

**Results Note**  
1 July 2014

**Wescoal Holdings Ltd**  
**FY 14 Results – Positives Dampened by Eskom**

Share Code: WSL – Market Cap: R374m – PE: 12.9x – DY: 1.3%

<b>12m Target Price</b>	<b>301cps</b>
<b>Share Price</b>	<b>200cps</b>
<b>Implied Return</b>	<b>48%</b>

Coal Mining & Trading | South Africa

**FY 14 Results: Once-off Costs Create Earnings Miss**

- Wescoal reported its FY 14 results with revenue rising 70% to R1.1bn (FY 13: R0.7bn), largely driven by the H2:14 inclusion of the MacPhail acquisition into the Group’s Coal Trading segment.
- Excluding the once-off profits on the sale of mineral assets during the period, the Group recorded an “Operational” EBITDA growth of 124% and HEPS rising to 15.7cps (FY 13: 12.4cps),
- While the Group’s revenue slightly surpassed our forecast of R1.0bn, restructuring and relocation costs in the Coal Trading segment (R6m), intangibles amortisation (R2m), higher than expected costs and a more aggressive rehabilitation programme at Khanyisa and a general dip in Eskom-related volumes of coal collectively saw the Group miss our target HEPS of 21.2cps.

**Our Thoughts: Uncontrollable Eskom and Spot Price Variables**

- The Group has identified mine extensions for Khanyisa and Intibane while Elandspruit is progressing well towards an expected first production during January 2015.
- MacPhail is integrating well into the Group’s Coal Trading segment and the enlarged business’s prospect look positive.
- Two key variables that will determine the Group’s short-term prospects are (1) Eskom-related coal volumes, and (2) the Rand-price of inland coal. Both variables were soft during FY 14E and—while hard to forecast—indications point to upside here.

**Forecast, Valuation and Implied Return: Relatively Flat Update**

- We lower our fair value by 5% to 240cps (previous: 253cps), as the time value of money has been offset by a lower spot coal price and slightly lower Eskom volumes.
- The implied PE of 15.3x is not very illustrative, though, as both Elandspruit and MacPhail are currently adding to our SOTP, but not yet (fully) contributing to the Group’s profits.
- Based off this fair value, we marginally raise our 12m TP by 4% to 301cps (previous 12m TP: 287cps), implying a 48% return on an Exit PE of 12.2x (which still would *not* include a full year’s steady-state contribution from Elandspruit).

**Share Price against the ALSI**



Sources: Bloomberg, Blue Gem Research

**Share Price against the Coal Mining Index**



Sources: Bloomberg, Blue Gem Research

**Price Earnings (x) and Dividend Yield (%)**



Sources: Bloomberg, Blue Gem Research

Key Forecasts (R m)	Mar 12A	YoY %	Mar 13A	YoY %	Mar 14A	YoY %	Mar 15E	YoY %	Mar 16E	YoY %
Revenue	631	13%	677	7%	1147	70%	1551	35%	1862	20%
Net Profit	20.6	-147%	19.7	-4%	86.7	340%	45.5	-48%	73.5	62%
HEPS (Cont. Ops.)	13.0cps	-260%	12.4cps	-5%	15.7cps	27%	24.6cps	57%	39.8cps	62%
Return on Equity (%)	13.1%	-	11.1%	-	31.7%	-	14.8%	-	20.3%	-
Price Earnings ratio (x)	15.6x	-	16.4x	-	12.9x	-	8.2x	-	5.1x	-
Price-to-Book ratio (x)	2.0x	-	1.8x	-	1.4x	-	1.2x	-	1.0x	-

