New Zealand Equity Research
2 April 2014

FORSYTH BARR

Bathurst Resources

OUTPERFORM

Battening down the hatches

Coking coal prices are falling and BRL has responded by battening down the hatches. Costs have been cut and full scale mining at Escarpment postponed until coking coal prices have recovered

What's changed?

- **Earnings:** FY14 EBITDA, increased +$3.5m to $1.6m
  FY15 EBITDA, cut -$11.8m to $7.8m
- **Target Price:** Reduced -15cps to 15cps
- **Rating:** Unchanged at OUTPERFORM

Can BRL stave off a capital raising?

The key question for investors is whether BRL can be a sustainable business on its domestic operations alone. Raising capital without having a coking coal project about to start would be unpalatable. Recent financial performance from the domestic assets has not been great, due in large part to extensive pre-stripping. The pre-stripping is now complete and with the cost cutting initiatives in place (29 positions disestablished and -30% cut in executive salaries) we believe that BRL should be cash flow positive for the next 12 – 18 months on the back of stronger coal production.

We assume Escarpment commences in FY16

With spot coking coal prices around ~US$110/tonne, it was no surprise that the Escarpment project has been delayed. We currently assume the coking coal price will firm back towards US$150/tonne and that mining commences in FY16. However, there is a great deal of uncertainty as to when prices will firm again and to what level. High stock levels have resulted in weak demand and an over-supplied market. With many coal mining operating costs well above US$110/tonne we expect to see a continued reduction in supply, which should help prices firm.

1H14 result sheds little new light

The 1H14 result, the details of which were released in mid-March, contained little new information. The largest component of the reported +$8.5m NPAT result were non-cash items totalling $13.0m. In addition, if coal prices remain at low levels, we expect there to be a significant impairment charge, as the fixed assets are not worth the ~$300m book value.

Target price slashed

We have halved our target price from $0.30 to $0.15. The main driver of the lower target price has been the lowering of our long-term coal price assumption -US$10/tonne to US$150/tonne. Other factors include the delay in starting Escarpment, the increase of the risk weightings and a slightly higher NZDUSD fx rate assumption.

Investment View

BRL is now an option play. The market is paying little for BRL's coking coal resources, which is understandable given the weak coking coal prices. However, downside risks now appear limited and BRL will perform well with any recovery in coking coal prices. Our rating is OUTPERFORM.

12-month Target Price	NZ$0.15
Expected share price return	78.6%
Net dividend yield	0.0%
Total 12-month estimated return	78.6%
Risk assessment	High

Market Data	
NZX code	BRL
Share price	NZ$0.08
Issued shares	821.5m
Market cap / NZX 50 weight	NZ$69.m / n/a
Average daily turnover	404.4k (NZ$78k)

Share Price Performance

Financials (NZ$m)	13A	14E	15E	16E
NPAT*	-27.2	7.3	1.0	-5.8
EPS* (NZc)	-3.9	1.0	0.1	-0.8
EPS growth* (%)	1.4	n/a	-86.2	n/a
DPS (NZc)	0.0	0.0	0.0	0.0
Imputation (%)	100	100	100	100

Valuation (x)	13A	14E	15E	16E
EV/EBITDA	n/a	40.1	8.5	3.8
EV/EBIT	n/a	9.7	40.9	n/a
PE	n/a	8.1	n/a	n/a
Price / NTA	0.3	0.2	0.2	0.2
Gross dividend yield (%)	0.0	0.0	0.0	0.0

*Historic and forecast numbers based on underlying profits

Mining Sector

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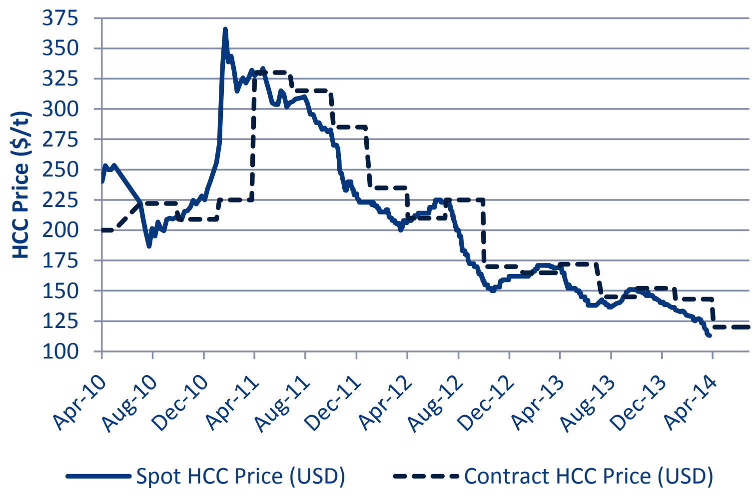
Facing up to the reality of weak coal prices

