

INDIA

Gujarat NRE Coke

21 July 2008

GNC IN **Outperform**

Stock price as of 18 Jul 08	Rs	113.60
12-month target	Rs	251.00
Upside/downside	%	+121.0
Valuation	Rs	251.00
- Sum of Parts		

GICS sector		materials
Market cap	Rs m	38,293
30-day avg turnover	US\$m	9.8
Market cap	US\$m	890
Number shares on issue	m	337.1

Investment fundamentals

Year end 31 Mar		2008A	2009E	2010E	2011E
Total revenue	m	11,594	32,015	46,348	47,080
EBITDA	m	1,540	10,761	17,628	18,047
EBITDA growth	%	210.0	598.9	63.8	2.4
Adjusted profit	m	1,684	5,241	9,145	8,212
EPS adj	Rs	4.37	13.61	23.75	21.33
EPS adj growth	%	192.4	211.2	74.5	-10.2
PE adj	x	26.0	8.3	4.8	5.3
Total DPS	Rs	0.00	0.00	0.00	0.00
Total div yield	%	0.0	0.0	0.0	0.0
ROA	%	4.5	24.7	28.5	23.9
ROE	%	19.8	37.8	41.1	25.6
EV/EBITDA	x	33.5	4.8	2.9	2.9
Net debt/equity	%	66.0	75.2	17.1	1.7
Price/book	x	3.8	2.7	1.5	1.2

GNC IN rel SENSEX performance, & rec history



Source: Datastream, Macquarie Research, July 2008 (all figures in INR unless noted)

Analysts

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Bonus time

Event

- **1Q standalone results above expectation:** GNC has declared 1Q results which beat our estimates by 47% on a standalone basis, mostly due to better-than-expected margin but also partly due to the inclusion of profits from BNCL (60% JV of GNC). It also announced a bonus share issue in a 2:5 ratio.

Impact

- **Strong 1Q standalone results:** Net sales at Rs3.7bn grew 154% YoY. EBITDA grew 114% YoY to Rs1.3bn. Net profit at Rs899m rose 129% YoY. GNC has taken the facilities of its 60% joint venture company on lease on a tolling basis. Hence, in addition to better profitability, the results were helped by higher volume.
- **Profitability of mining subsidiary – to recover:** The unaudited results of the mining subsidiary (GNM AU, Not rated) were subdued due to the booking of costs from the second Elourea mine with no corresponding sales volume in this quarter. We expect mining profitability to recover sharply over the next three quarters.
- **Upgrading coke and coal price forecasts:** Our global commodities team has upgraded coke prices by 22% for FY09, FY10 and FY11, to US\$667/t, US\$656/t and US\$588/t, respectively. This is to reflect the upgrades in coking coal prices by 16.7% in FY10 to US\$350/t and 7.1% in FY11 to US\$300/t.
- **Expansion without equity raising:** GNC has announced its intention to increase coke capacity by 1mnt in eastern India at Andhra Pradesh to be completed over next two to three years. However, it has decided to cancel the proposed rights issue, as internal accruals are expected to be sufficient to fund the expansion.

Earnings revision

- We have upgraded our EPS forecasts for FY09 and FY10 by 9.5% and 2.6%, respectively, from Rs13.0 and Rs23.1 to Rs14.3 and Rs23.8.

Price catalyst

- 12-month price target: Rs251.00 based on a Sum of Parts methodology.
- Catalyst: Rising coke prices and meeting forecasted coking coal mine production.

Action and recommendation

- **Maintain Outperform:** We believe that Gujarat NRE coke is one of the best ways to play the upcycle in coking coal and coke prices. It is trading at a deep discount to its peers in spite of having one of the best growth profiles.
- **Hedge to steel portfolio:** The major threat to steel companies for FY10 is rising coking coal prices. We recommend investors to increase exposure to GNC to hedge their steel portfolios.

Please refer to the important disclosures and analyst certification on inside back cover of this document, or on our website www.macquarie.com.au/research/disclosures.

