, ownership and compliance with the various South African mining and minerals laws. While this may be an outlying risk, we have further assumed no breach, break or change in these mineral rights and/or the laws and regulations governing them.

Coal Trading

Table 4: Segment Key Forecasts

Trading Segment (Rm)	FY 11A	FY 12A	FY 13A	FY 14E*	FY 15E	FY 16E	FY 17E	FY 18E
Revenue	315	359	359	1020*	1040	1061	1082	1104
Growth in revenue (% y/y)	0.15	14%	0%	184%*	2%	2%	2%	2%
Operating Profit	2	5	4	13	22	23	25	27
Growth in Operating Profit (% y/y)	4410%	176%	-18%	221%	63%	8%	7%	7%

Sources: Wescoal (various), Blue Gem Research workings, assumptions and forecasts

** Assumed 12m consolidation of recently acquired "Coal Trading Business" with c.R641m in turnover. I.e. That all outstanding conditions of the acquisition are fulfilled.*

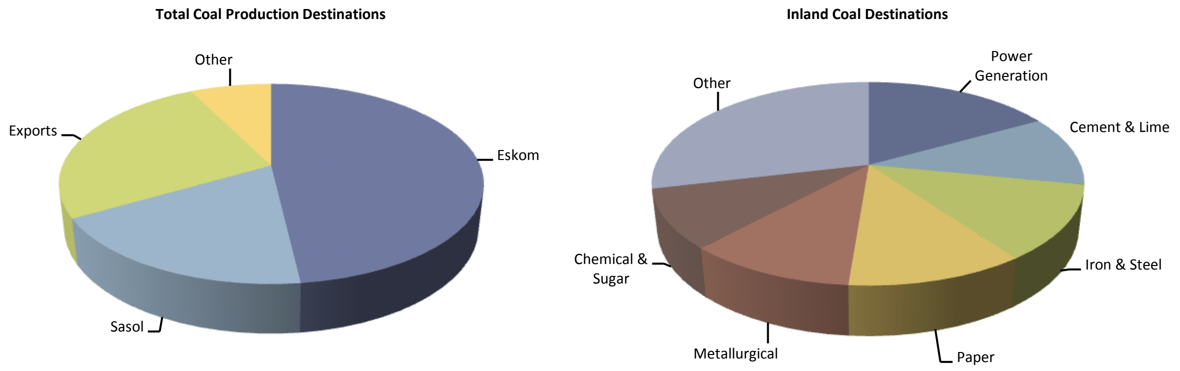
Chandler Coal (Pty) Ltd was the original business of Wescoal and constituted the bulk of this reporting segment historically. Chandler is a large coal trader in the Southern African domestic market with offices and depots situated in Gauteng, Eastern and Western Cape.

Since 2008, local coal traders have had to compete with the primary producers for supply of the inland market, resulting in reduced volumes and pressure on margins. On 13 June 2013, Wescoal therefore announced the acquisition of a Coal Trading Business for R79m in cash with the intention of consolidating some of the market, achieving cost-saving synergies and returns to scale in this segment.

A key outstanding condition for this acquisition is the Competition Commission's approval. For the purposes of this report, we have assumed that this approval will be forthcoming and that this acquisition becomes unconditional.

While Eskom consumes the bulk of South Africa's coal (c.135mtpa to 150mtpa), between 60mtpa and 70mtpa of high quality thermal coal is exported via Richards Bay Coal Terminal (RBCT). The balance (c.60mtpa) is predominantly used as feedstock into Sasol's coal-to-liquids production (c.45mtpa to 50mpta) and the remainder is consumed by local industry (Figure 4).

Figure 4: Approximate South African Coal Consumption/Destination Splits



Sources: Wescoal, Various Reports and Blue Gem Research workings and assumptions

Chandler Coal is a key player in the local coal trading market with a long established track record. We have built our expectations for this segment on the fulfilment of the Coal Trading Business acquisition taking this segment's revenues to c.R1bn on full consolidation, 10% synergies being realised and 2% y/y volume growth.

The 2% y/y volume growth is built to be in line with South Africa's 31-year 2.3% average growth in coal production (Figure 7) and c.2% y/y real GDP growth over the medium term.

Coal Market

Coal is predominantly used as a solid fuel to produce electricity through combustion. Other major uses include metallurgic industrial applications and coal-to-liquid processing as an oil substitute.

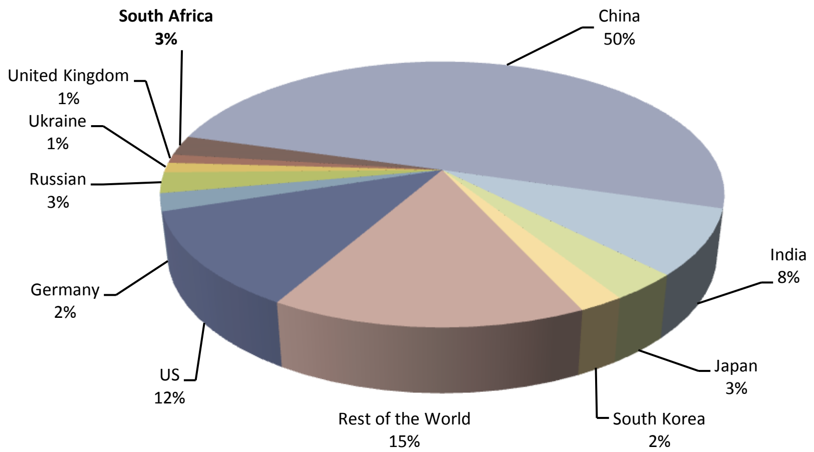
As a bulk energy commodity, the coal market has massive global linkages along with more local intricacies.

Global Coal Market

China currently consumes c.50% of the world's coal resources (Figure 5), with about 80% of its country's power being coal-based.

While China has vast coal reserves (Figure 6), the country's rapid economic growth has forced it to become a net importer of thermal coal to satisfy its power generation needs. As a resource poor geography, Japan is also a key net importer of thermal coal while India is increasingly becoming a large importer, particularly from Africa.