Sources: Wescoal, Bloomberg, Blue Gem Research



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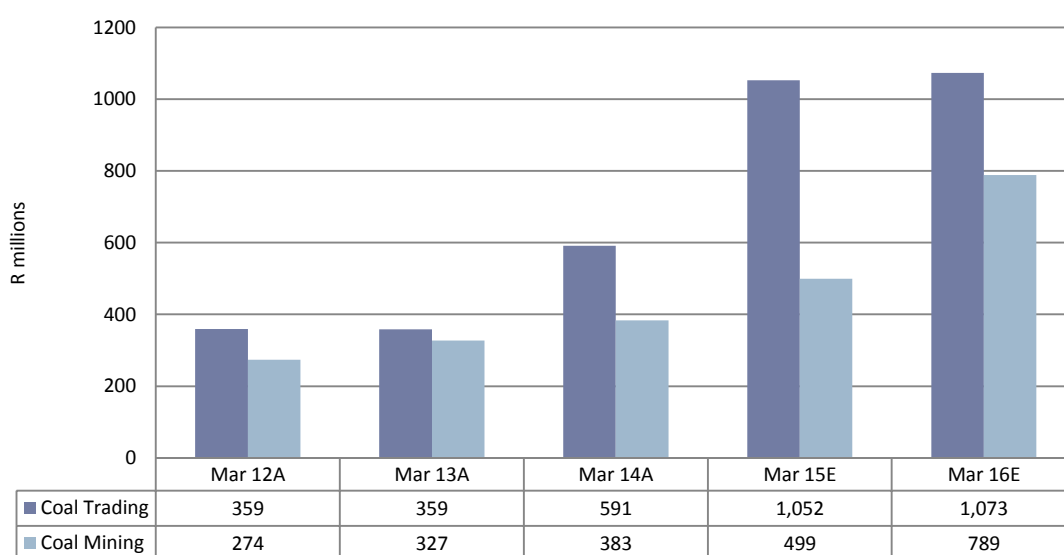
Key Forecasts (R m)	Mar 12A	YoY %	Mar 13A	YoY %	Mar 14A	YoY %	Mar 15E	YoY %	Mar 16E	YoY %
<b>Revenue</b>	<b>631</b>	<b>13%</b>	<b>677</b>	<b>7%</b>	<b>1147</b>	<b>70%</b>	<b>1551</b>	<b>35%</b>	<b>1862</b>	<b>20%</b>
- Coal Trading	359	14%	359	0%	591	65%	1052	78%	1073	2%
- Coal Mining	274	13%	327	19%	383	17%	499	30%	789	58%
- Khanyisa	274	13%	274	19%	222	-19%	225	1%	250	11%
- <i>Khanyisa (Mtpa)</i>	<i>1.18</i>	<i>-15%</i>	<i>1.31</i>	<i>11%</i>	<i>0.89</i>	<i>-32%</i>	<i>0.90</i>	<i>1%</i>	<i>1.00</i>	<i>11%</i>
- Intibane	-	-	-	-	257	>100%	257	0%	167	-35%
- <i>Intibane (Mtpa)</i>	-	-	-	-	<i>1.03</i>	<i>&gt;100%</i>	<i>1.03</i>	<i>0%</i>	<i>0.67</i>	<i>-35%</i>
- Elandspruit	-	-	-	-	-	-	142	>100%	569	>100%
- <i>Elandspruit (Mtpa)</i>	-	-	-	-	-	-	<i>0.57</i>	<i>&gt;100%</i>	<i>2.28</i>	<i>&gt;100%</i>
- Inter-Group	-2	>100%	-9	274%	173	-2110%	-	-	-	-
<b>Gross Profit</b>	<b>64.1</b>	<b>126%</b>	<b>72.7</b>	<b>13%</b>	<b>125.5</b>	<b>73%</b>	<b>283.5</b>	<b>126%</b>	<b>356.1</b>	<b>26%</b>
<i>GP Margin (%)</i>	<i>10.2%</i>	-	<i>10.7%</i>	-	<i>10.9%</i>	-	<i>18.3%</i>	-	<i>19.1%</i>	-
Operating Costs	-40.9	-19%	-48.8	20%	-82.4	69%	-151.0	83%	-173.9	15%
<b>EBITDA</b>	<b>30.5</b>	<b>-592%</b>	<b>27.7</b>	<b>-9%</b>	<b>150.1</b>	<b>442%</b>	<b>212.9</b>	<b>42%</b>	<b>277.1</b>	<b>30%</b>
<i>EBITDA Margin (%)</i>	<i>4.8%</i>	-	<i>4.1%</i>	-	<i>13.1%</i>	-	<i>13.7%</i>	-	<i>14.9%</i>	-
<b>Operating Profit</b>	<b>30.5</b>	<b>-243%</b>	<b>27.7</b>	<b>-9%</b>	<b>118.9</b>	<b>329%</b>	<b>132.5</b>	<b>12%</b>	<b>182.3</b>	<b>38%</b>
- Coal Trading	5.1	-	4.2	-18%	4.7	13%	73.1	1460%	48.0	-34%
- Coal Mining	29.9	-	34.7	16%	52.4	51%	132.4	153%	230.1	74%
- Khanyisa (Estimated)	30		35		13		14		15	
- Intibane (Estimated)	-		-		39		109		51	
- Elandspruit (Estimated)	-		-		-		10		164	
<i>Operating Profit Margin (%)</i>	<i>4.8%</i>	-	<i>4.1%</i>	-	<i>10.4%</i>	-	<i>8.5%</i>	-	<i>9.8%</i>	-
<b>Net Profit (Att. Parents)</b>	<b>20.6</b>	<b>-147%</b>	<b>19.7</b>	<b>-4%</b>	<b>86.7</b>	<b>340%</b>	<b>45.5</b>	<b>-48%</b>	<b>73.5</b>	<b>62%</b>
<i>Net Profit Margin (%)</i>	<i>3.3%</i>	-	<i>2.9%</i>	-	<i>7.6%</i>	-	<i>2.9%</i>	-	<i>3.9%</i>	-
Issued Shares (millions)	157.9	0%	157.9	0%	184.8	17%	184.8	0%	184.8	0%
Weighted Shares (millions)	157.9	5%	157.9	0%	170.1	8%	184.8	9%	184.8	0%
EPS (Cont. Ops.)	13.1	-216%	12.5	-5%	51.0	308%	24.6	-52%	39.8	62%
HEPS	13.0	-150%	12.4	-5%	15.7	27%	24.6	57%	39.8	62%
<b>HEPS (Cont. Ops.)</b>	<b>13.0</b>	<b>-260%</b>	<b>12.4</b>	<b>-5%</b>	<b>15.7</b>	<b>27%</b>	<b>24.6</b>	<b>57%</b>	<b>39.8</b>	<b>62%</b>
<b>DPS (cps)</b>	<b>-</b>	<b>-</b>	<b>3</b>	<b>&gt;100%</b>	<b>4</b>	<b>27%</b>	<b>7</b>	<b>72%</b>	<b>11</b>	<b>62%</b>
Assets	282	3%	289	3%	724	150%	546	-25%	648	19%
<i>Return on Assets (%)</i>	<i>7.3%</i>	-	<i>6.8%</i>	-	<i>12.0%</i>	-	<i>8.3%</i>	-	<i>11.3%</i>	-
Liabilities	282	1%	289	3%	724	150%	546	-25%	648	19%
Equity (Parent)	157	15%	177	13%	273	54%	308	12%	363	18%
<b>Return on Equity (%)</b>	<b>13.1%</b>	-	<b>11.1%</b>	-	<b>31.7%</b>	-	<b>14.8%</b>	-	<b>20.3%</b>	-
NAV (cps)	99.5	10%	112.4	13%	148.0	32%	166.4	12%	196.3	18%
Tangible NAV (cps)	56.1	21%	63.2	13%	87.4	38%	53.9	-38%	86.5	60%
Cash flow from operations	12	-29%	38	214%	92	139%	284	209%	258	-9%
<i>Cash conversion ratio (%)</i>	<i>40.1%</i>	-	<i>138.8%</i>	-	<i>61.3%</i>	-	<i>133.4%</i>	-	<i>93.3%</i>	-
Cash flow from investing	-4	-82%	-25	473%	-200	701%	-194	-3%	-94	-51%
Change in cash for the year	-11	-157%	1	87%	31	2013%	-178	478%	56	-69%
Net cash	19	-37%	21	9%	-129	-719%	-126	-2%	-70	-44%
Price Earnings ratio (x)	15.6	-	16.4	-	12.9	-	8.2	-	5.1	-
Price-to-Book ratio (x)	2.0	-	1.8	-	1.4	-	1.2	-	1.0	-
Price-to-Tangible-Book ratio	3.6	-	3.2	-	2.3	-	3.8	-	2.3	-
EV/EBITDA ratio (x)	11.6	-	12.8	-	2.4	-	1.7	-	1.3	-
Dividend Yield (%)	-	-	1%	-	2%	-	3%	-	5%	-