Strong 1Q results

- GNC has declared strong 1Q results driven by higher profitability due to higher coke prices and partial use of low-cost coking coal. This is reflected in the growth of its EBIT/t for the coking business to US\$175/t against last year's US\$125/t. Management has guided that they will be able to maintain this profitability going forward, as rising coke prices take care of higher coking coal cost.
- GNC has also taken the coke oven batteries of its 60% joint venture company, BNCL, on operating lease. This has resulted in the profits of BNCL being booked in the GNC standalone numbers. Hence, the volume for the quarter has been up to 156kt versus our assumption of around 115kt.

Fig 1 1Q FY3/09 profitability numbers

Profitability (Rs m)	1QFY09	1QFY08	YoY	4QFY08	QoQ
Net sales	3,776	1,489	154%	3,806	-1%
EBITDA	1,265	592	114%	873	45%
EBITDA margin	33.5%	39.8%	-16%	22.9%	46%
EBITDA/ tonne of coke (Rs)	7,955	5,797	37%	5,332	49%
Depreciation	75	56	35%	58	31%
Interest	97	69	42%	112	-13%
PBT	1,092	467	134%	704	55%
Tax	193	74	161%	249	-22%
PAT	899	393	129%	455	98%
EPS - fully diluted (Rs)	2.45	1.11	120%	1.67	47%

Source: Macquarie Research, July 2008

Fig 2 1Q FY3/09 production & realisation

	1QFY09	1QFY08	YoY	4QFY08	QoQ
Coke production (tonnes)	156,000	123,345	26%	119,247	31%
Coke sales (tonnes)	159,000	102,097	56%	163,700	-3%
Coke realisation (US\$/tonne)	3,739	1,479	153%	3,836	-3%

Source: Macquarie Research, July 2008

Fig 3 1Q FY3/09 cost breakdown

	1QFY09	1QFY08	YoY	4QFY08	QoQ
Change in stocks	(374)	(525)	-29%	206	-282%
Purchases	2,520	1,213	108%	2,144	18%
Staff	29	19	52%	23	26%
Other expenses	336	190	77%	561	-40%
Total cost	2,512	897	180%	2,934	-14%

Source: Macquarie Research, July 2008

Fig 4 1Q FY3/09 cost/tonne breakdown

	1QFY09	1QFY08	YoY	4QFY08	QoQ
Raw material/t (Rs/t)	13,758	5,575	147%	19,702	-30%
Employee cost/t (Rs/t)	187	156	20%	194	-3%
Other expenses/t (Rs/t)	2,155	1,541	40%	4,705	-54%
Total cost/t (Rs/t)	16,100	7,272	121%	24,601	-35%

Source: Macquarie Research, July 2008

Mining subsidiary profits to pick up

- Management has been guiding for operating profit of US\$80–85/t for the mining profitability for this year. It is based on run of mine coal realisation of US\$165/t and fob cost of US\$80–85/t.
- In the first quarter, the company booked all the costs from the second mine, Elouera, which just started production in June. The costs for this mine will vary widely over quarters as its production will be concentrated, with development work taking longer time.
- The bulk of the sales were booked at the lower costs prevailing during the last fiscal year and only the last shipment was booked at higher prices. The effect of higher coking coal prices will be reflected in the current quarter.

Fig 5 GNM reported numbers FY08 and 1Q FY3/09

A\$	FY08	1QFY09
Net sales	45,682,761	34,040,329
(Inc)/Decrease in stock in trade	(1,443,563)	(1,490,361)
Purchase/mine operating expense	10,443,456	10,683,282
Staff & wages cost	21,952,407	7,007,961
Other expenditure	20,974,244	12,400,279
Total expenditure	51,926,544	28,601,161
EBITDA	(6,243,783)	5,439,168
Depreciation	2,577,002	620,306
Interest	2,008,940	601,728
EBIT	(10,829,725)	4,217,134
Other income	1,551,811	14,799
PBIT	(9,277,914)	4,231,933
Current tax	-	25,000
Deferred tax	-	-
Tax rate		1%
PAT	(9,277,914)	4,206,933
Exceptional items	42,932	(31,876)
PAT - reported	(9,234,982)	4,175,057

Source: Company reports, Macquarie Research, July 2008

Fig 6 Mining operation volumes, realisation and cost breakdown - turning the corner