Figure 5: Global Coal Consumption

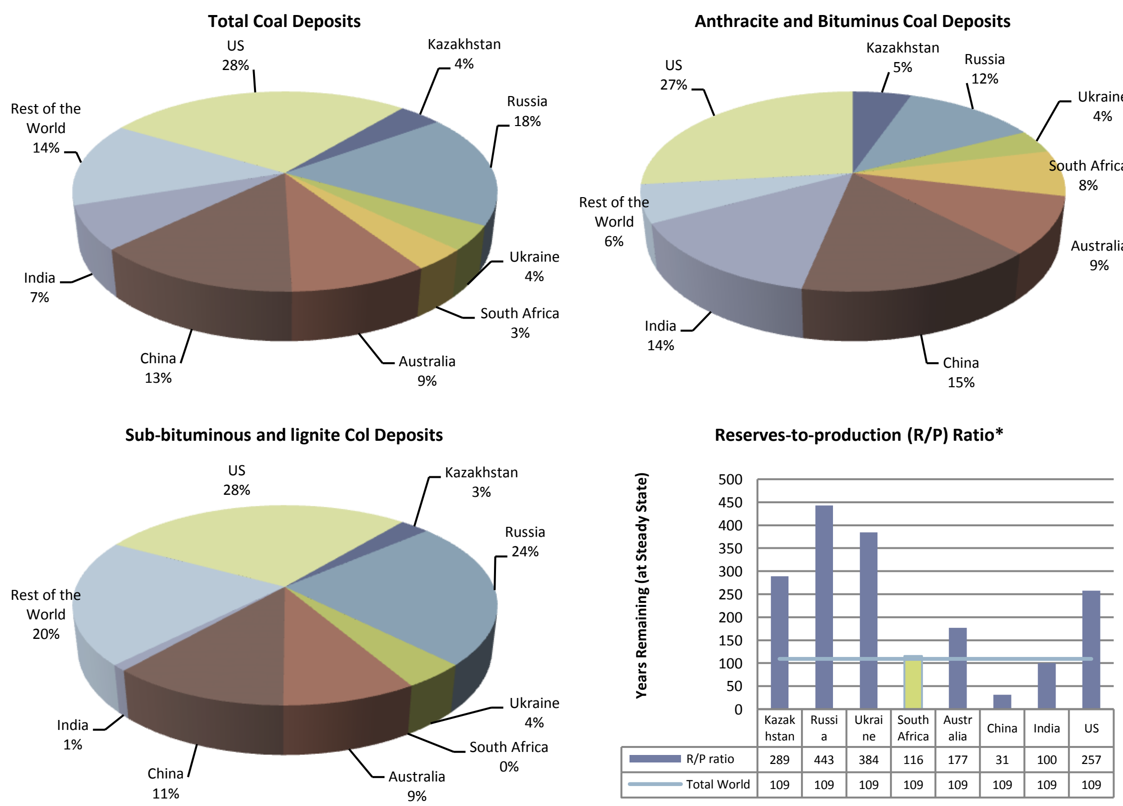


Sources: I-Net Bridge, BP Statistical Review of World Energy June 2013, Blue Gem Research workings and assumptions

Australia is a major exporter of coal predominantly into Asia. Australia's coal exports are both coking and thermal coal and the country's Reserves-to-Production ratio (R/P – current reserves divided by current production) are c.177 years, well over the world mean of 109 years (Figure 6). South Africa has a comfortable 116 years R/P ratio, but has predominantly thermal coal reserves (with minor anthracite/coking deposits, mainly in KwaZulu-Natal).

Potentially key to long-term systemic changes in the international coal markets is the Chinese Coal Cliff. China has coal reserves (taking into account c.6% growth in both coal production and consumption) with a limited lifespan of eight to ten years, but consumes c.50% of the world's coal to generate c.80% of its power. Holding only c.13% of the world's coal reserves implies that China's demand for imported thermal coal may spike dramatically in coming years (hence the Chinese Coal Cliff). China's recent focus on consuming local coal rather than importing may shorten this time horizon, while increasing use of alternative power generation and the development of the country's massive shale gas reserves may in fact lengthen this time horizon.

Figure 6: Division of Global Coal Reserves and Estimated Lives of Country Deposits



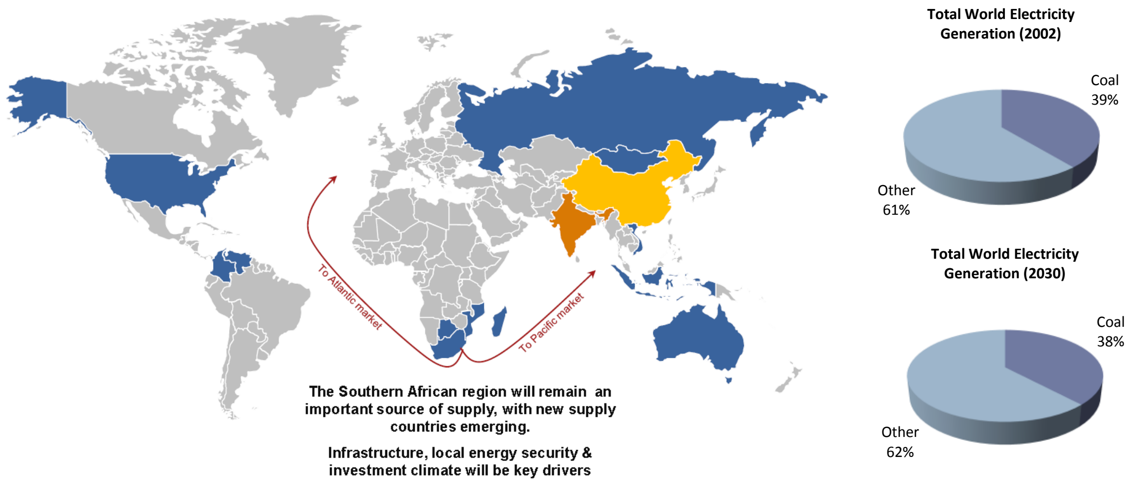
	Kazakhstan	Russia	Ukraine	South Africa	Australia	China	India	US
R/P ratio	289	443	384	116	177	31	100	257
Total World	109	109	109	109	109	109	109	109

Sources: I-Net Bridge, BP Statistical Review of World Energy June 2013, Blue Gem Research workings and assumptions
** Current reserves divided by current production*

India too has become a major coal importer as numerous new coal-fired power plants have been built across the fast-growing country in an attempt to battle chronic power shortages. South Africa's thermal coal exported through Richard's Bay Coal Terminal (RBCT) to India has in fact surpassed China as the major customer of our local thermal product.

