10 December 2010 | 16 pages

Coal M&A

Observations & Opportunities

- Industry Overview

- **The rise & rise of the strategic investor** — The trend in M&A is the increasing dominance of strategic investors in the coal sector. We have analyzed almost 80 coal-related deals from the past 4 years worth US$35bn and conclude that strategic investors have increased their share of resources purchased from 38% in 2007 to 85% today. Moreover, they now also dominate the number of transactions with 16 of 25 deals in 2010 at the hands of strategics.

- **Super-size me** — Strategic investors show a preference for large coal deposits as we consider their overarching motivation to be security of supply. The average transaction size in terms of resource has grown to 1.8Bt for strategics but is 'only' 573Mt for asset purchases by coal companies.

- **It pays to differentiate** — EV/t of resource is an often quoted metric in coal M&A. We find that the largest number of coal project transactions take place at less than US$0.50/t whereas producing asset are centered on US$1.50/t and US$4.00/t. In weighted average terms, the data set returned US$0.98/t for all transactions and US$0.51/t for projects alone.

- **Recommendation(s)** — We believe the pace of coal M&A will continue as more resources are unlocked by emerging companies. Coal producers like New Hope are seeking growth and have the means to buy assets while strategic investors have an eye on long-term security. Outside of companies already in play (NEC & RIV), we highlight Whitehaven, which has opened a data room, and Resource Generation and Cockatoo. Elsewhere, we recommend seeking companies with a strong differentiator, particularly port access, which is highly prized.

David Haddad
+61-2-8225-3162
david.haddad@citi.com

Craig Sainsbury
+61-2-8225-4871
craig.sainsbury@citi.com

Clarke Wilkins
+61-2-8225-4858
clarke.wilkins@citi.com

Daniel Seeney
+61-2-8225-4862
daniel.seeney@citi.com

Meredith Schwarz
+61-2-8225-4892
meredith.schwarz@citi.com

See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

Coal M&A: Observations & Opportunities

With perhaps the exception of gold, coal mining more than any other sector has attracted corporate predators keen to secure an old-fashioned but highly in-demand commodity. Current transactions disclosed by the companies include:

- Rio Tinto/Riversdale: A$3.5bn for 100%
- New Hope/Northern Energy: A$193m for 100%
- Guangdong Rising/Caledon: A$406m for 100%
- Bathurst Resource/Eastern Resources: A$35m for 100%
- Walter Energy/Western Coal: US$3.1bn for 100%
- Itochu/Aston Resources: A$345m for 15%

Despite its relative abundance, seaborne coal markets remain constrained due largely to mismatched mine/infrastructure capacity and the industrialization of Pacific basin economies. As a fuel, coal continues to be a cheap and reliable source of base load power even as environmental concerns grow in the industrialized economies while the difficulty in finding new coking coal deposits to support steel production is well known.

These features of the seaborne market have seen the rise to prominence of the strategic investor, whether a utility/steel maker, trader or other cornerstone group. While these investors have always been present at the asset or corporate level, they have until recently tended to assume more of a background role, e.g. Japanese traders and steel makers in Australian coal companies holding 5-10% of an asset. Our analysis suggests that this group is now the driving force in coal M&A buying 85% of resource tonnes transacted.

We estimate that strategic investors (as separate from coal-to-coal M&A) now account for almost 2/3 of the volume of transactions – 16 of 25 completed and potential transactions in 2010 – and now dominate the total value of deals with US$9bn out of a total of US$15bn for the YTD.

Whereas strategic investors are paying more in total for coal assets, they are buying them more cheaply than coal companies on a $/t of resource basis. For example, the weighted average purchase price paid by coal companies in 2010 is US$0.81/t whereas the strategic investor has averaged A$0.59/t. Much of this has to do with the quality of the resource, such as location or lack of infrastructure with strategics apparently comfortable with longer development timelines.

Strategic investors mainly from China and India have shown a willingness to buy into early stage projects backed by large resources e.g. Tata group and Riversdale and hence the unit costs appear lower. In 2010, for example, the average size of coal resource underlying transactions was 591Mt for coal company purchases versus 1.8Bt for strategic investor purchases.

Within our ASX coal coverage universe, we highlight Resource Generation as a strong candidate for M&A activity. We also believe that Cockatoo may come under scrutiny but its tighter register would likely lead to a more complex process. Elsewhere, we believe the most attractive companies combine a large resource base and infrastructure access to both coal companies and strategic parties alike.