	FY08	1QFY09
Mine production (tonnes)	486,658	200,000
Realisation/t (A\$)	93.9	170.2
Cost/t (A\$)	106.7	143.0
EBITDA/t (A\$)	-12.8	27.2
Mine operating cost (A\$/t)	21.5	53.4
Staff cost (A\$/t)	45.1	35.0
Other expenditure (A\$/t)	43.1	62.0

Source: Macquarie Research, July 2008

Upgrading our forecasts

- We have increased our EPS forecasts to reflect the better outlook for both coking coal and coke prices.
- But we have reduced coke production estimates by 10%, as we now expect the ongoing expansion by 250kt is unlikely to be completed before 4Q, making it a doubtful contributor this year.
- Our net sales and expenditure numbers are a bit bloated compared with reported numbers as given the absence of an annual report we are unable to reconcile for inter-company sales. However, they remain perfectly in line from EBITDA onwards.

Fig 7 Change in estimates

Gujarat NRE	Old forecasts				New forecasts				% chg EPS
	Sales	EBITDA	PAT	EPS (Rs)	Sales	EBITDA	PAT	EPS (Rs)	
FY3/09E	31,846	10,719	5,014	13.0	32,015	10,761	5,241	14.3	9.5%
FY3/10E	45,243	18,280	8,911	23.1	46,348	17,628	9,145	23.8	2.6%
FY3/11E	na	na	na	na	47,080	18,047	8,212	21.3	na

Source: Macquarie Research, July 2008

Due to upgrade in our global forecasts

- Our global commodities team is very bullish on both coking coal and coke, and has significantly upgraded the price forecasts.

Fig 8 Change in coke price forecast

(US\$/tonne)	FY08	FY09E	FY10E	FY11E	FY12E
Coke - previous	341	550	538	488	431
Coke - new	340	667	656	588	525
% change from last forecast	0%	21%	22%	21%	22%
% increase (YoY)	107%	96%	-2%	-10%	-11%

Source: Macquarie Research, July 2008

Fig 9 Change in hard coking coal price forecast

(US\$/tonne)	FY08	FY09E	FY10E	FY11E	FY12E
Coking coal - previous	98	300	300	280	225
Coking coal - new	98	300	350	300	275
% change from last forecast	0.0%	0.0%	16.7%	7.1%	22.2%
% increase (YoY)	-14.8%	206.1%	16.7%	-14.3%	-8.3%

Source: Macquarie Research, July 2008

Fig 10 Change in exchange rate forecasts

	FY08	FY09E	FY10E	FY11E	FY12E
US\$/Rs - previous	40	41	39	38	37
US\$/Rs - new	40	44	42	41	40
% change from last forecast	0%	7%	8%	9%	7%
	FY08	FY09E	FY10E	FY11E	FY12E
A\$/US\$ - previous	0.88	0.88	0.85	0.81	0.77
A\$/US\$ - new	0.88	0.92	0.88	0.84	0.80
% change from last forecast	0%	4%	4%	4%	4%