Coking coal prices have continued to track lower, forcing BRL to postpone its mine plans for Escarpment until prices have recovered to more sustainable levels. Coking coal prices are now ~US$110/tonne, and a miserable ~NZ$130/tonne. The quarterly benchmark contract price for the April/June 2014 quarter has been set at US$120/tonne.

Figure 1. Coking coal prices



Source: Bloomberg, Forsyth Barr analysis

We believe the move that BRL has undertaken to delay full scale mining is the right one, albeit BRL had little choice with the spot price below the top end of BRL's estimated operating cost range of US$120/tonne, let alone accounting for capital expenditure. That said, BRL is undertaking sufficient work to mine and send to potential customers samples large enough to be tested in their furnaces. With the testing complete, BRL will be in a position to commence mining very quickly once conditions allow. We expect that prices would need to be above US$140/tonne before BRL even considered starting the Escarpment mine.

With regard to mine plan approvals, we understand that all local council plan approvals have been received, and the only plans outstanding are those still with the Department of Conservation. The end of an extremely time consuming and expensive process is finally coming to an end.

Preserving the cash

In addition to delaying the Escarpment project, BRL has had to move into serious cost-cutting mode in order to prevent a capital raising. 29 positions have been disestablished (a combination of redundancies, positions redefined and vacant positions not filled), with most of them head office related functions around resource consenting and exploration. In addition, BRL has cut executive salaries -30%, a real sign of the need to preserve cash.

The issue BRL is dealing with is a modest cash balance of $10.7m as at 31 December and cash burn over the past three quarter of -$8.9m per quarter. The cash burn has been high because:

- BRL was resourcing itself to a level required when Escarpment was operating
- Ongoing resource consent costs
- Undertaking extensive pre-strip activities at Cascade and Southland

We believe that a combination of cutting corporate costs ~-50% from ~-$10m per annum to ~-$5 per annum, plus the fact pre-strip activities have ended for the next 12 to 18 months should ensure positive operational cash flows in the near term.

Deferred consideration issues

However, whilst operationally we believe BRL should be ok, it still has deferred consideration payments due. The first, is a modest $150,000 due in August 2014 for the Canterbury Coal purchase. That said, the financial statements indicate there is $3.4m of deferred consideration payments, predominantly royalties, payable during 2014. We suspect most of this total relates to Escarpment royalties that would have been payable.

The potentially more problematic payment is for A$10.6m for the New Brighton permit area, although that is not due until December 2015. However, until the final payment is made, BRL faces an undisclosed higher royalty rate.

1H14 Result Comments

BRL's 1H14 NPAT result was positive in an accounting sense, but the quality was not poor. EBIT was -$4.4m, but NPAT was +$8.5m with the difference being due to adjustments to the substantial deferred consideration balance (relating mainly to the two US$40m L&M payables). The largest adjustment (+$9.4m) has been due to the strengthening of the NZD vs the USD, reducing the amount payable in NZD terms. The other large positive adjustment (+$5.0m) has come from the expected delay in the expecting timing of deferred consideration (due to the Escarpment delay) and/or an increase in the discount rate applied due to rising interest rates.

In addition to the weak operational result, pre-strip capex amounted to $14.1m – hence the large cash burn for BRL.