Figure 1. Coal Asset Transactions, 2007-2010

Acquirer	Target	Interest	Date	Price (US$m)	EV (US$m)	Status	Product	Resource (Mt)	Reserve (Mt)	EV/Resc	EV/Resv	EV/Prod
Itochu	Aston Resources	15%	Dec-10	339	2260	Project	SSCC/Th	610	356	3.71	6.35	n/a
Public (IPO)	Carabella Coal	25%	Dec-10	12	47	Project	HCC	92	n/a	0.51	n/a	n/a
Coal of Africa	Chapudi project	100%	Nov-10	75	75	Project	HCC/Th	1040	n/a	0.07	n/a	n/a
Walter Energy -- PENDING	Western Coal	100%	Nov-10	3106	3106	Producing	Metallurgical	446	190	6.96	16.37	971
Bathurst Resources -- PENDING	Eastern Resources	100%	Nov-10	35	35	Producing	HCC/Th	29	n/a	1.21	n/a	143
JSW Energy	CIC Energy	100%	Nov-10	431	431	Project	Thermal	2622	n/a	0.16	n/a	n/a
Guangdong Rising -- PENDING	Caledon Resources	100%	Nov-10	406	406	Producing	HCC/Th	748	17	0.54	23.77	677
New Hope Coal -- PENDING	Northern Energy	100%	Oct-10	190	190	Project	HCC/PCI/Th	519	112	0.37	1.70	n/a
Bhushan Steel	Bowen Energy	100%	Sep-10	8	8	Project	PCI/Th	n/a	n/a	n/a	n/a	n/a
CESC	Resource Generation	10%	Sep-10	10	99	Project	Thermal	3122	636	0.03	0.16	n/a
Continental Coal	Mashala Resources	62%	Sep-10	35	56	Producing	Thermal	424	n/a	0.13	n/a	81
Macarthur Coal	MDL162	90%	Aug-10	318	353	Project	SHCC/PCI/Th	222	n/a	1.59	n/a	59
Public (IPO)	Aston Resources	33%	Aug-10	399	1199	Project	SSCC/Th	610	356	1.97	3.37	n/a
Adani Enterprises	EPC1690 (Linc Energy)	100%	Aug-10	2739	2739	Project	Thermal	7800	n/a	0.35	n/a	n/a
Kepco/Posco/Cockatoo	Anglo coal assets	100%	Jul-10	580	580	Project	CC/Th	847	n/a	0.68	n/a	n/a
Kepco	PT Bayan Resources	20%	Jul-10	512	2560	Producing	Thermal	1008	477	2.54	5.37	205
Banpu	Centennial Coal	80%	Jul-10	1946	2429	Producing	Thermal	2218	332	1.10	7.32	162
Cliffs Natural Resources	INR Energy	100%	Jul-10	757	757	Producing	Met/Th	n/a	107	n/a	7.07	223
Wuhan Iron & Steel	Zambeze (Riversdale)	40%	Jun-10	800	2000	Project	HCC/Th	9045	n/a	0.22	n/a	n/a
Vale	Belvedere (AMCI)	25%	Jun-10	92	376	Project	HCC	2475	n/a	0.15	n/a	n/a
Xinyang Iron & Steel	Northern Energy	13%	Apr-10	21	168	Project	HCC/PCI/Th	484	112	0.35	1.50	n/a
Massey Energy	Cumberland Resources	100%	Mar-10	960	960	Producing	Met/Th	n/a	416	n/a	2.31	136
Essar Group	Trinity Coal	100%	Mar-10	600	600	Producing	Met/Th	n/a	200	n/a	3.00	86
Itochu	Vickery South	49%	Feb-10	10	20	Project	SSCC/Th	n/a	n/a	n/a	n/a	n/a
Jindal Steel & Power	Rocklands Richfield	100%	Jan-10	187	187	Project	Metallurgical	171	n/a	1.09	n/a	n/a
Macarthur Coal	Gloucester Coal	100%	Dec-09	602	602	Producing	CC/Th	209	45	2.88	13.38	354
Macarthur Coal	Middlemount	25%	Dec-09	117	468	Project	SHCC/PCI/Th	100	57	4.68	8.21	166
Meijin Energy	Rocklands Richfield	100%	Dec-09	187	187	Project	Metallurgical	171	n/a	1.09	n/a	n/a
CSN	Riversdale	16%	Nov-09	176	1100	Project	HCC/Th	4356	193	0.25	5.71	n/a
Posco	PT Motto Resources	65%	Nov-09	n/a	0	Project	Thermal	24	n/a	n/a	n/a	n/a
Cloud Peak Energy	Rio Tinto NA coal	52%	Nov-09	741	1425	Producing	Thermal	1239	953	1.15	1.50	17
Meijin Energy	Rocklands Richfield	100%	Nov-09	184	184	Project	Metallurgical	171	n/a	1.08	n/a	n/a
Aston Resources	Maules Creek	100%	Nov-09	432	432	Project	SSCC/Th	398	n/a	1.09	n/a	n/a
ENRC	CAMEC	100%	Nov-09	925	925	Project	HCC/Th	925	n/a	0.90	n/a	n/a
Kangaroo Resources	Mamahak Coal Project	85%	Oct-09	11	13	Project	Thermal	10	n/a	1.29	n/a	n/a
Essar Group	Rocklands Richfield	100%	Oct-09	150	150	Project	Metallurgical	171	n/a	0.88	n/a	n/a
Whitehaven	Vickery	100%	Oct-09	29	29	Project	SSCC/Th	300	n/a	0.10	n/a	n/a
SAMTAN	Bandanna Coal	10%	Sep-09	20	196	Project	PCI/Th	1248	n/a	0.16	n/a	n/a
Crosby Capital -- FAILED	Rey Resources	100%	Sep-09	43	43	Project	Thermal	511	n/a	0.08	n/a	n/a
Jindal Steel & Power	Rocklands Richfield	100%	Sep-09	134	134	Project	Metallurgical	171	n/a	0.78	n/a	n/a
Resource Portfolio Partners	Broughton	90%	Aug-09	9	10	Project	HCC/SHCC	30	n/a	0.33	n/a	n/a
Baosteel	Aquila	15%	Aug-09	240	1600	Producing	HCC/PCI/Th	1457	33	1.10	48.48	2500
Yanzhou	Felix	100%	Aug-09	2870	2870	Producing	SSCC/Th/PCI	765	386	3.75	7.44	603

Source: Company reports and Citi Investment Research and Analysis

Figure 2. Coal Asset Transactions, 2007-2010 (cont)