Source: Macquarie Research, July 2008

Key assumptions – we turn more conservative

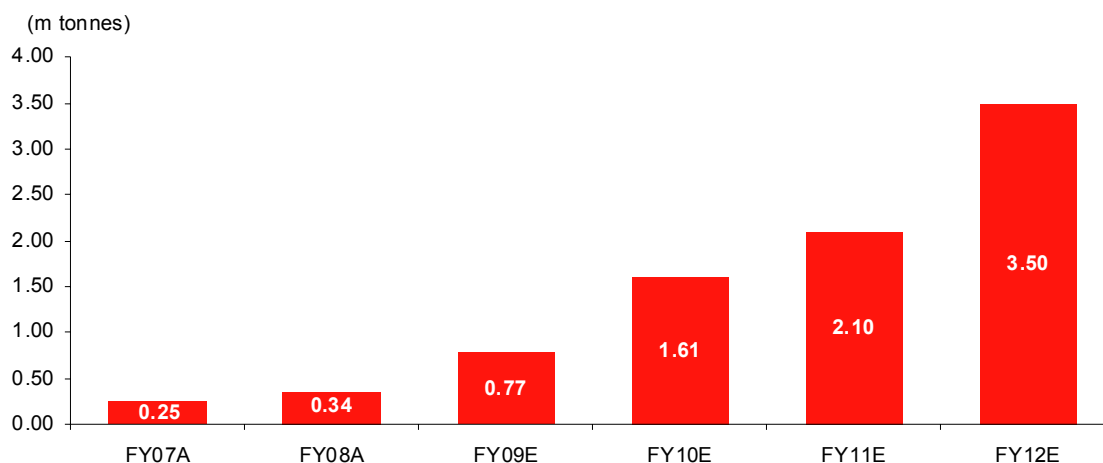
Fig 11 Key GNC assumptions

		FY07A	FY08A	FY09E	FY10E	FY11E	FY12E
Coke sales							
GNC (standalone)	tonnes	393,322	440,016	605,800	708,320	792,200	792,200
BNCL	tonnes		234,900	243,000	259,200	259,200	259,200
Total coke	tonnes	393,322	674,916	848,800	967,520	1,051,400	1,051,400
Coke realisation							
	US\$/tonne	192	358	625	616	551	493
Raw coal consumption							
	tonnes	552,033	730,491	897,676	1,042,514	1,144,848	1,144,848
Raw coal cost							
	US\$/tonne	156	187	320	390	340	315
Operating expense - coke							
	Rs m	5,191	8,226	16,920	21,217	20,012	18,327
ROM coking coal production							
	m tonnes	0.35	0.49	1.10	2.30	3.00	5.00
Coking coal production							
	m tonnes	0.25	0.34	0.77	1.61	2.10	3.50
ROM coking coal realisation							
	US\$/tonne	50	83	190	225	190	193
Mine Operating cost							
	A\$/tonne	55	106	99	89	87	77

Source: Macquarie Research, July 2008

We have reduced our production estimates for both coke and coking coal marginally in view of uncertainty on completion of the expansion.

Fig 12 Coking coal production



Source: Macquarie Research, July 2008

Valuations – reach attractive levels

- GNC is trading at very attractive valuation of below 8x PER on FY09E and below 5x on FY10E. On asset valuation, it is trading around US\$2/t of resources.

Fig 13 Peer comparison - rated stocks (Asia Pac)

Company	Country	Recom	PER		EV/EBITDA	
			1 Yr Fwd	2 Yr Fwd	1 Yr Fwd	2 Yr Fwd
China Shenhua Energy	China	Outperform	19.2x	15.0x	10.2x	8.0x
Yanzhou Coal Mining	China	Outperform	9.5x	7.4x	5.4x	4.0x
Hidili Industry	China	Outperform	15.5x	9.9x	13.1x	7.8x
China Coal Energy	China	Outperform	18.4x	11.8x	9.2x	6.6x
Zijin Mining	China	Outperform	21.5x	18.9x	11.5x	10.1x
Bumi Resources	Indonesia	Outperform	12.4x	6.7x	5.5x	2.5x
Xishan Coal and Electricity	China	Underperform	37.3x	33.3x	18.4x	15.9x
Datong Coal Industry	China	Underperform	31.0x	25.3x	11.4x	9.1x
Western Mining	China	Neutral	13.3x	10.1x	7.7x	5.2x
Pingdingshan Tianan Coal	China	Underperform	16.5x	14.2x	8.7x	7.1x
Gujarat NRE Coke	India	Outperform	8.7x	4.9x	4.8x	2.4x

Source: Macquarie Research, July 2008

Fig 14 Peer comparison - unrated stocks

Company	Market cap (US\$m)	Current price (Icy)	PER		EV/EBITDA		EV/t (US\$)
			1 Yr Fwd	2 Yr Fwd	1 Yr Fwd	2 Yr Fwd	
Massey Energy Co	5,634	69.9	23.2x	12.2x	10.2x	6.4x	8.9
Consol Energy Inc	15,077	82.5	27.0x	10.0x	12.1x	5.4x	3.6
Arch Coal Inc	7,898	54.8	20.3x	9.3x	11.2x	5.9x	4.8
Peabody Energy Corp	17,836	65.7	25.3x	11.7x	13.0x	6.9x	2.2
Centennial Coal Co Ltd	1,744	5.1	27.4x	8.6x	9.9x	4.9x	3.3
Macarthur Coal Ltd	3,543	16.7	67.3x	8.8x	38.8x	5.8x	24.5