While South Africa's coking coal reserves are below average given the country's aggregate coal reserves, the country does have amongst the fifth largest thermal coal reserves in the world. South Africa's reserves and geographic placing in the world (Figure 7) position it to benefit from the currently growing Indian demand for thermal coal and the potential of the Chinese Coal Cliff.

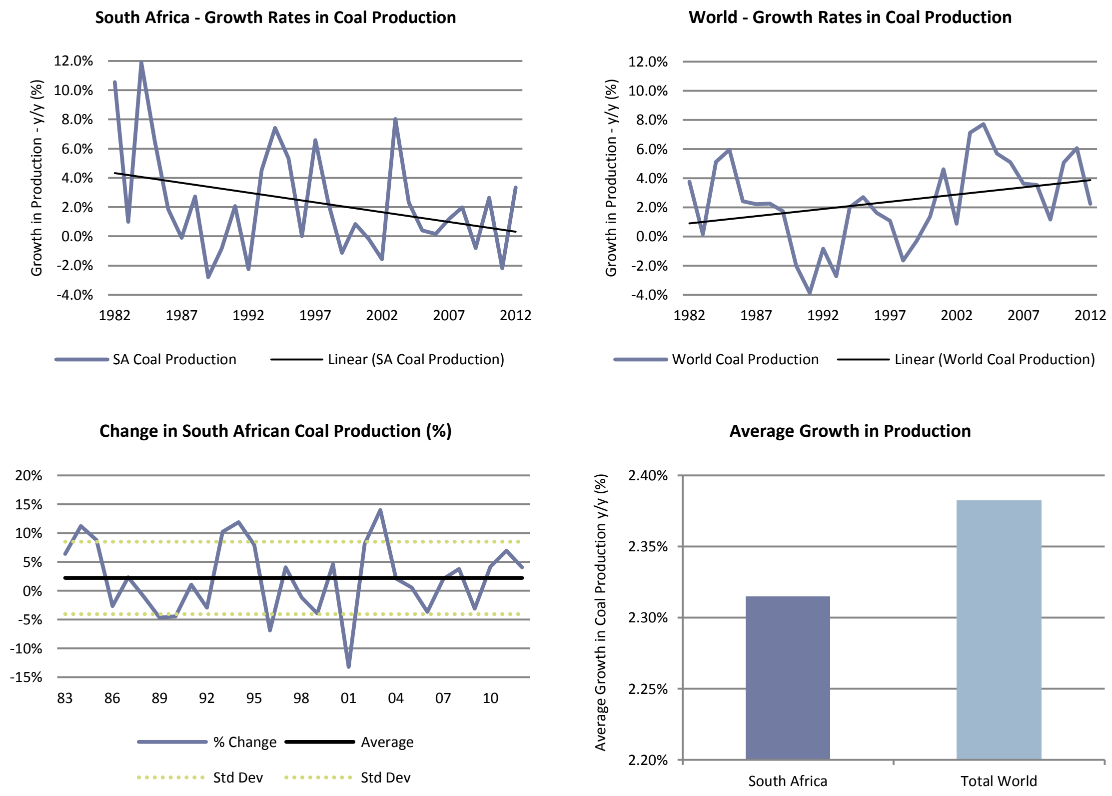
Figure 7: South Africa Is Excellently Positioned to Supply East and West Thermal Coal Markets



Source: SA Coal Roadmap October 2012, Blue Gem Research estimates and workings

Interestingly, while the world's coal production has grown on average 2.4% y/y for the last 31 years (Figure 8), the growth in South Africa's coal production has only averaged 2.3% y/y over the same time period. This is likely the result of declining grades and rising costs on the major Witbank and Highveld coalfields coupled with the Transnet Freight & Rail (TFR) outbound bottleneck in railage to RBCT for export purposes limiting the ability of producers to physically export the mined coal. The next major coalfield in South Africa, the Waterberg, remains largely undeveloped due to logistical, environmental and capital challenges, although various scenarios and planned railage may open this reserve up to future exploitation.

Figure 8: Growth in Coal Production Globally and in South Africa



Sources: I-Net Bridge, BP Statistical Review of World Energy June 2013, Blue Gem Research workings and assumptions