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

## FY 14 Results Highlights

- Wescoal reported its FY 14 results with the following key aspects:
  - Revenue rose 70% to R1.1bn (FY 13: R0.7bn), largely driven by the H2:14 inclusion of the MacPhail acquisition into the Group’s Coal Trading segment,
  - Excluding the once-off profits on the sale of mineral assets during the period, the Group recorded an “Operational” EBITDA growth of 124% and HEPS rising to 15.7cps (FY 13: 12.4cps),
  - The Group hiked its dividend to 3.8cps (FY 13: 3.0cps).
- While the Group’s revenue slightly surpassed our forecast of R1.0bn, restructuring and relocation costs in the Coal Trading segment (R6m), intangibles amortisation (R2m), higher than expected costs and a more aggressive rehabilitation programme at Khanyisa and a general dip in Eskom-related volumes of coal collectively saw the Group miss our target HEPS of 21.2cps.

Figure 1: Segmental Revenue Split, Trends and Forecasts for Wescoal



Sources: Wescoal, Blue Gem Research forecast and assumptions

- The Group concluded the MacPhail acquisition during the period, has plotted its Elandspruit mine (first coal expected during January 2015) and concluded a smart washing plant acquisition (Muhanga) that sets the scene for an exciting FY 15E and future.

## Coal Mining

Table 1: Segment Key Forecasts (consolidated)

Mining Segment (Rm)	FY 11A	FY 12A	FY 13A	FY 14A	FY 15E*	FY 16E	FY 17E	FY 18E
Revenue	243	274	327	383	499	789	655	455
Cost of production	278	244	223	278	352	551	479	291
Average Revenue per ton (Rand/t)*	225	243	250	250	250	250	250	250
Average cost per ton (Rand/ton)	200	207	250	145	141	139	146	128
Operating Profit	-	30	35	76	71	148	103	91