Acquirer	Target	Interest	Date	Price (US$m)	EV (US$m)	Status	Product	Resource (Mt)	Reserve (Mt)	EV/Resc	EV/Resv	EV/Prod
Kores	Narrabri	8%	Aug-09	105	1313	Project	Thermal	438	103	3.00	12.74	233
Vitol	Hillsborough	76%	Jul-09	25	33	Producing	Thermal	53	22	0.62	1.50	63
Kepco	PT Adaro Energy	2%	Jul-09	57	2850	Producing	Thermal	n/a	n/a	n/a	n/a	98
Coal of Africa	Limpopo Coal	26%	Jul-09	8	31	Project	HCC	485	n/a	0.06	n/a	n/a
Bhushan Steel	Bowen Energy	78%	Jul-09	7	9	Project	PCI/Th	n/a	n/a	n/a	n/a	n/a
Alpha Natural Resources	Foundation Coal	100%	May-09	2000	2000	Producing	HCC\Th	n/a	1562	n/a	1.28	29
Noble	Gloucester Coal	100%	May-09	429	429	Producing	CC/Th	209	38	2.05	11.29	241
Metinvest	United Coal Company	100%	May-09	1000	1000	Producing	HCC/PCI/Th	n/a	160	n/a	6.25	143
Mechel	Bluestone Industries	100%	Apr-09	1068	1068	Producing	HCC	458	261	2.33	4.09	350
ArcelorMittal	Coal of Africa	16%	Apr-09	45	281	Project	CC/Th	441	n/a	0.64	n/a	n/a
PTT Group	Straits Asia Resources	28%	Mar-09	335	1196	Producing	Thermal	638	111	1.88	10.78	62
Black Range Resources	Jonesville Project	100%	Jan-09	2	2	Project	Thermal	34	n/a	0.06	n/a	n/a
EdF	Narrabri	8%	Aug-08	104	1300	Project	Thermal	438	103	2.97	12.62	230
J-Power	Narrabri	8%	Aug-08	108	1350	Project	Thermal	438	103	3.08	13.11	240
Arch Coal	Jacobs Creek	100%	Jul-08	760	760	Producing	Thermal	n/a	381	n/a	1.99	18
BHPB	New Saraji	100%	Jul-08	2359	2359	Project	HCC	690	n/a	3.42	n/a	n/a
Public (IPO)	Coalworks Ltd	100%	Jun-08	98	98	Project	Thermal	280	n/a	0.35	n/a	n/a
Enterprise Energy	Bandanna Coal	100%	May-08	221	221	Project	PCI/Th	567	n/a	0.39	n/a	n/a
ArcelorMittal	Macarthur Coal	10%	May-08	416	4160	Producing	PCI/Th	1081	98	3.85	42.45	799
ArcelorMittal	Coal of Africa	16%	Apr-08	132	825	Project	CC/Th	441	n/a	1.87	n/a	n/a
Xstrata	Resource Pacific	100%	Feb-08	968	968	Producing	SSCC/Th	250	112	3.87	8.64	968
Public (IPO)	Pike River Coal	31%	Dec-07	57	184	Project	HCC	59	11	3.12	16.72	n/a
Anglo	Foxleigh	70%	Dec-07	635	907	Producing	PCI/Th	290	n/a	3.13	n/a	363
Macarthur Coal	Middlemount	70%	Dec-07	242	346	Project	SHCC/PCI/Th	100	n/a	3.46	n/a	n/a
Tata Steel	Benga	35%	Nov-07	88	251	Project	HCC/Th	1225	n/a	0.21	n/a	n/a
Whitehaven	Werris Creek	60%	Nov-07	55	92	Producing	PCI/Th	26	7	3.53	13.10	76
Xstrata	Austral Coal	100%	Oct-07	503	503	Producing	HCC	225	74	2.24	6.80	251
Xstrata	Anvil Hill (Mangoola)	100%	Sep-07	375	375	Project	Thermal	522	138	0.72	2.72	36
Vale	Belvedere	51%	Jul-07	89	175	Project	HCC	2745	n/a	0.06	n/a	n/a
CITIC	Macarthur Coal	8%	Jul-07	98	1225	Producing	PCI/Th	1158	100	1.06	12.25	245
Sojitz	Moolarben	10%	Jul-07	77	770	Project	Thermal	616	234	1.25	3.29	57
AMCI	Felix	19%	Mar-07	147	774	Producing	SSCC/Th/PCI	1012	270	0.76	2.87	210
Vale	AMCI	100%	Feb-07	647	647	Producing	CC/Th	n/a	103	n/a	6.28	n/a
SK Corp/Kores	Angus Place	50%	Dec-06	63	126	Producing	Thermal	197	30	0.64	4.20	36
Sojitz Corp	Minerva	15%	Aug-06	25	167	Producing	Thermal	84	35	1.98	4.76	67
Linear Average (all)										**1.48**	**9.07**	**240**
Weighted Average (all)										**0.98**	**6.73**	
Weighted Average (projects)										**0.51**	**3.95**	
Median										**1.08**	**6.32**	

Source: Company reports and Citi Investment Research and Analysis

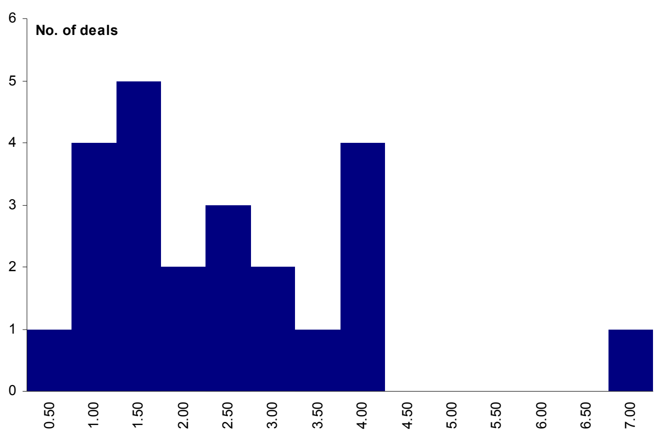
Coal M&A Comps

We have compiled a list of +75 coal-related transactions from the past 4 years valued at ~US$34bn (Figure 1). The list covers both projects and producing assets and the dominant trend is the increasing role of strategic investors who are willing to pay high prices for long-term security of supply.