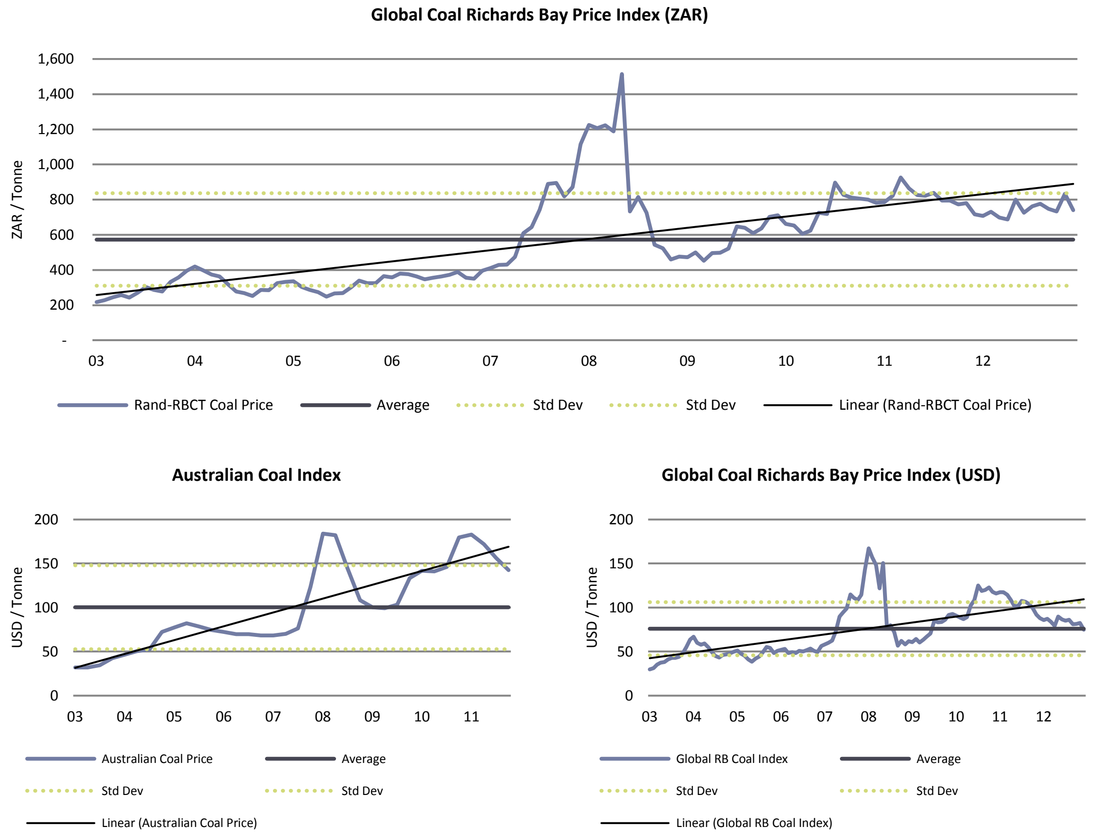
South African Inland Coal Market

South Africa's coal market is split between exported product and locally consumed product.

Given the declining local gold industry and the troubles in the platinum industry, coal has become South Africa's most valuable commodity export.

The exported product is routed via Transnet Freight & Rail (TFR) from the Highveld and Witbank regions down to Richards Bay Coal Terminal (RBCT), achieving relatively high USD-based pricing (Figure 9) on the international market.

Figure 9: Richards Bay Coal Terminal (RBCT) and Other Export Coal Prices



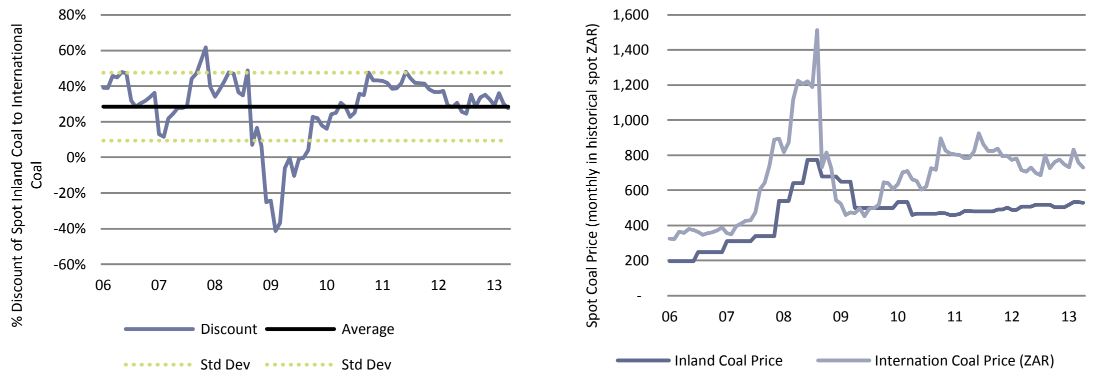
Sources: I-Net Bridge and Blue Gem Research workings and assumptions

China, India and Europe are the major customers of South Africa's exported coal, but increasing use of Shale Gas as a coal substitute in the USA (the Shale Gas Revolution) is leading to increasing coal exports from the region and has had a detrimental effect on the international spot coal price. The recent weakness in the Rand has however protected local coal exports against the worst of this spot coal weakness (Figure 9).

RBCT has capacity to export 91mtpa of coal, but it only achieved 68mt in 2012 (and has only achieved an annualised equivalent of 66mt by June 2013 for CY 13) due to TFR railage constraints into the port. The current Project Shongololo may lift the coal corridors railage to 81mtpa. There are also plans to build a Lesotho link, and long-term plans to link the basically virgin Waterberg coalfield (third largest in South Africa) via railage to RBCT and/or Maputo. The current reality however is that the TFR's outbound railage is the major export bottleneck in the South African coal market.

In part due to these export constraints, a significant amount of coal is consumed inland. Given the logistical costs involved in exporting coal versus its relative quality and uses, the average inland spot coal price tends to be at a discount to the export spot price (Figure 10).