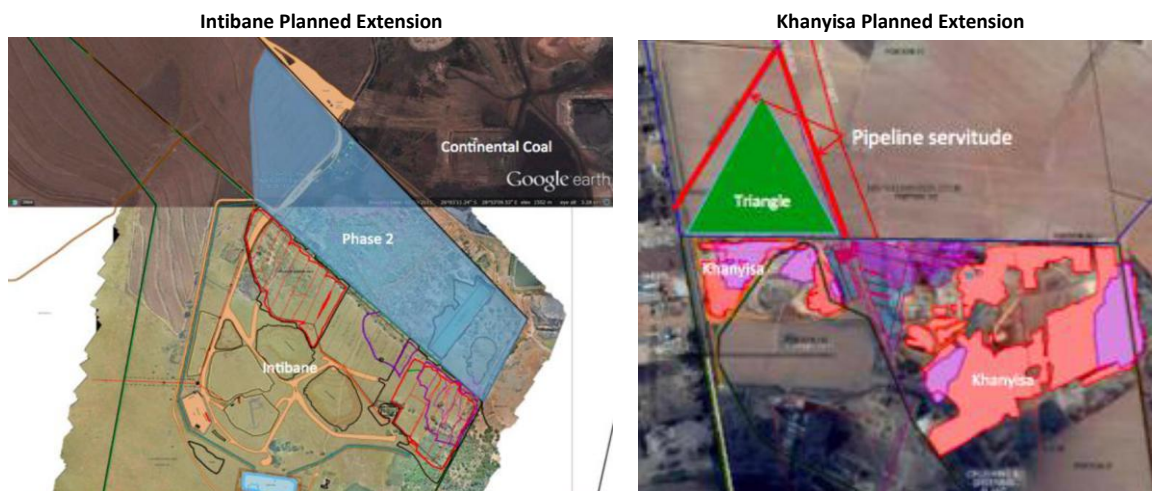
Sources: Wescoal (various), Blue Gem Research workings, assumptions and forecasts

\* 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 (previously used spot: R261/t). Based off 32% realization of RBCT’s API#4 price in ZAR (historical average of 30% to 34%) at 24 June 2014.

- The Coal Mining segment grew revenues by 74% to R556m (FY 13: R318m) off the back of increased contribution from Intibane (0.0mt grew to 1.03mt) offsetting a decline in Eskom-driven volumes in Khanyisa (1.31mt dropping to 0.9mt).

- Khanyisa saw higher production and rehabilitation costs that limited this segment’s Operating Profit growth to only 50% to R52.3m (FY 13: R34.7m), missing our previous forecasts of R90m Operating Profit.
- The major customer of this segment, Eskom lowered its order volumes. This is likely due to the utilities own operational and funding challenges. While Eskom’s order volumes appear to have recovered (at least, until March 2015), we note that the local utilities is a key risk to this segment.
- Both Khanyisa and Intibane are short-life assets (and becoming increasingly so), but the Group has identified some low-risk, minimal capex extensions to the mines (Figure 2). While neither of these deals have been concluded, management believe that they will be able to consolidate the Phase 2 and Triangle extensions to Intibane and Khanyisa respectively, extending the LoM’s to c.2017.

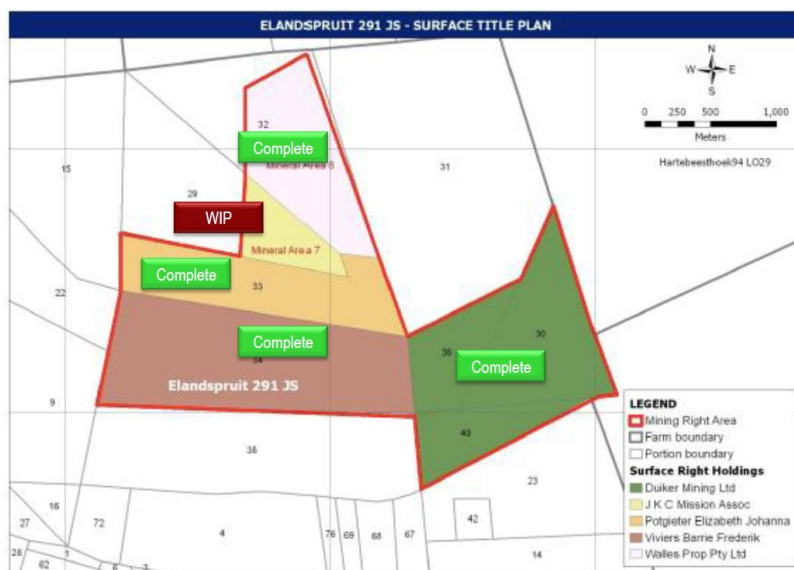
Figure 2: Khanyisa & Intibane Extensions



Source: Wescoal

- Management have completed the mine plan for the Group’s flagship mining asset, Elandspruit. A key point is that, while the scale is larger than any other mine management have developed, the basic approach has been proven at Intibane and Khanyisa and is appears quite scalable.