With new resources being unlocked by emerging coal companies and a strong level of competition for these assets, we strongly believe that there is still plenty of M&A to come in the coal sector. Features of past and proposed transactions are:

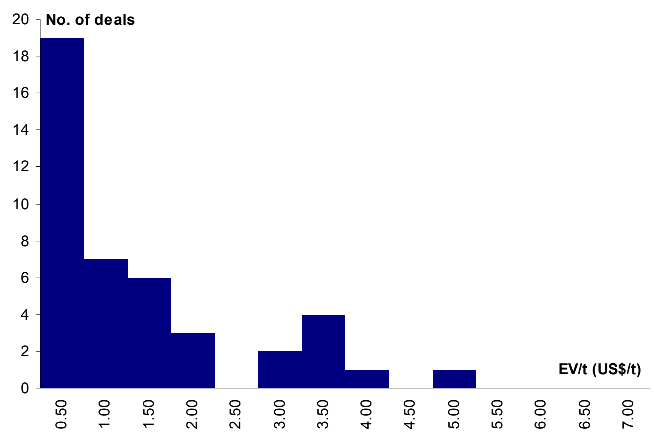
- The linear average deal value per tonne of resource **is US$1.48/t.**
- The weighted average deal value per tonne is **A$0.98/t.**
- For projects only, the weighted average is **A$0.51/t whereas for producing assets it is US$1.88/t.**
- Transactions for projects account for 60% of the total.
- Strategic buyers are represented in 58% of all transactions.
- For YTD 2010, strategic buyers make up 64% of transactions.
- Total deal value in YTD 2010 is ~US$15bn with strategics accounting for 62% or US$9bn. This has grown from US$320m or 11% of the 2007 total.
- Of underlying resources, strategics purchased 85% of the total transacted assets in YTD 2010 compared to 38% in 2007.
- Strategics prefer larger resources with 1.8Bt average in YTD 2010 versus 573Mt for coal company purchases.

Figure 3. Producing Asset Histogram – Transactions vs. EV/t Resource



Source: Citi Investment Research and Analysis

Figure 4. Project Asset Histogram – Transactions vs. EV/t Resource



Source: Citi Investment Research and Analysis

There is ~50% difference between the linear and weighted average transaction values due to the competing influence of more highly valued producers versus often large, low value projects. Coal projects account for 60% of all deals and naturally attract a discount to producing assets for capex and infrastructure risk, etc.

Digging more deeply, our data set contains only one transaction of a **producing asset** that priced at <US$0.50/t of resource, which was paid by Continental Coal for a South African company (Figure 3). The majority of producing asset transactions took place between US$0.50 and US$1.50/t but a significant number occurred in the US$4.00/t range.

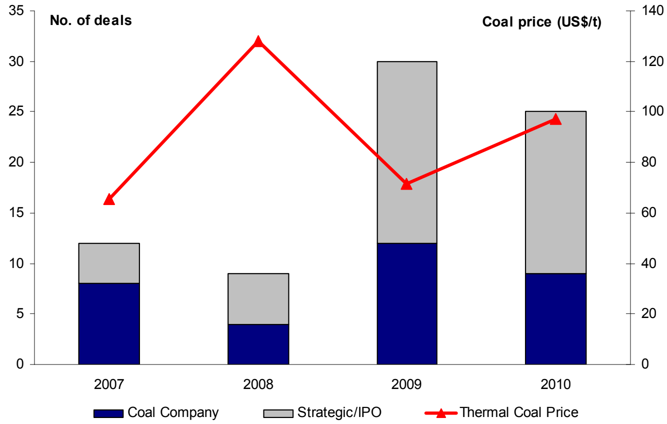
In contrast, the greatest number of **project transactions** – 19 out of 47 – occurred at less than US$0.50/t with +80% less than US$2.00/t. The only outlier is Macarthur Coal's purchase of Middlemount at ~US$4.70/t, an asset in which it already had ownership.

EV/t is a widely used metric for coal asset sales and it clearly highlights the value differential between producing assets and projects. We note however, that this is a very broad brush and takes no direct account of coal type, yield, cash cost etc. Rather risk is often implicitly recognized in the multiple. As such, it is open to abuse and we feel is often inappropriately used to justify valuations. Based on the results above, we believe more appropriate EV/t multiples are:

- **Projects**: up to US$0.50/tl; and
- **Producers**: US$2.00/t on average.