Figure 10: Inland Coal Pricing History and Discount to Export Coal Price



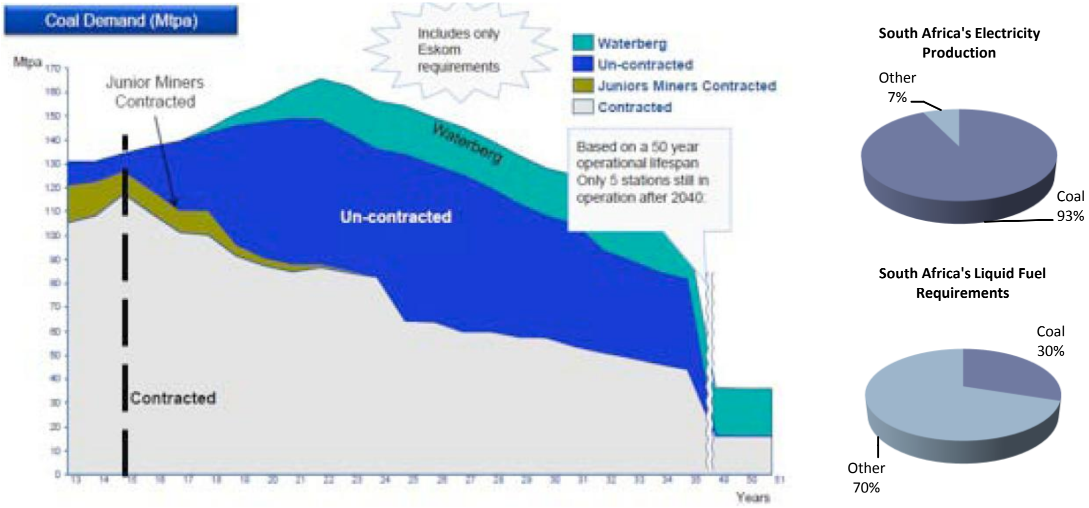
Sources: I-Net Bridge, Wescoal data, Blue Gem Research workings and assumptions

Historically the average inland coal price is c.29% lower than the Rand-based export coal price via RBCT. These dynamics may shift dramatically over the medium term due to an expected short supply to Eskom in 2015 (Figure 11).

Eskom is the largest single inland consumer of coal (the balance being consumed by industry). As existing coal supply contracts run out, with limited new coal mines coming into production and as Medupi and Kusile coal fired power stations come on line, Eskom may run into critical inland supply shortages.

While this scenario may work very much in favour of the inland spot coal price, the Government's potential classification of coal as a "strategic resource" may open up the risk of market regulation to mitigate the risk to Eskom and the broader South African economy. This scenario would likely be negative for inland coal suppliers.

Figure 11: Currently Perceived Eskom Supply Gap Coming in 2015 & World Electricity Generation



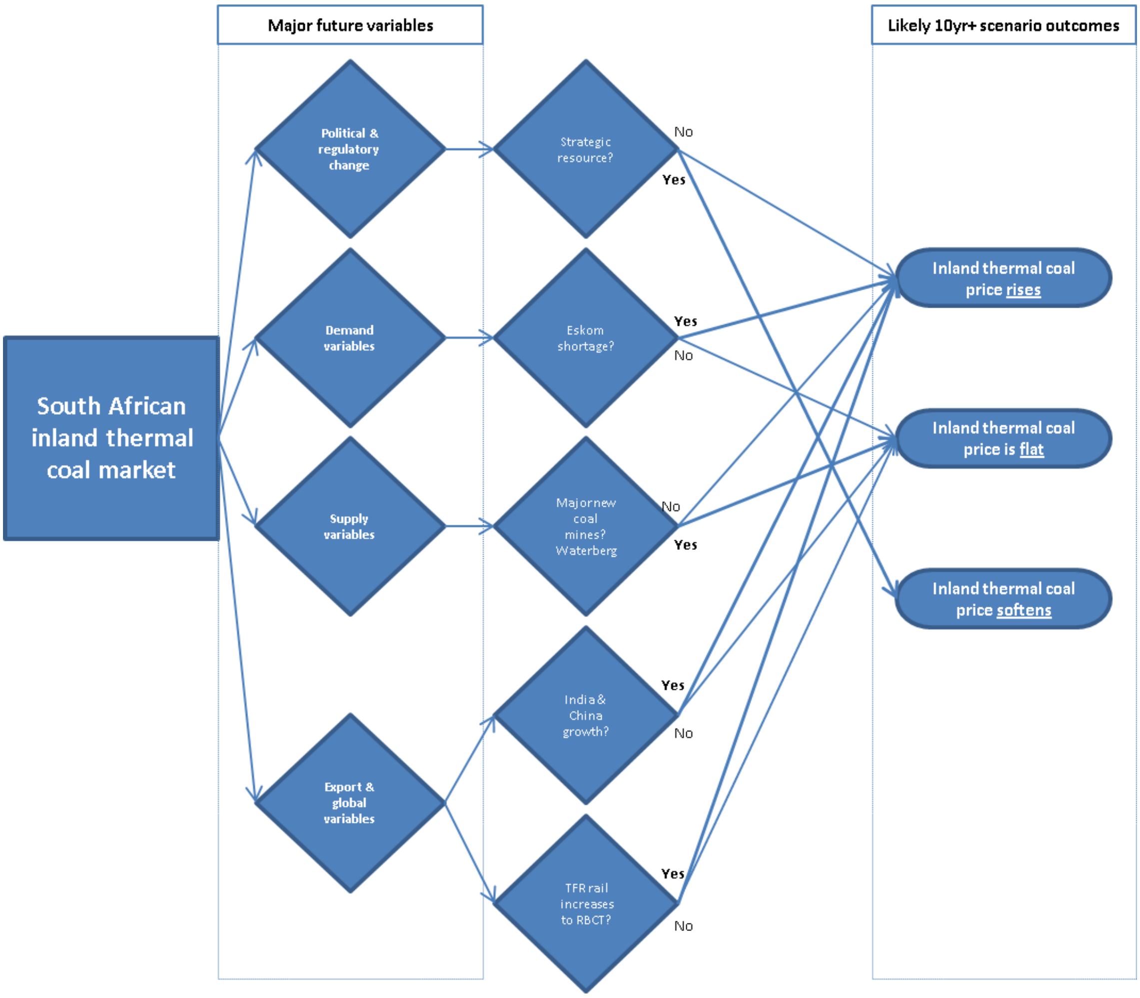
Sources: Wescoal, IE 2004, Blue Gem Research Workings and Assumptions

Depending on global coal dynamics (that appear dependent on the opposing forces of the Chinese Coal Cliff and the Shale Gas Revolution), this may well lead to a scenario where inland coal pricing comes in line with export pricing (or perhaps even a slight premium, net of costs).