Based on reserves as of 31 December 2007

Source: Factset, Macquarie Research, July 2008

Gujarat NRE Coke (GNC IN, Outperform, Target price: Rs268.00)

					Profit & Loss					
					2008A	2009E	2010E	2011E		
					Revenue	m	13,613	35,164	48,813	47,427
					Gross Profit	m	0	0	0	0
					Cost of Goods Sold	m	11,325	23,260	30,293	28,382
					EBITDA	m	2,288	11,905	18,520	19,045
					Depreciation	m	358	1,019	1,227	1,562
					Amortisation of Goodwill	m	0	0	0	0
					Other Amortisation	m	0	0	0	0
					EBIT	m	1,930	10,886	17,923	17,483
					Net Interest Income	m	-515	-1,307	-1,823	-1,850
					Associates	m	0	0	0	0
					Exceptionals	m	0	0	0	0
					Forex Gains / Losses	m	0	0	0	0
					Other Pre-Tax Income	m	1,371	913	789	814
					Pre-Tax Profit	m	2,786	10,492	16,259	16,446
					Tax Expense	m	-698	-3,514	-6,166	-7,063
					Net Profit	m	2,089	6,979	10,093	9,383
					Minority Interests	m	-339	-397	-313	-292
					Reported Earnings	m	2,089	6,979	10,093	9,383
					Adjusted Earnings	m	1,750	6,582	9,780	9,091
					EPS (rep)		5.43	18.13	26.22	24.37
					EPS (adj)		4.54	17.10	25.40	23.61
					EPS Growth (adj)	%	203.8	276.2	48.6	-7.0
					PE (rep)	x	18.5	5.5	3.8	4.1
					PE (adj)	x	22.1	5.9	3.9	4.2
					Total DPS		0.00	0.00	0.00	0.00
					Total Div Yield	%	0.0	0.0	0.0	0.0
					Weighted Average Shares	m	385	385	385	385
					Period End Shares	m	385	385	385	385
Profit and Loss Ratios					2008A	2009E	2010E	2011E		
Revenue Growth	%	164.6	158.3	38.8	-2.8					
EBITDA Growth	%	360.7	420.3	55.6	2.8					
EBIT Growth	%	688.7	464.0	58.9	1.1					
Gross Profit Margin	%	0.0	0.0	0.0	0.0					
EBITDA Margin	%	16.8	33.9	37.9	40.2					
EBIT Margin	%	14.2	31.0	35.4	36.9					
Net Profit Margin	%	15.3	19.8	20.7	19.8					
Payout Ratio	%	0.0	0.0	0.0	0.0					
EV/EBITDA	x	20.2	3.9	2.5	2.4					
EV/EBIT	x	24.0	4.2	2.7	2.6					
Balance Sheet Ratios					2008A	2009E	2010E	2011E		
ROE	%	20.1	43.8	40.0	26.0					
ROA	%	7.8	26.1	28.2	24.0					
ROIC	%	17.1	35.7	36.5	28.8					
Net Debt/Equity	%	60.1	53.8	7.6	-8.1					
Interest Cover	x	3.7	8.3	9.5	9.4					
Price/Book	x	3.2	2.1	1.3	1.0					
Book Value per Share		31.1	46.8	80.0	101.6					
					Cashflow Analysis					
					2008A	2009E	2010E	2011E		
					EBITDA	m	2,801	11,905	18,520	19,045
					Tax Paid	m	-698	-3,514	-6,166	-7,063
					Chgs in Working Cap	m	137	-5,317	-2,952	40
					Net Interest Paid	m	-515	-1,307	-1,823	-1,850
					Other	m	-358	-1,019	-1,227	-1,562
					Operating Cashflow	m	1,367	749	6,352	8,609
					Acquisitions	m	0	0	0	0
					Capex	m	-7,360	-4,817	-3,520	-4,479
					Asset Sales	m	0	0	0	0
					Other	m	858	913	789	814
					Investing Cashflow	m	-6,502	-3,904	-2,731	-3,665
					Dividend (Ordinary)	m	-509	-960	-786	-766
					Equity Raised	m	1,061	350	350	0
					Debt Movements	m	1,151	4,986	1,587	-2,405
					Other	m	4,286	70	3,780	0
					Financing Cashflow	m	5,989	4,446	4,931	-3,171
					Net Chg in Cash/Debt	m	855	1,291	8,552	1,773
					Balance Sheet					
					2008A	2009E	2010E	2011E		
					Cash	m	2,073	4,392	13,814	17,145
					Receivables	m	3,418	7,298	8,746	8,313
					Inventories	m	3,936	10,065	13,918	13,543
					Investments	m	0	0	0	0
					Fixed Assets	m	12,891	16,689	18,982	21,899
					Intangibles	m	197	197	197	197
					Other Assets	m	8,992	13,180	15,014	14,189
					Total Assets	m	31,508	51,822	70,672	75,285
					Payables	m	6,617	13,580	16,902	15,663
					Short Term Debt	m	0	0	0	0
					Long Term Debt	m	9,685	14,671	16,258	13,853
					Provisions	m	1,769	3,686	4,548	4,191
					Other Liabilities	m	761	770	764	759
					Total Liabilities	m	18,832	32,707	38,471	34,467
					Shareholders' Funds	m	11,992	18,034	30,807	39,132
					Minority Interests	m	684	1,081	1,394	1,686
					Other	m	0	0	0	0
					Total S/H Equity	m	12,676	19,114	32,201	40,818
					Total Liab & S/H Funds	m	31,508	51,822	70,672	75,285