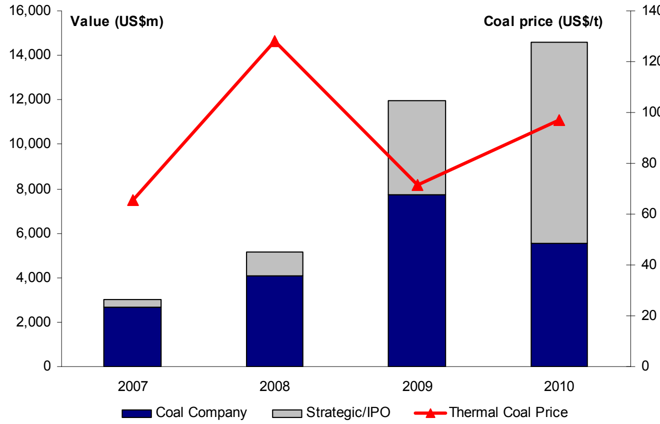
We again stress the general nature of these multiples, which do not account for coal quality (met vs. thermal), recoveries, country risk (South Africa is discounted relative to Australia and North America) or resource size (non-linear relationship between EV and in-situ coal). Nor do they capture specific strategic objectives of individual parties, e.g. Middlemount is the key to Macarthur's medium-term growth profile and a premium is appropriate.

Figure 5. Deal intensity – deals per year



Source: Citi Investment Research and Analysis

Figure 6. Total deal value per year

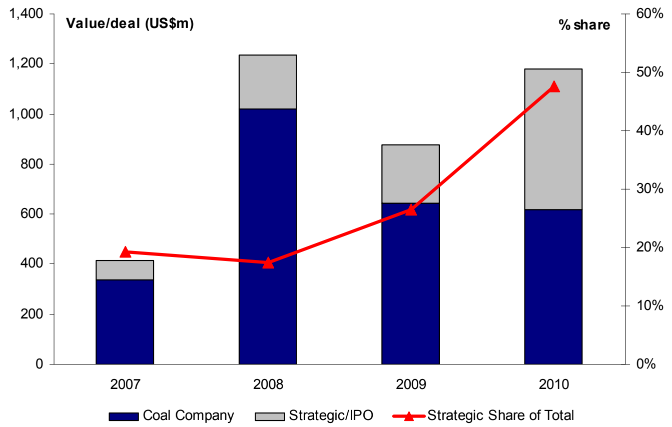


Source: Citi Investment Research and Analysis

In Figure 5/Figure 6, we plot deals per year and the total US$ transacted. The number of transactions jumped to 25-30 p.a. in 2009/10 from ~8-10 p.a. in 2007/08 following the global financial crisis and fall in coal prices. As Figure 6 indicates, money flow into these assets has increased steadily over the past 4 years, growing from ~US$3bn in 2007 to over US$14bn in 2010 YTD.

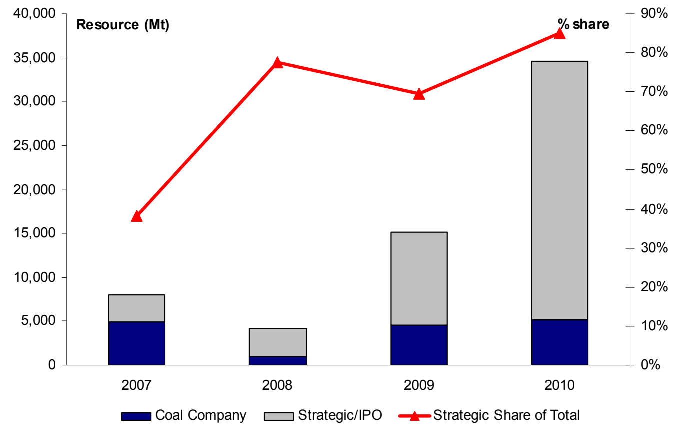
The charts also show the relative activity of coal companies and strategic investors. The trend over the past 4 years is the increasing dominance of strategic buyers, who make up well over half of all transactions (Figure 5) and almost 2/3 of total funds employed (Figure 6).

Figure 7. Deal intensity – average value per deal per year



Source: Citi Investment Research and Analysis

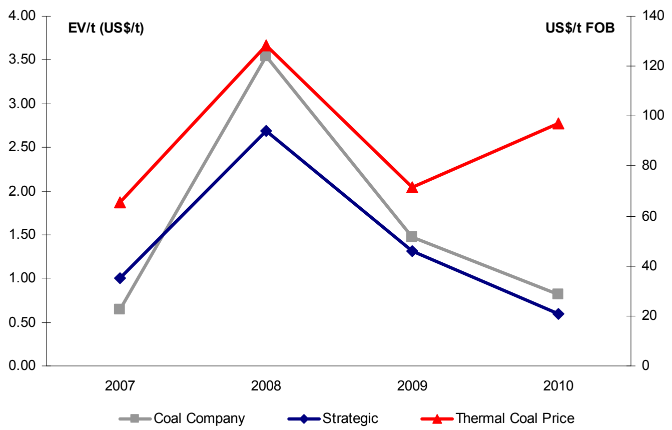
Figure 8. Total resource base of transactions



Source: Citi Investment Research and Analysis

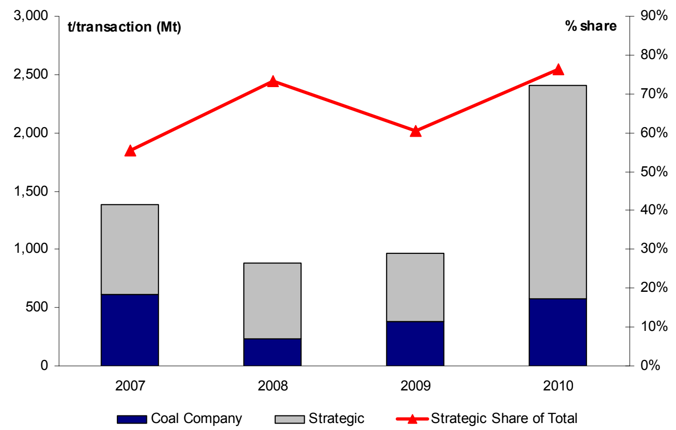
We observe a similar trend in the average transaction size (Figure 7). Purchases by strategics have climbed from 20% in 2007/08 to 45% in 2010 YTD. In terms of the underlying resources, strategic buyers now account for 85% of all coal traded in asset sales, demonstrating their preference for large deposits such as Riversdale's Benga and Linc Energy's EPC1690 (Figure 8)