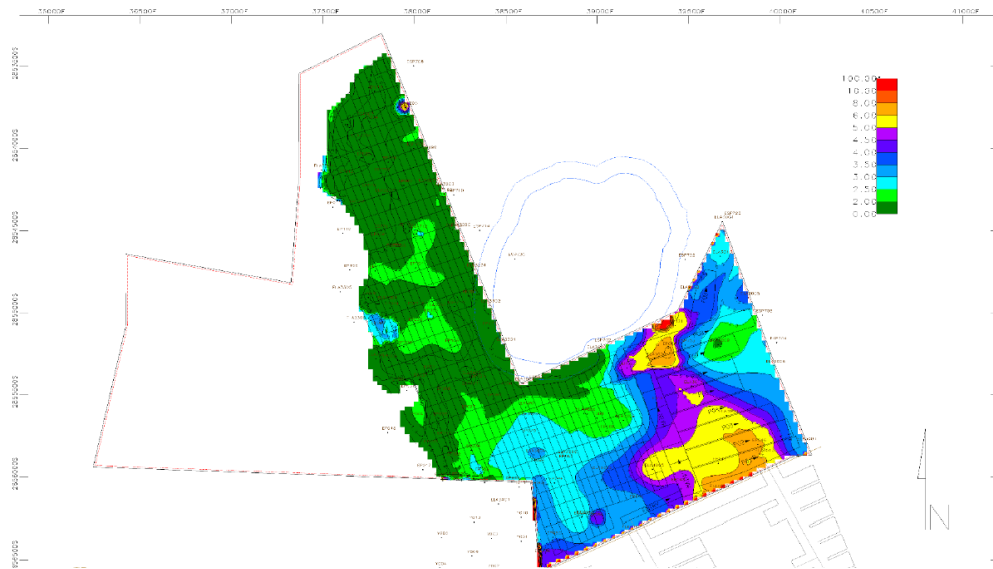
Figure 3: Elandspruit Surface Rights – Only One Minor Section Remains Work In Progress



Source: Wescoal

- Critical to the mining of Elandspruit is the expected Stripping Ratio's (Figure 4) and the timing of them in the mining process.
- Wescoal will begin the mining process in the lowest Stripping Ratio area (green on Figure 4 below at an average Stripping Ratio of 1.0x to 2.0x, which we have modelled in our forecasts at 2.0x), which should last roughly half the Life of Mine.

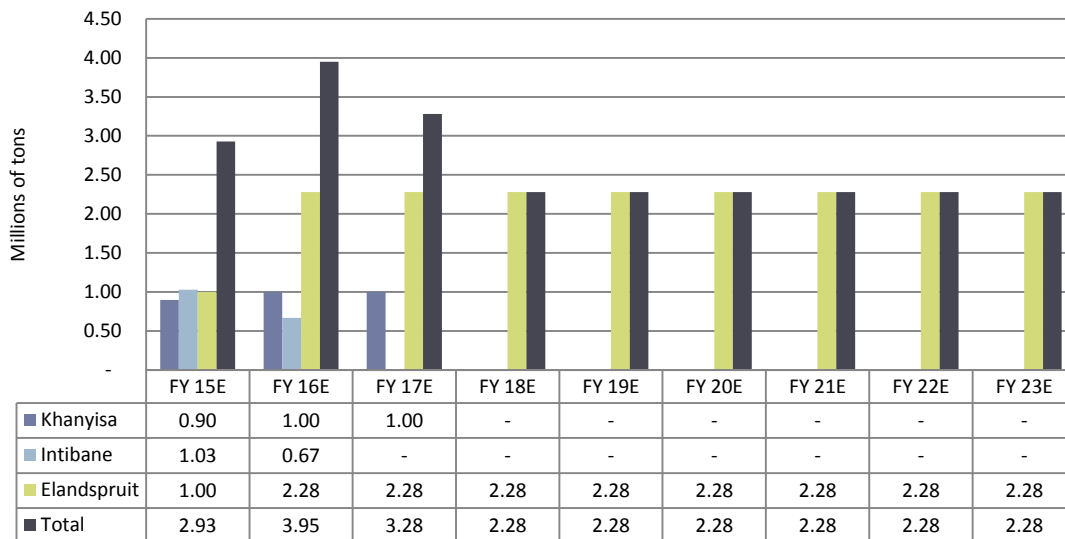
**Figure 4: Elandspruit Forecast Stripping Ratios (From Dark Green ~ 0.0x to 2.5x to Dark Red ~ 10.0x to 100.0x)**



Source: Wescoal

- Once the low Stripping Ratio portion of the mine is complete, our model indicates that the remainder is unprofitable to mine at *current* coal prices and assuming *current* technology and costs.
- That said, this portion of the resource will likely only be reached in about nine years' time, therefore the long-term coal price (which we believe is likely to be buoyant – see our [Initiation of Coverage on Wescoal](#) for more information hereon) will determine the profitability of this resource.
- We have been conservative and assumed no contribution from an earnings perspective and a value of only R1/t in situ value from a valuation perspective.