As noted above, the South African Government classifying coal as a "strategic natural resource" may pave the way for regulating and/or taxing of export coal and/or inland coal pricing, which may counteract future buoyancy in the international spot coal price.

We have built a scenario map for some of inland coal's major variables (Figure 12) and arrive at the conclusion that the majority of these variables point to a rising inland coal price (at least relative to the export coal price).

Figure 12: Macro Scenario Map for Inland Coal



Sources: Blue Gem Research workings and assumptions

Note that our Wescoal forecasts and valuation model all assume a flat spot coal price (both inland and export). However unrealistic that assumption is, it is useful for a simplification process.

Refer to Figure 13 for a sensitivity analysis of how changes in the spot coal price change some of our valuation models. In summary, we have found that our valuation of Wescoal rises by c.50% for every 10% rise in the coal price. Given that our above inland coal scenario analysis implies likely upside in the inland coal price, we see our valuation as holding likely upside risk too.

Forecasts

Revenues and profitability

Wescoal is currently profitable with most of its profits flowing from its Khanyisa coal mining operation. Intibane's profitable nine- to ten-month contribution from FY 14E should add to this significantly.

We have assumed that all outstanding conditions are fulfilled with the Group's acquisitions of the Elandspruit mining right and the Coal Trading Business. These acquisitions and businesses have been consolidated into the Group's financial statements and built into our forecasts.

The Coal Trading Business adds c.R641m in revenues to the Group's Coal Trading segment, while we have assumed flat Gross Margins and 10% synergistic savings from FY 15E onwards (FY 14E will likely have once-off integration costs that offset any savings). Regarding the Group's Coal Mining segment, refer to Table 3 for our various key assumptions, timing of mining ramp-ups and steady states, most notably relating to Intibane in the short term.

Liquidity, solvency and assets

At the end of FY 13, Wescoal's balance sheet was in a net cash position. Per our forecasts, despite building up Intibane and thereafter Elandspruit into producing mines, the Group will likely remain debt free.

Typical of Wescoal's approach to mining junior coal deposits, both Intibane and Elandspruit will have staggered capex spend, largely being funded internally from the mines' cash flows. Also, the bulk of each mine's costs (Figure 2) will be variable in nature. The bulk of these variables costs goes towards the mining contractor and is structured per ton of earth moved (i.e. affected dramatically by each mine's Stripping Ratio).

While this cost model limits Wescoal's operating leverage, it does lend itself to slightly more defensive mining operations with less initial and continuing draw-downs on capital.

Therefore, we see little issue regarding Wescoal's current or prospective liquidity and solvency. Given that the Coal Mining segment's major customer is Eskom, we also do not foresee any major credit risk and expect steady working capital (tracking activity levels).

Valuation and 12m TP

Valuation

Coal Mining Segment

A mine is a finite life asset, thus a Discounted Free Cash Flow (DCF) model is the most appropriate methodology for valuing Wescoal's Coal Mining segment.

Regarding a DCF valuation (Table 5), we have decided to value Wescoal on a *per mine* basis to arrive at a Sum-of-the-Parts (SOTP) fair value. These DCF fair values are then checked against an implied Rand/ton of coal resource as a reasonableness check per mine.

Our key assumptions across the Group are:

- Cost of Equity of 19.2% (based off an Equity Risk Premium of 5.5% and a Rule of Thumb beta of 2.0x, which steps outside of our normal 1.2x to 1.5x range due to the associated extremely high risk of the Group's junior mining activities).
- A flat spot coal price (across all export, trading and inland/Eskom prices and various coal types).
- A flat cost base without inflation. Inflation is taken into account via the Cost of Equity (CoE) and the Weighted Average Cost of Capital (WACC) being nominal in nature.
    - As the Group is essentially self-funded and debt free, WACC is equal to the CoE.
    - Cash outflow from the rehabilitation of mined land is included in the contractor's cost, except for the final year's rehabilitation when Wescoal assumes final rehabilitation duties.
    - In Elandspruit's case, there is an extra R5.00/t royalty payable to Proudafrique that also needs to be taken into account.

- A flat effective tax rate (taking into account the additional Royalty Tax on mining activities).
- All debt and cash are held at Group-level.
- Linear production ramp-up, steady-state and ramp-down cycles at each mine.
- Various other key assumptions shown in Table 3.

We arrive at fair values of R65m for Khanyisa (R16.13/t), R102m for Intibane (R59.17/t) and R209m for Elandspruit (R7.34/t). Intibane's R/t is so much higher than the others' due to our model utilising an extremely low Stripping Ratio, while Elandspruit's R/t is lower than the others' due to the DCF building in a ramp-up to production only in FY 15E (i.e. time value of money to the present day).

Table 5: Discounted Free Cash Flow (DCF) Models for Wescoal's Khanyisa, Intibane and Elandspruit Mines

Khanyisa	**FY 14E**	**FY 15E**	**FY 16E**	**FY 17E**	**FY 18E**	**FY 19E**	**FY 20E**	**FY 21E**	**FY 22E**	**FY 23E**	**FY 24E**	**FY 25E**	**FY 26E**	**FY 27E**
Revenue	325	325	325	25	-	-	-	-	-	-	-	-	-	-
Variable cash costs	-267	-267	-267	-21	-	-	-	-	-	-	-	-	-	-
Aggregate taxes	-14	-14	-14	3	-	-	-	-	-	-	-	-	-	-
Capex	-12	-12	-12	-1	-	-	-	-	-	-	-	-	-	-
Rehabilitation	-	-	-	-14	-	-	-	-	-	-	-	-	-	-
Free cash flows (FCF)	32	32	32	-8	-	-	-	-	-	-	-	-	-	-
Discount factor	R0.84	R0.70	R0.59	R0.50	-	-	-	-	-	-	-	-	-	-
Discounted FCF	27	23	19	-4	-	-	-	-	-	-	-	-	-	-
Net Present Value														65
Net Debt														-
Fair value														**R65m**
Fair value per Wescoal share (cps)														**37cps**
Implied fair value per estimated resource (R/t)														*R16.13/t*