Figure 2. 1H14 result summary

	1H13 $m	1H14 $m	Mvmt %
Revenue	19.0	27.4	44%
Operating costs	-24.7	-26.9	9%
EBITDA	**-5.7**	**0.5**	**-108%**
Depreciation	-1.1	-4.8	325%
EBIT	**-6.9**	**-4.4**	**-37%**
Net interest	1.0	0.1	-90%
Other	-4.0	12.6	-419%
Pre-tax profit	**-9.9**	**8.4**	**-185%**
Tax expense	2.0	0.1	-93%
Post-tax profit	**-7.9**	**8.5**	**-208%**
Operating cash flow	-5.8	0.7	-113%
Capital expenditure	-15.8	-19.4	22%
Free cash flow	**-21.6**	**-18.7**	**-13%**
Production - HCC (000t)	0.0	0.0	
Production - SSCC (000t)	32.2	24.4	-24%
Production - Thermal (000t)	97.1	109.3	13%
Total Production (000t)	**129.3**	**133.6**	**3%**
NZDUSD	0.816	0.813	0%

Source: BRL, Forsyth Barr analysis

Note: 1H13 comparative data are a Forsyth Barr estimates based on translating the A$ results reported when BRL was Australian domiciled company

One of the interesting aspects of the result is the fact that the carrying value of the mining assets is ~$300m (after deducting deferred consideration), which is materially higher than the current market capitalisation of BRL of ~$70m. It suggests to us that the coal price assumption underpinning the impairment test is probably too generous and we expect at the FY14 result there will be a material write-down of BRL's book value of assets when the impairment test is undertaken with a greater degree of rigour. That said, in the scheme of things the book value is somewhat irrelevant, although it does provide some indication of where the business believes value lies.

Outlook and Investment View

Our revised FY14 forecasts have built in the cost savings (less estimated costs associated with the cost out programme of ~$1.5m) and the fact that Escarpment is not going to produce any coal in FY14. Our FY14 EBITDAF is now positive at $1.6m, however our FY15 forecast is -60% lower at $7.8m due to the assumption that the Escarpment project does not start until FY16.

Figure 3. Forecast changes

	FY14 Old	FY14 New	% Chg	FY15 Old	FY15 New	% Chg
Revenue	61.8	55.7	-10%	142.3	64.8	-54%
Operating costs	-63.7	-54.2	-15%	-122.7	-57.0	-54%
EBITDAF	**-1.9**	**1.6**	**n/m**	**19.6**	**7.8**	**-60%**
Depreciation	-6.8	-7.7	12%	-27.1	-6.2	-77%
EBIT	**-8.7**	**-6.1**	**-30%**	**-7.5**	**1.6**	**-122%**
Net interest	-0.3	0.1	-139%	-4.3	-0.2	-95%
Other	0.0	12.6		0.0	0.0	
Pre-tax profit	**-8.9**	**6.7**	**-174%**	**-11.8**	**1.4**	**-112%**
Tax expense	2.5	0.6	-75%	3.3	-0.4	-112%
Post-tax profit	**-6.4**	**7.3**	**-213%**	**-8.5**	**1.0**	**-112%**
Capital expenditure	-33.2	-23.1	-30%	-47.8	-6.7	-86%
Operating cash flow	-4.1	1.6	-138%	9.3	6.4	-31%
Production - HCC (000t)	101.3	0.0	-100%	445.5	0.0	-100%
Production - SSCC (000t)	87.5	87.4	0%	126.0	126.0	0%
Production - Thermal (000t)	233.7	264.5	13%	302.3	362.3	20%
Total Production (000t)	**422.5**	**351.9**	**-17%**	**873.8**	**488.3**	**-44%**
NZDUSD	0.816	0.817	0%	0.798	0.800	0%

Source: Forsyth Barr analysis

BRL's medium-term outlook is muted at best. Without an increase in the coking coal price, there is limited value in BRL. Whilst the business may be able to wash its face with the domestic operations, it does not provide the kind of upside that investors are looking for. We estimate that the value of BRL on the domestic operations alone is 3cps to 5cps, net of corporate costs.

That said, we believe that the current coking coal prices are unsustainable in the medium-to-long-term and a recovery can be expected. Until then, BRL is in effect an option on a coking coal price recovery. Bloomberg consensus coal prices remain around US$150/tonne and that is our new long-term coking coal price assumption, down -US$10/tonne. That, the delays to the Escarpment project, lower risk weightings (-10%) and a higher NZDUSD fx rate has lowered our DCF valuation -50% to 13cps.