**Figure 5: Forecast Production Profile of the Group (assuming no further resource expansion)**



Source: Blue Gem Research forecasts – Note that management forecast volumes of c.4.0mt in FY 17E

## Coal Trading

**Table 2: Segment Key Forecasts**

Trading Segment (Rm)	FY 11A	FY 12A	FY 13A	FY 14A	FY 15E	FY 16E	FY 17E	FY 18E
Revenue	315	359	359	591	1052	1073	1095	1116
Growth in revenue (% y/y)	0.15	14%	0%	65%	78%	2%	2%	2%
Operating Profit	2	5	4	5	73	48	32	27
Growth in Operating Profit (% y/y)	4410%	176%	-18%	13%	1460%	-34%	-32%	-17%

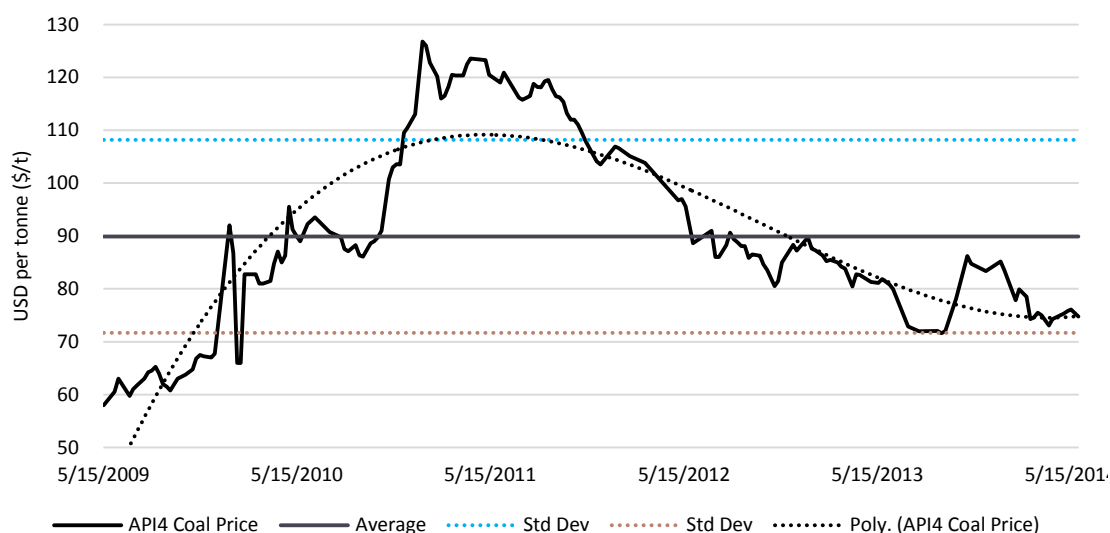
Sources: Wescoal (various), Blue Gem Research workings, assumptions and forecasts

- The Coal Trading segment performed well as the MacPhail acquisition was bedded down (at a cost of c.R6m in integration costs) and, from January 2014, synergies and cost savings began to flow.
- The segment’s revenues rose to R591m (FY 13: R356m), of which MacPhail contributed R202m during its consolidation in H2:14. This is marginally below our expected revenue of R638m, but was negatively impacted by an Eskom-driven drop in the Independent Power Producers (IPPs) demand for thermal coal.
- The segment also grew its “Operational” EBITDA by 50% to R9.3m (FY 13: R6.1m), once the integration costs are excluded. If the once-off costs are included, Operational Profits of R4.6m are more or less in line with our forecasts of R3m for the period.
- We expect this segment to breach R1bn in turnover in FY 15E as MacPhail is consolidated for the full FY 15E and, given the lack of once-off costs and full benefit of the cost savings and synergies, this should see Operating Profits jump to c.R73m (FY 14: R4m).

## Coal Market

- See our [Initiation of Coverage for Wescoal](#) for our long-term views regarding the local coal market.
- The key local API4 (FOB) coal price at Richards Bay Coal Terminal (RBCT) continues to ease downwards (Figure 2) as the Shale Gas Revolution in the States creates an excess international coal supply.
- Despite this, the coal price remains almost a full standard deviation below the long-term average coal price and we remain bullish on this commodities local (driven by Eskom Supply Cliff) and international (driven by the Chinese Supply Cliff) future demand.

**Figure 2: Richards Bay Coal Terminal (RBCT) and Other Export Coal Prices**



Sources: Bloomberg and Blue Gem Research workings and assumptions

- We previously used an assumed inland coal price of R261/t, which we have decided to lower marginally to R250/t given the recent spot weakness in the international market only being partially offset by currency movements and increasing inland parity of the spot price.

- Nothing substantial has occurred for us to alter our previously stated macro view of the international and local coal markets (see our Initiation of Coverage on Wescoal). We remain bullish on the long-term fundamentals of both international and inland coal markets, though note that possible Government interference in the South African coal market remains an outlying risk.

## Forecasts

### Revenues and profitability

- Key changes to our forecasts for Wescoal are:
  - Current spot coal price is c.4% lower at R250/t (previously: R261/t).
  - Elandspruit starts during H2:15 and both Intibane and Khanyisa succeed in their extension projects, modelled around management expectations.
- These, and the above noted segmental assumptions, result in the following FY 15E financial forecasts:
  - Revenue growing to R1.5bn (FY 14: R1.1bn) driven by the full consolidation of MacPhail as well as the ramp-up at Elandspruit during the period,
  - HEPS rising strongly to 24.6cps (FY 14: 15.7cps), and
  - A full year dividend of 7cps (FY 14: 3.8cps).

### Liquidity, solvency and assets

- According to our forecasts, Wescoal appears likely to remain both solvent and liquid.
- While management note that the funding of Elandspruit/Muhanga remain an outlying risk, but we believe that (and have based this report on) Wescoal's successful track record attractive sufficient and reasonably priced funding.