Intibane	**FY 14E**	**FY 15E**	**FY 16E**	**FY 17E**	**FY 18E**	**FY 19E**	**FY 20E**	**FY 21E**	**FY 22E**	**FY 23E**	**FY 24E**	**FY 25E**	**FY 26E**	**FY 27E**
Revenue	175	240	18	-	-	-	-	-	-	-	-	-	-	-
Variable cash costs	-74	-101	-7	-	-	-	-	-	-	-	-	-	-	-
Aggregate taxes	-24	-35	3	-	-	-	-	-	-	-	-	-	-	-
Capex	-37	-9	-1	-	-	-	-	-	-	-	-	-	-	-
Rehabilitation	-	-	-10	-	-	-	-	-	-	-	-	-	-	-
Free cash flows (FCF)	40	95	2	-	-	-	-	-	-	-	-	-	-	-
Discount factor	R0.84	R0.70	R0.59	-	-	-	-	-	-	-	-	-	-	-
Discounted FCF	34	67	1	-	-	-	-	-	-	-	-	-	-	-
Net Present Value														102
Net Debt														-
Fair value														**R102m**
Fair value per Wescoal share (cps)														**59cps**
Implied fair value per estimated resource (R/t)														*R59.17/t*

Elandspruit	**FY 14E**	**FY 15E**	**FY 16E**	**FY 17E**	**FY 18E**	**FY 19E**	**FY 20E**	**FY 21E**	**FY 22E**	**FY 23E**	**FY 24E**	**FY 25E**	**FY 26E**	**FY 27E**
Revenue	-	475	570	570	570	570	570	570	570	570	570	570	570	380
Variable cash costs	-	-247	-296	-296	-296	-296	-296	-296	-296	-1346	-1346	-1346	-1346	-897
Aggregate taxes	-	-49	-61	-61	-59	-59	-59	-59	-59	236	236	236	236	162
Capex	-16	-40	-22	-22	-100	-22	-22	-22	-22	-22	-22	-22	-22	-14
Rehabilitation	-1	-1	-1	-1	-1	-1	-1	-1	-1	-1	-1	-1	-1	-25
Free cash flows (FCF)	-17	138	190	190	114	193	193	193	193	-562	-562	-562	-562	-395
Discount factor	R0.84	R0.70	R0.59	R0.50	R0.42	R0.35	R0.29	R0.25	R0.21	R0.17	R0.15	R0.12	R0.10	R0.09
Discounted FCF	-14	97	112	94	48	67	56	47	40	-97	-82	-69	-58	-34
Net Present Value														209
Net Debt														-
Fair value														**R209m**
Fair value per Wescoal share (cps)														**121cps**
Implied fair value per estimated resource (R/t)														*R7.34/t*

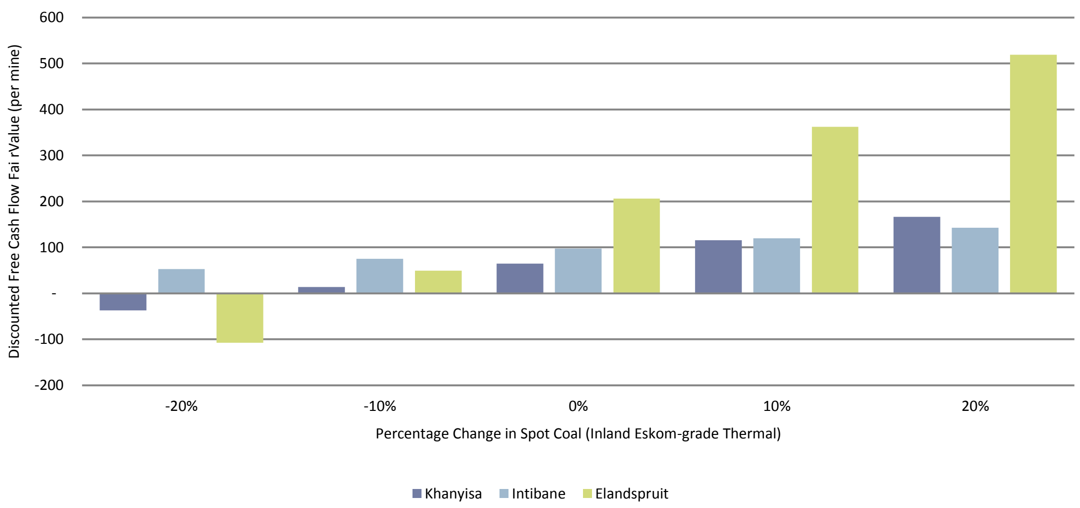
Sources: Wescoal (various), I-Net Bridge, Blue Gem Research workings, assumptions and forecasts

Our above DCF models assume a flat (Eskom-grade) spot coal price (which is relative to export) of R250/t. Assuming a change in coal price (-20%, -10%, +10% and +20%), the fair values that our DCF models produce vary (Figure 13).

Intibane's low Stripping Ratio makes it a low-cost producer and highly defensive against a low spot coal price. Given the number of variables in Elandspruit's planned operations, we have built in a certain amount of operating leverage that makes this mine's DCF fair value the most sensitive to any spot coal price movements.

Broken down to a *per share* basis, Wescoal's fair value changes between 10cps to 13cps for every 1% change in the (inland) coal price.

Figure 13: Wescoal's Coal Mining Segment's Sensitivity to Changes in the Spot (Inland) Coal Price



Source: Blue Gem Research workings and assumptions

That said, it is worth noting that the spot coal price (export and inland) has come under increasing pressure since peaks reached in 2008 and, more recently, during 2011/2012 (Figure 9). Even taking into account the Shale Gas Revolution driving USA's coal exporting that currently supresses international coal prices, our earlier Coal Market analysis and scenario map of variables influencing the spot price of inland coal (Figure 12) lead us to believe that inland coal spot price risks medium-term upside. Our DCF valuations of Wescoal's Coal Mining segment therefore also risks upside.