Figure 4. Sum-of-the-parts valuation

	Unrisked NPV ($m)	Risk weighting	Risk Weighted NPV	$/share
Escarpment	15	80%	12	$0.01
Wharetea West	137	50%	69	$0.08
Coalbrookdale	24	50%	12	$0.01
North Buller	0	50%	0	$0.00
Deep Creek	8	33%	3	$0.00
Cascade	26	100%	26	$0.03
Southland	58	100%	58	$0.07
Canterbury	11	100%	11	$0.01
less Rehabilitation costs	-3	100%	-3	-$0.00
less Corporate	-82	100%	-82	-$0.10
add cash	5	100%	5	$0.01
TOTAL	**198**		**109**	**$0.13**

Source: Forsyth Barr analysis

Our revised target price is 15cps, half what we had previously. However, even achieving that price is dependent on some sort of recovery in the coking coal price. Nevertheless, at current levels we see reasonable value in BRL, however it is extremely leveraged to the coking coal price. Our rating is OUTPERFORM.

Bathurst Resources Limited (BRL) — June year end — Price as at: 01 Apr 2014 (NZ$0.08)

Valuation Summary	NZ$ per share
12-month Target Price*	**0.15**
Valuation methodology	Sum of the parts and market multiples
Spot valuations	
1. Sum of the parts	0.13
2. Comparable company	0.17
3. n/a	n/a

DCF valuation summary (NZ$m)		Key WACC assumptions	
Total firm value	109	Risk free rate	5.5%
Less net debt	-5	Equity beta	1.09
Value of equity	104	Market risk premium	7.3%
Shares (m)	821	**WACC**	**10.9%**
BRL DCF valuation (NZ$ per share	0.13	Terminal growth	n/a

Profit and Loss Account (NZ$m)	2012A	2013E	2014E	2015E	2016E
Sales revenue	33.5	41.0	55.7	64.8	133.1
Cost of sales	n/a	n/a	n/a	n/a	n/a
Gross profit	n/a	n/a	n/a	n/a	n/a
EBITDA	**-14.8**	**-10.1**	**1.6**	**7.8**	**17.4**
Depreciation and amortisation	3.1	3.2	7.7	6.2	23.7
EBIT	**-37.6**	**-18.3**	**6.6**	**1.6**	**-6.4**
Net Interest	4.4	-4.5	0.1	-0.2	-1.7
Tax	-5.6	4.5	-0.6	0.4	-2.3
Minority interests	0.0	0.0	0.0	0.0	0.0
Associate income	0.0	0.0	0.0	0.0	0.0
Reported NPAT (pre-abnormals)	**-27.6**	**-27.2**	**7.3**	**1.0**	**-5.8**
Abnormal items	0.0	0.0	0.0	0.0	0.0
Reported NPAT	**-27.6**	**-27.2**	**7.3**	**1.0**	**-5.8**
Normalised NPAT	**-27.6**	**-27.2**	**7.3**	**1.0**	**-5.8**

Cash Flow (NZ$m)	2012A	2013E	2014E	2015E	2016E
EBITDA	**-14.8**	**-10.1**	**1.6**	**7.8**	**17.4**
Working capital (inc) / dec	-1.1	-1.3	-2.9	-1.2	-3.7
Interest & tax paid	3.4	1.3	1.9	-0.2	-1.7
Other	3.4	0.1	1.0	0.0	0.0
Operating cash flow	**-9.1**	**-10.0**	**1.6**	**6.4**	**12.0**
Capital expenditure	-31.0	-34.6	-23.1	-6.7	-46.3
Acquisitions/divestments	0.1	0.2	0.0	-3.4	-11.1
Other	-6.4	-3.3	-2.6	0.0	0.0
Funding available (required)	**-46.4**	**-47.7**	**-24.1**	**-3.7**	**-45.5**
Dividends paid	0.0	0.0	0.0	0.0	0.0
Equity raised (returned)	3.9	0.6	18.3	0.0	0.0
Increase (decrease) in net debt	**42.5**	**47.0**	**5.8**	**3.7**	**45.5**