Figure 9. EV/t of resource vs. thermal coal price



Source: Citi Investment Research and Analysis

Figure 10. Average resource per deal



Source: Citi Investment Research and Analysis

Other factors that influence EV/t include the prevailing coal price (Figure 9). With the exception of 2010, average EV/t has been closely correlated with coal price. This deviation in 2010 can be explained by Figure 10, which shows the leap in the average size of resource per deal. Thus while increased funds have flowed into coal M&A the targeted asset size has more than doubled and EV/t has declined as a result.

Figure 10 also shows the apparent preference strategic investors have for larger resources. We interpret this to stem from the high level of competition for assets and the tendency of utilities to security of long-term coal supply. Examples include steel company buying of Riversdale and Adani's purchasing large coal holdings from Linc Energy. We note that many of the larger resources are located in Africa, where traded assets have tended to be large and discounted relative to other parts of the world.

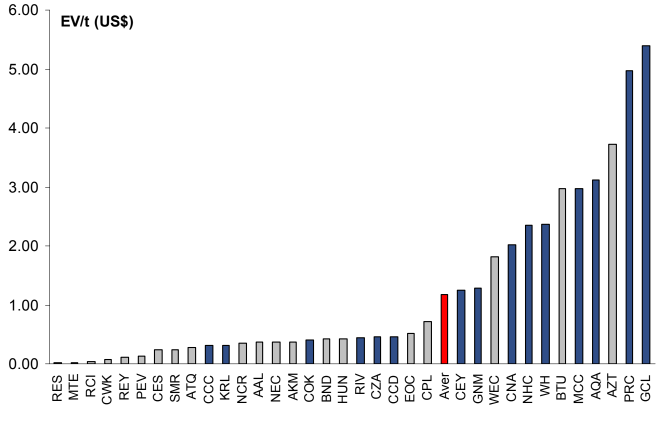
The ASX Coal Sector

In terms of numbers, the listed coal sector in Australia is dominated by emerging companies. Producers, especially of any scale are rare. Of 35 ASX coal stocks with a resource we have examined (including Centennial Coal), 15 have some coal production but only 9 produce in excess of 1Mtpa and just 5 companies – Coal & Allied, New Hope, Whitehaven, Macarthur and Centennial – produce more than 3Mtpa.

Many of the smaller or non-producers do own sizeable coal resources, however, and most have plans to aggressively grow production. Based on public statements from emerging companies, **the planned average mine size is almost 7Mtpa**. Logistics issues aside, we view most targets as very ambitious on a 3-4 year time frame and think 2-3Mtpa average is more likely.

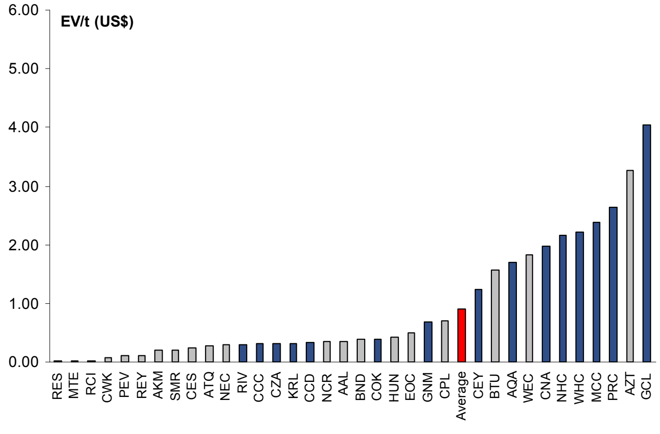
Producing companies naturally attract a premium for lower execution and funding risk but on an EV/t resource basis, several emerging companies are priced at the upper end of our spectrum of coal companies.

Figure 11. ASX coals EV/t resource (stated resource)



Source: Citi Investment Research and Analysis

Figure 12. ASX coals EV/t resource (thermal coal equivalent)



Source: Citi Investment Research and Analysis

In Figure 11 above, we rank all 35 companies according to EV/t resource as stated in publicly available documents. We include JORC Inferred resources but exclude exploration targets. While allowable under the JORC code, we prefer to stick with the more robust numbers of Measured, Indicated and Inferred categories.

The average of all companies is A$1.18/t of resource but the range is broad, stretching from a low of A$0.01/t for Resource Generation to A$5.39/t for Gloucester Coal. Not surprisingly, companies in the range below average are generally non-producers but several are producing coal at <1Mtpa. Conversely, several non-producers attract a premium to the average including Aston, which is priced at A$3.73/t and Bathurst Resources at A$2.98/t.

Aston's premium rating is partly due to Itochu's recent purchase of 15% of the company, which is equivalent to A$2.3bn market cap while Bathurst has attracted a premium for its status as a potential hard coking coal producer. The company plans to initially mine 1Mtpa hard coking coal from an open pit and although small, assets of this type are uncommon.

In an attempt to level the playing field with respect to coal type and EV/t, we plot the data as thermal coal equivalent tonnes (Figure 12). Our approach is to convert the stated resource using long-term coal prices of US$170/t for coking coal and US$90/t for thermal coal. We have also had to estimate the relative proportion of coal type in the resource and use production guidance from the companies as a basis.