## Valuation and 12m TP

### Valuation

#### Coal Mining Segment

- Our valuation methodology is unchanged (DCF) and our key assumptions are materially unchanged (other than updating the models for our latest forecast and production changes).
- Our fair value for Khanyisa falls to R14m (previous: R69m) or c.R4.61/t (previous: R17.19/t), as this mine approaches the end of its life. Note that management have identified what they believe to be a viable extension (Figure 2) to the mine.
- Our fair value for Intibane remains flat at R105m (previous: R101m) or R61.91/t (previous: R58.26/t). As noted above, management have identified what they believe to be a viable extension (Figure 2) to the mine.
- Elandspruit is drawing closer to production, while the Muhanga plant acquisition both de-risks the project as well as saves on some of our capex assumptions. Therefore this mines valuation jumps to R426m (previous: R280m) or R10.61/t (previous: R9.82/t). While we use a flat spot price (R250/t) for our DCF's, this creates a situation where the Stripping Ratio rise from FY 24E in Elandspruit implies that this mine will no longer be profitable from this point onwards. This view, though, is obviously dependent on what the realizable spot price of coal is in 2023, which may differ materially from our flat R250/t. Given our positive view of the long-term fundamentals of coal, we have to assume that this *in situ* resource has *some* measure of value and have therefore assumed that it is worth R1.00/t in FY 23E (the equivalent of c.R5.80/t in present value terms).
- Note that a 4% higher spot coal price of c.R250/t (previous: R261/t) has also been assumed, thus negatively impacting on each mines' respective DCF valuation.

**Table 3: Discounted Free Cash Flow (DCF) Models for Wescoal's Khanyisa, Intibane and Elandspruit Mines**

Khanyisa	FY 15E	FY 16E	FY 17E	FY 18E	FY 19E	FY 20E	FY 21E	FY 22E	FY 23E	FY 27E
Revenue	225	250	250	-	-	-	-	-	-	-
Variable cash costs	-202	-225	-225	-	-	-	-	-	-	-
Aggregate taxes	-5	-5	-1	-	-	-	-	-	-	-
Capex	-9	-10	-10	-	-	-	-	-	-	-
Rehabilitation At end of LoM	-	-	-14	-	-	-	-	-	-	-
Free cash flows (FCF)	9	10	-0	-	-	-	-	-	-	-
Discount factor	R0.84	R0.70	R0.59	R0.49	-	-	-	-	-	-
Discounted FCF	8	7	-0	-	-	-	-	-	-	-
Net Present Value										14
Net Debt										-
<b>Fair value</b>										<b>R14m</b>
<b>Fair value (per Wescoal share - cps)</b>										<b>8cps</b>
<i>Implied fair value per estimated resource (R/t)</i>										<i>R4.61/t</i>
Intibane	FY 15E	FY 16E	FY 17E	FY 18E	FY 19E	FY 20E	FY 21E	FY 22E	FY 23E	FY 27E
Revenue	257	167	-	-	-	-	-	-	-	-
Variable cash costs	-128	-83	-	-	-	-	-	-	-	-
Aggregate taxes	-31	-15	-	-	-	-	-	-	-	-
Capex	-10	-7	-	-	-	-	-	-	-	-
Rehabilitation At end of LoM	-	-16	-	-	-	-	-	-	-	-
Free cash flows (FCF)	87	46	-	-	-	-	-	-	-	-
Discount factor	R0.84	R0.70	R0.59	R0.49	R0.00	R0.00	R0.00	R0.00	R0.00	R0.00
Discounted FCF	73	32	-	-	-	-	-	-	-	-
Net Present Value										105
Net Debt										-
<b>Fair value</b>										<b>R105m</b>
<b>Fair value (per Wescoal share - cps)</b>										<b>57cps</b>
<i>Implied fair value per estimated resource (R/t)</i>										<i>R60.84/t</i>
Elandspruit	FY 15E	FY 16E	FY 17E	FY 18E	FY 19E	FY 20E	FY 21E	FY 22E	FY 23E	FY 27E
Revenue	142	569	569	569	569	569	569	569	569	-
Variable cash costs	-85	-341	-341	-341	-341	-341	-341	-341	-341	-
Aggregate taxes	-3	-48	-48	-45	-45	-45	-45	-45	-45	-
Capex	-121	-51	-23	-100	-23	-23	-23	-23	-23	-
Rehabilitation	-1	-1	-1	-1	-1	-1	-1	-1	-1	-
Free cash flows (FCF)	-68	128	156	82	159	159	159	159	159	-
Discount factor	R0.84	R0.70	R0.59	R0.49	R0.41	R0.35	R0.29	R0.24	R0.20	R0.00
Discounted FCF	-57	90	92	41	66	55	46	39	33	-
Net Present Value										405
Value of in situ resource*										21
Net Debt										-
<b>Fair value</b>										<b>R426m</b>
<b>Fair value (per Wescoal share - cps)</b>										<b>231cps</b>
<i>Implied fair value per estimated resource (R/t)</i>										<i>R10.61/t</i>

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

\* Valued at R1.00/t per remaining in situ resource. From this point onwards the average Stripping Ratio makes the resource uneconomical to mine. However, this is not likely the case as the Spot Coal Price is likely to be significantly higher this far in the future and/or other related cost variables. Therefore we have assumed a value of R1.00/t for this remaining resource during FY 23 (the equivalent of c.R5.80/t in Present Value terms).