Balance Sheet (NZ$m)	2012A	2013E	2014E	2015E	2016E
Working capital	-1.8	-1.7	1.2	2.4	6.1
Fixed assets	418.6	469.9	485.4	485.9	519.6
Intangibles	0.0	0.0	0.0	0.0	0.0
Other assets	6.6	6.0	8.7	8.7	8.7
Total assets	**423.4**	**474.3**	**495.3**	**497.0**	**534.4**
Net debt	-66.2	-8.0	-2.3	1.5	46.9
Other non current Liab.	269.7	281.8	274.6	271.6	269.4
Shareholder's funds	220.0	200.5	222.9	223.9	218.1
Minority Interests	0.0	0.0	0.0	0.0	0.0
Total liabilities/SHF	**423.4**	**474.3**	**495.3**	**497.0**	**534.4**

Capital Structure	2012A	2013E	2014E	2015E	2016E
Interest cover EBIT (x)	0.0	0.0	0.0	0.0	0.0
Interest cover EBITDA (x)	3.4	-2.3	-16.2	33.5	10.4
Net debt/ND+E (%)	-49.7	-3.8	-0.9	0.6	15.8
Net debt/Total assets (%)	-13.2	-1.6	-0.4	0.3	9.1
Net debt/EBITDA (x)	4.5	0.8	-1.4	0.2	2.7

Valuation Ratios	2012A	2013E	2014E	2015E	2016E
EV/EBITDA (x)	1.3	-3.2	40.1	8.5	3.8
EV/EBIT (x)	0.5	-1.7	9.7	40.9	-10.5
PE (x)	-2.1	-2.2	8.1	58.5	-10.1
Price/NTA (x)	0.3	0.3	0.2	0.2	0.2
Free cash flow yield (%)	-58.0	-64.6	-31.2	-0.5	-49.8
Net dividend yield (%)	0.0	0.0	0.0	0.0	0.0
Gross dividend yield (%)	0.0	0.0	0.0	0.0	0.0
Pay-out ratio (%)	0	0	0	0	0

Growth Rates	2012A	2013E	2014E	2015E	2016E
Revenue (%)	312.2	22.6	35.9	16.3	105.3
EBIT (%)	66.5	-51.4	-136.0	-75.2	-491.8
Normalised NPAT (%)	60.8	-1.4	-126.8	-86.2	-677.3
Normalised EPS (%)	60.8	-1.4	-126.8	-86.2	-677.3

Key Ratios	2012A	2013E	2014E	2015E	2016E
Return on assets (%)	-3.6	-2.7	-1.2	0.3	-1.2
Return on equity (%)	-12.5	-13.6	3.3	0.4	-2.7
ROIC (%)	-7.6	-4.8	1.5	0.2	-0.8
Gross margin (%)	n/a	n/a	n/a	n/a	n/a
EBITDA margin (%)	-44.3	-24.6	2.9	12.1	13.0
EBIT margin (%)	-112.3	-44.5	11.8	2.5	-4.8
Capex to sales (%)	92.5	84.2	41.4	10.4	34.8
Capex to depreciation (%)	992	1074	302	108	195

	Reserves		Resources		
Mt	ROM	Prod'	M&I	Inferred	Total
HCC	23.3	15.5	23.7	5.7	29.4
Export SHCC/SSCC	10.7	9.2	30.1	35.3	65.4
Domestic SSCC	0.4	0.4	1.3	0.3	1.6
Thermal	0.0	0.0	4.5	7.8	12.3
	34.4	**25.1**	**59.6**	**49.1**	**108.7**

Sales volumes (000t)	2012A	2013E	2014E	2015E	2016E
HCC	0	0	0	0	263
Export SHCC/SSCC	0	0	0	0	98
Domestic SSCC	54	94	115	126	126
Thermal	185	171	278	355	389
	239	**265**	**393**	**481**	**876**

Coal price assumption	2012A	2013E	2014A	2015A	2016A
Hard coking coal (HCC) (USD/t)	243	161	135	135	150
Export SSCC (USD/t)	184	123	101	101	113
Hard coking coal (HCC) (NZD/t)	302	197	165	169	193
Export SSCC (NZD/t)	229	150	123	127	145
Domestic SSCC (NZD/t)	146	162	159	175	161
Domestic thermal coal (NZD/t)	73	86	92	94	96
Weighted average (NZD/t)	**90**	**113**	**112**	**115**	**140**
Operating cost/tonne (NZD/t) (est)	-90	-80	-67	-65	-102
Operating margin	0	33	45	50	38
NZDUSD	0.804	0.822	0.817	0.800	0.779

Company Description

BRL is a coal mining company with operations on the West Coast of the South Island, and Southland. Current production totals 0.3mtpa. The company is in the process of developing a new coking coal mine on the West Coast, with targetted production of 2mtpa. Total resources are 109m tonnes and total product reserves are 25m tonnes.