Key points are:

- The average falls to **A$0.91/t from A$1.18/t.**
- Little changes at the very low end of the range with pure thermal coal company, **Resource Generation still at A$0.01/t.**
- **Gloucester still trades at the greatest premium** but at a lower level of A$4.03.
- Bathurst appears much 'cheaper' at A$1.58/t but **Aston still attracts one of the highest premiums** despite a large proportion of semi-soft coal.

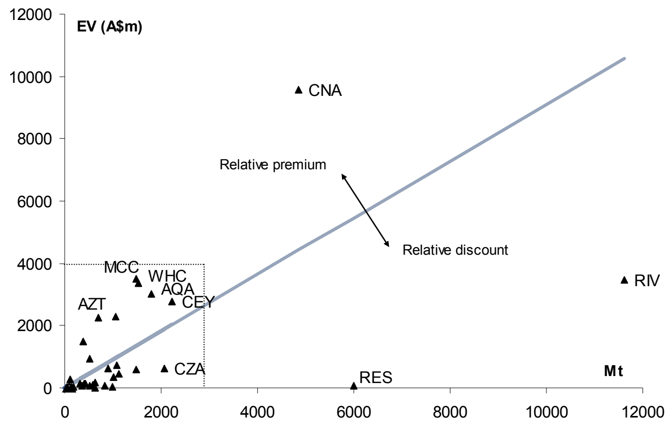
Plotting EV vs. thermal coal equivalent reveals a small number of outliers that result mainly from holding an exceptionally large resource base (Figure 13). Most companies combine an EV of less that A$4bn and resource under 2Bt with the only exceptions being C&A, Riversdale and Resource Generation.

C&A receives a premium rating because of the size of its operations and ownership of long-life, tier-1 assets. Riversdale and Resource Generation are anomalous by virtue of owning >6Bt each of resources. The picture would be somewhat different if we only considered the <u>reserve</u> base:

- C&A: 924Mt of thermal coal equivalent reserve or **A$10.38/t.**
- Riversdale: 483Mt of reserve or **A$7.21.**
- Resource Generation: 603Mt of reserve or **A$0.13/t.**

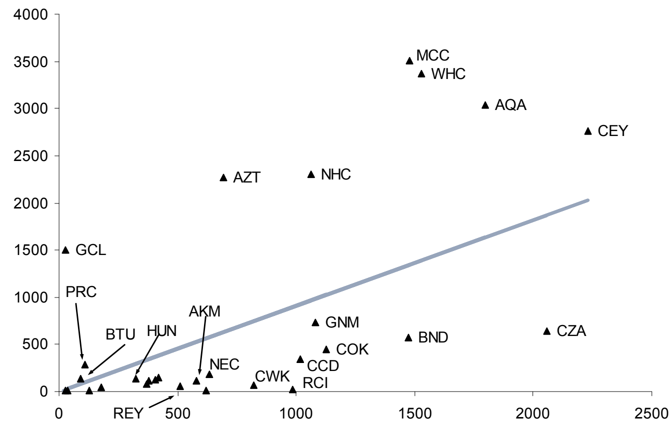
Hence Riversdale would plot much closer to C&A on this basis whereas Resource Generation would remain a prominent outlier.

Figure 13. EV vs. thermal coal equivalent resource



Source: Citi Investment Research and Analysis

Figure 14. Detail from Figure 13



Source: Citi Investment Research and Analysis

Outliers aside, premium priced companies relative to the average EV/t resource tend to marry production with a large resource base. Exceptions are Aston and some of the smaller coking coal producers that trade on higher EV/t multiples. Companies that appear below the line in Figure 14 are discounted relative to the average EV/t resource and the further to the right they are, the better the EV/t multiple.

Companies shown on Figure 14 that appear attractively priced due to a combination of large resources (>1Bt) and EV of ~A$600m or less include:

- Cockatoo
- Bandanna
- Coal of Africa
- Gujarat
- Caledon
- Rocklands Richfield

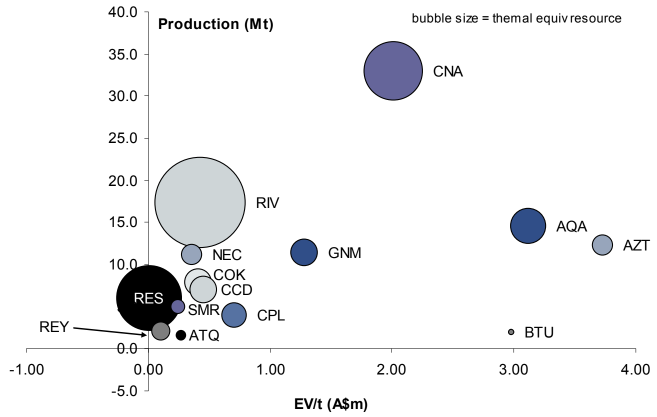
For producers and prospective producers who have completed feasibility work, we show their relative position according to capex, EV and proposed output (Figure 15 & Figure 16). Those with the greatest premium are Aston, Bathurst and Aquila. Aston and Aquila have moderate to large resources and plan to be amongst the largest independent producers. Bathurst by comparison is small in every way except its EV/t multiple. Companies that appear attractively priced with >5Mtpa thermal equivalent production include:

- Gujarat
- NEC
- Cockatoo
- Caledon

- Resource Generation
- Riversdale
- Stanmore

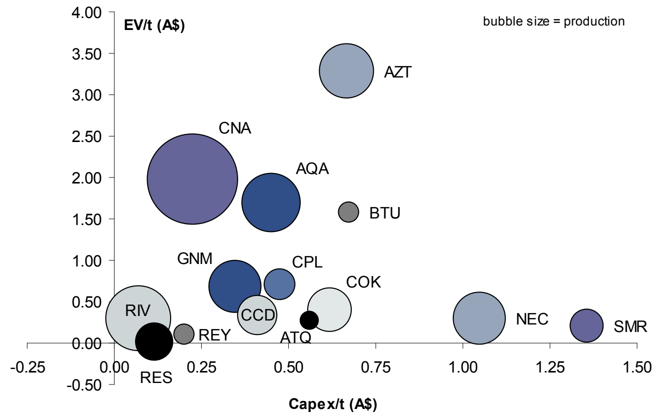
When capex is brought into the equation (Figure 16), NEC and Stanmore stand out as having relatively intensive operations in terms of capex.

Figure 15. EV/t vs. production



Source: Citi Investment Research and Analysis

Figure 16. Capex intensity vs. EV/t



Source: Citi Investment Research and Analysis

A Short List of Candidates

The following table summarizes our view on the M&A potential within our coverage universe. We also show other names that we think are topical in the M&A sphere or which we have been indentified above as having features that have proven attractive for acquirers in the past, e.g. large resources, infrastructure solutions.

Figure 17. Potential Coal M&A Summary

Company	Share Price	Rating	Target Price	Rationale/Possibilities
Coal & Allied	A$113.60	Hold/Medium	A$115.00	Majority owned by Rio Tinto (75%) and in many ways would make more sense inside the parent. As disclosed by Riversdale on 6 Dec 2010, Rio has held talks with the company on a possible transaction and thus Rio may have its hands full in the near term, however.
Cockatoo	A$0.55	Buy/High	A$0.70	>1Bt or resource and 3.5Mtpa of port access. Large land holding in QLD & NSW and keen to grow.
Macarthur	A$12.92	Sell/Medium	A$11.50	Premier seaborne shipper of LV PCI and growing from 5Mtpa to 10Mtpa. Takeover looks more difficult since the Peabody offer expired and we are not convinced CITIC is a seller at this point.
New Hope	A$4.87	Hold/Medium	A$5.40	With ~A$2bn cash and a lacklustre growth profile in the short term, New Hope is more likely to be an acquirer as it has shown with NEC, Macarthur and Resource Pacific. A lack of success with NEC will not deter New Hope from attempting other acquisitions in our view.
Northern Energy	A$1.70	Hold/High	A$1.75	We previously identified NEC as a target and the company is currently the subject of A$193m offer from New Hope. IE report suggested NEC was worth up to A$4.75 share so any competing bid would fall within its reference. IER has reset the bar for any competition but if New Hope does decide to bump its offer, we believe it will be small.
Resource Generation	A$0.47	Buy/Speculative	A$0.95	Inexpensive on almost every measure but suffers from discounts for South Africa and execution risk. M&A activity around similar deposits in Botswana at US$0.16/t and CESC deal within RES show that Indian consumers have an appetite for this type of asset. Will attract more attention as de-risking progresses.
Riversdale	A$16.22	Hold/High	A$14.00	Well publicized approach by Rio and AFR reported on 9 Dec 2010 that a competing bid looked likely. Could well go higher from here but the best gains are probably now behind it.
Whitehaven	A$6.99	Hold/High	A$7.00	Often cited as the next takeover target, the company formally opened a data room in Oct 2010 for potential acquirers. High level of management ownership means the company could easily be delivered to an interested party. We believe A$7-8/share may do the trick but Itochu's purchase of 15% of WHC's neighbour, Aston Resources at a substantial premium may encourage WHC to seek something more.
Bandanna	A$1.59	Not covered	Not covered	Like Cockatoo, Bandanna has a large resource base exceeding 1Bt and 4Mtpa of access at WICET Stage 1. As one of the few emerging companies with port access, Bandanna has a strong differentiating factor. We believe there would be many synergies in a merger with Cockatoo as a combined company would own >2Bt of resources and almost 8Mtpa port capacity.
Coal of Africa	A$1.36	Not covered	Not covered	Low EV/t resource multiple compared to peer average and one of the few companies in production but has recently suffered from a perception that its mining rights in South Africa were under threat. Although this threat has now waned, caution around the stock may take a little longer to clear.
Caledon	A$1.63	Not covered	Not covered	Also trades on a low EV/t multiple compared to the peer average but already the subject of a recommended offer. Note the company was also pre-selected for WICET Stage 1, receiving 4Mtpa. Coking coal is attractive to steel makers and the Caledon has had its share of suitors.
Gujarat	A$0.75	Not covered	Not covered	While Gujarat has growth in hard coking coal and trades on a small EV/t resource multiple, it is unlikely that its owners, Gujarat NRE Coke (77%) are sellers. The company sells coal unwashed to its parent in India and hence it has greater value as a strategic holding.
Rocklands Richfield	A$0.16	Not covered	Not covered	Once the subject of an intense bidding war, the acquirers evaporated without any deal being done. Rocklands also has exposure to coke making in China but its history in relation to M&A may make other potential acquirers reluctant.
Stanmore	A$1.31	Not covered	Not covered	The shares have performed strongly since listing in late 2009 but market cap is still just over A$150m. Resource has grown steadily and includes coking coal but the key will be its success in securing Stage 2 access at WICET so first coal is not likely before 2015.

Source: Citi Investment Research and Analysis; share prices as of 9 December 2010.

Appendix A-1

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