Coal Trading Valuation

Formerly made up entirely of Chandler Coal (Pty) Ltd, Wescoal's Coal Trading segment recently acquired a large competitor in a conditional transaction worth R79m. The combined annual revenues of these two businesses will be c.R1bn, implying a Price-to-Sales ratio for inland coal trading businesses of 0.1x on an implied PE of 6.7x (based-off pro-forma financial effects released by Wescoal).

The challenges in valuing Wescoal's coal trading segment are effectively overcome by this recent acquisition, as it establishes a fair value for this type of business. The assumption is that if Wescoal is willing to buy a slightly larger coal trading business that shares many of the characteristics of Chandler Coal for R79m, then this must be a fair price (and related relative valuation metrics) for such a business.

Table 6: Relative Valuation of Wescoal's Coal Trading Segment

	Rm
Coal Trading Business acquisition:	
(1) Implied revenue	641
(2) Fair value based off Wescoal's "arm's length" purchase price of the business	79
Implied acquisition Price Earnings (x)	*6.7x*
(2) / (1) = (3) Price/sales (x)	***0.1x***
Chandler Coal:	
(4) FY 13 revenue	357
(3) Price/sales (x)	*0.1x*
(3) x (4) = (5) Fair value	**R44m**
Implied Price Earnings (x)	*11.9x*
Sum of the Parts:	
(2) Coal Trading Business	R79m
(5) Chandler coal	R44m
(6) Synergies (10%)	R12m
(2) + (5) + (6) = Fair value of segment	**R135m**
Fair value of segment (cps)	**79cps**
Implied (post-synergy, full-year consolidated earnings) Price Earnings (x)	*8.6x*

Sources: Wescoal, Blue Gem Research workings and assumptions

Extrapolating this acquisition price to value Chandler Coal, building in 10% synergistic benefits and adding the R79m fair value of the acquisition, we arrive at a fair value of R135m or 79cps (Table 6).

Our fair value of R135m or 79cps implies a (pro-forma) PE of 8.6x. This is slightly higher than the Coal Trading Business's acquisition's implied PE of c.6.7x, but does involve assumed synergies of 10% (not yet in historical profits) as well the removal of an unlisted illiquidity discount as the Coal Trading Business is now effectively listed. Therefore, we are comfortable valuing the Coal Trading segment on a historical PE of 8.6x that should start to lower as synergies from the acquisition come through (post-synergies PE of 6.7x).

Note that we assume the outstanding conditions remaining on the Coal Trading Business acquisition will be fulfilled and the acquisition will become unconditional. The key outstanding condition is the Competition Commission approval. In the absence of the Coal Trading Business acquisition (and related synergies), Chandler Coal appears worth R44m or c.26cps.

Sum-of-the-Parts (SOTP)

Adding the fair value of the Coal Mining segment to the Coal Trading segment, taking out the cash paid for the Coal Trading Business (R79m), adding back Group net cash and taking out a 20% discount due to assumed Group listed overheads, we arrive at what we believe is a good estimate of Wescoal's fair value (Table 7).

Wescoal appears to be worth R367m or 213cps, or 54% more than the current share price on an implied PE of 18.6x of historical earnings. This fair value places the share on a much more palatable Forward PE of 8.9x.

Table 7: Sum-of-the-Parts (SOTP)

Rm	Fair Value	%	12m TP	%
Mining segment	**R376m**	**103%**	**R448m**	**106%**
- Khanyisa	65	18%	77	18%
- Intibane	102	28%	122	29%
- Elandspruit	209	57%	249	59%
- Assumed external funding	-	0%	-	0%
Trading segment	**R56m**	**15%**	**R82m**	**19%**
- New acquisition	79	22%	94	22%
- Cost of new acquisition*	-79	-22%	-79	-19%
- Chandler coal	44	12%	52	12%
- Returns to Scale & Synergies	12	3%	15	3%
Group net cash	21	6%	-	-
Group overheads (20%)	-86	-24%	-106	-25%
Sum of the Parts (SOTP)	**R367m**	**100%**	**R424m**	**100%**
Issued shares (millions)	172	-	172	-
Valuation per share (cps)	**213cps**	**-**	**246cps**	**-**
Implied Price Earnings Ratio (x)	*18.6x*	-	*10.6x*	-
Share price's implied discount to fair value (%)	*54%*	-	-	-
Implied Return (%)	-	-	*78%*	-

Sources: I-Net Bridge and Blue Gem Research workings and assumptions

** While the Coal Trading Business acquisition is worth R79m, Wescoal will have to pay R79m in cash for it. Therefore, the Group's cash drops by this amount. The value uplift to the Group, though, through synergies of R12m and incremental roll-forward of the R79m in fair value is c.R15m (=R94m – R79m).*

Rolling forward all the fair values at our Cost of Equity (19.2%), we arrive at our 12m TP of 246cps for Wescoal on a comfortable Exit PE of 10.6x. This implies a 78% return; however, as the Group is effectively a junior miner, we draw your attention to the key identifiable risks of the valuation in the section below.

Valuation, 12m TP and Implied Return

We peg Wescoal's fair value to 213cps on an implied PE of 18.6x. Rolling this forward, we arrive at a 12m TP of 246cps for Wescoal on an Exit PE of 10.6x, implying an attractive 78% return.

Key risks to our valuation

The key risks to our above valuation methodology are:

- “Above-ground” and “below-ground” risk implicit in Wescoal’s mining activities and operations (e.g. resource risk, labour risk, fuel price, stripping ratio variability).
- Changes in the spot coal price (market-related and/or any regulatory market intervention).
- Underlying inflation of the Group’s cost base.
- Significant interest rate movements.
- Significant Rand movements.
- Overall equity market’s performance (i.e. beta).
- Competition Commission rejection of the Group’s acquisition of the Coal Trading Business.

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