## Coal Trading Valuation

- We have decided to leave our valuation methodology for Wescoal's Coal Trading segment unchanged and merely updated our fair value calculation with the latest numbers from the segment (Table 4).

**Table 4: Relative Valuation of Wescoal's Coal Trading Segment**

	R m
<b>MacPhail:</b>	
(1) Implied revenue	539
(2) Fair value based off Wescoal's "arm's length" purchase price of the business	79
Implied acquisition Price Earnings (x)	6.7
<i>(2) / (1) = (3) Price/sales (x)</i>	<i>0.1x</i>
<b>Chandler Coal:</b>	
(4) FY 13 revenue	513
<i>(3) Price/sales (x)</i>	<i>0.1x</i>
<i>(3) x (4) = (5) Fair value</i>	<i>R75m</i>
<b>Sum of the Parts:</b>	
(2) MacPhail	79
(5) Chandler coal	75
Synergies (10%)	15
<b>Fair value of segment</b>	<b>R169m</b>
<b>Fair value of segment (cps)</b>	<b>92cps</b>

Sources: Wescoal, Blue Gem Research workings and assumptions



- We raise the Coal Trading segment’s fair value to R169m (previous: R135m) or 92cps (previous: 79cps), putting this segment on a Forward Price earnings (PE) of 3.2x.
- While this exit multiple may appear low, we are utilising the same Price-to-Sales ratio implied by Wescoal’s acquisition of MacPhail as a benchmark for the valuation. Given any greater clarity in the future following the merging of the two businesses, we may revise this valuation approach.

### Sum-of-the-Parts (SOTP)

- Adding the fair value of the Coal Mining segment to the Coal Trading segment, taking out the net cash and taking out a 20% discount due to assumed Group overheads, we arrive at what we believe is a good estimate of Wescoal’s fair value (Table 5):
  - The fair value of 240cps (previous: 253cps) is 5% lower than our previous fair value – which makes sense given how the time value of money has been offset by a lower spot coal price and slightly lower Eskom volumes.
  - The fair value implies a PE of 15.3x. This PE is not very illustrative, though, as both Elandspruit and MacPhail are currently adding to our SOTP, but not yet (fully) contributing to the Group’s profits yet.
- Based off this fair value, we marginally raise our 12m TP by 4% to 301cps (previous 12m TP: 287cps):
  - This implies a 48% return on an Exit PE of 12.2x, though we note that Elandspruit will not have contributed a full year’s earnings yet on the denominator of this Exit PE.

Table 5: Sum-of-the-Parts (SOTP)

R m	Fair Value	%	12m TP	%
<b>Mining segment</b>	<b>546</b>	<b>123%</b>	<b>651</b>	<b>117%</b>
- Khanyisa	14	3%	17	3%
- Intibane	105	24%	126	23%
- Elandspruit	426	96%	508	91%
<b>Trading segment</b>	<b>169</b>	<b>38%</b>	<b>202</b>	<b>36%</b>
- New acquisition	79	18%	94	17%
- Chandler coal	75	17%	90	16%
- Returns to Scale & Synergies	15	3%	18	3%
Group net cash	-129	-29%	-126	-
Group overheads (20%)	-143	-32%	-171	-31%
<b>Sum of the Parts (SOTP)</b>	<b>R443m</b>	<b>100%</b>	<b>R557m</b>	<b>100%</b>
Issued shares (millions)	185m	-	185m	-
<b>Valuation per share (cps)</b>	<b>240cps</b>	-	<b>301cps</b>	-
Implied Price Earnings Ratio (x)	15.3x	-	12.2x	-
Share price’s implied discount to fair value (%)	18%	-	-	-
Implied Return (%)	-	-	48%	-

Sources: Bloomberg and Blue Gem Research workings and assumptions

- As the Group is 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 240cps (previous fair value: 257cps) on an implied PE of 15.3x.
- Rolling this forward, we raise our 12m TP by c.4% to 301cps (previous 12m TP: 287cps) for Wescoal on an Exit PE of 12.2x, implying a 48% return.

### Key risks to our valuation

- The major key risks to our above valuation methodology are:
  - “Above-ground” and “below-ground” risk implicit in junior 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).
  - Related timing, quantum and Life of Mines (LoM) of Intibane, Khanyisa and Elandspruit (including the Group securing adequate, reasonably priced funding for Elandspruit).

- Eskom-related order volumes of coal in the local economy.
- Underlying inflation of the Group's cost base.
- Significant interest rate movements.
- Significant Rand movements.
- Overall equity market's performance (i.e. beta).

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*All dates and market ratios pegged to close/intra-day as at 24 June 2014.*

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