* Forsyth Barr target prices reflect valuation rolled forward at cost of equity less the next 12-months dividend

Figure 5. Substantial Shareholders

Shareholder	Latest Holding
L1 Capital Partners Pty Ltd	9.9%
Coupland Cardiff Asset Management	13.3%

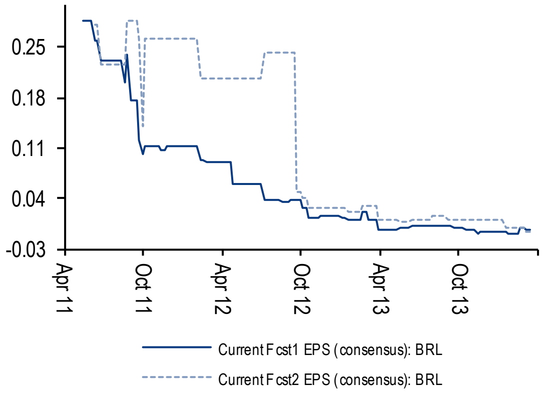
Source: NZX

Figure 6. International Compcos

Company	Code	Price	Mkt Cap	PE		EV/EBITDA		EV/EBIT		Cash Div
			(m)	fcst1	fcst2	fcst1	fcst2	fcst1	fcst2	Yield
Bathurst Resources	**BRL NZ**	**NZ$0.08**	**NZ$69**	**8.1x**	**>50x**	**38.3x**	**7.8x**	**9.3x**	**37.4x**	**0.0%**
Corsa Coal Corp	CSO CN	US$0.17	US$110	16.5x	8.3x	2.8x	2.6x	n/a	n/a	n/a
SouthGobi Resources Ltd	SGQ CN	US$0.60	US$112	<0x	<0x	45.1x	13.4x	<0x	<0x	0.0%
Walter Energy Inc	WLT US	US$7.51	US$471	<0x	<0x	14.3x	7.5x	<0x	33.9x	0.5%
James River Coal Co	JRCC US	US$0.72	US$26	<0x	<0x	<0x	<0x	<0x	<0x	n/a
Yancoal Australia Ltd	YAL AU	A$0.41	A$408	<0x	4.9x	13.5x	7.6x	43.0x	13.7x	2.4%
Whitehaven Coal Ltd	WHC AU	A$1.65	A$1,687	<0x	44.5x	21.4x	10.6x	71.1x	17.0x	0.6%
Alpha Natural Resources Inc	ANR US	US$4.21	US$931	<0x	<0x	12.5x	7.2x	<0x	<0x	0.0%
Arch Coal Inc	ACI US	US$4.73	US$1,003	<0x	<0x	16.0x	9.6x	<0x	>75x	0.2%
			Compco Average:	**16.5x**	**19.2x**	**18.0x**	**8.4x**	**57.1x**	**21.6x**	**0.6%**
EV = Current Market Cap + Actual Net Debt			**BRL Relative:**	**-51%**	**n/a**	**+113%**	**-7%**	**-84%**	**+74%**	**-100%**

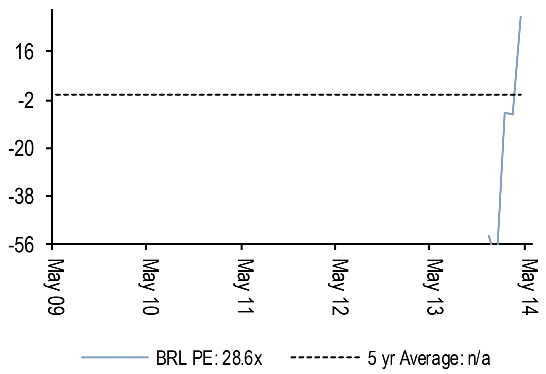
Source: Bloomberg Consensus

Figure 7. Consensus EPS Momentum



Source: Forsyth Barr analysis

Figure 8. 12 Month Forward PE



Source: Forsyth Barr analysis