All figures in INR unless noted.

Source: Company data, Macquarie Research, July 2008

Important disclosures:

Recommendation definitions	Volatility index definition*	Financial definitions
<p>Macquarie – Australia/New Zealand Outperform – return >5% in excess of benchmark return (>2.5% in excess for listed property trusts) Neutral – return within 5% of benchmark return (within 2.5% for listed property trusts) Underperform – return >5% below benchmark return (>2.5% below for listed property trusts)</p> <p>Macquarie – Asia Outperform – expected return >+10% Neutral – expected return from -10% to +10% Underperform – expected return <-10%</p> <p>Macquarie First South - South Africa Outperform – expected return >+10% Neutral – expected return from -10% to +10% Underperform – expected return <-10%</p> <p>Macquarie – Canada Outperform – return >5% in excess of benchmark return Neutral – return within 5% of benchmark return Underperform – return >5% below benchmark return</p> <p>Macquarie – USA Outperform (Buy) – return >5% in excess of benchmark return Neutral (Hold) – return within 5% of benchmark return Underperform (Sell) – return >5% below benchmark return</p> <p>Recommendations – 12 months</p> <p>Note: Quant recommendations may differ from Fundamental Analyst recommendations</p>	<p>This is calculated from the volatility of historic price movements.</p> <p>Very high–highest risk – Stock should be expected to move up or down 60–100% in a year – investors should be aware this stock is highly speculative.</p> <p>High – stock should be expected to move up or down at least 40–60% in a year – investors should be aware this stock could be speculative.</p> <p>Medium – stock should be expected to move up or down at least 30–40% in a year.</p> <p>Low–medium – stock should be expected to move up or down at least 25–30% in a year.</p> <p>Low – stock should be expected to move up or down at least 15–25% in a year.</p> <p>* Applicable to Australian/NZ stocks only</p>	<p>All "Adjusted" data items have had the following adjustments made: Added back: goodwill amortisation, provision for catastrophe reserves, IFRS derivatives & hedging, IFRS impairments & IFRS interest expense Excluded: non recurring items, asset revals, property revals, appraisal value uplift, preference dividends & minority interest</p> <p>EPS = adjusted net profit / efpowa* ROA = adjusted ebit / average total assets ROA Banks/Insurance = adjusted net profit / average total assets ROE = adjusted net profit / average shareholders funds Gross cashflow = adjusted net profit + depreciation *equivalent fully paid ordinary weighted average number of shares</p> <p>All Reported numbers for Australian/NZ listed stocks are modelled under IFRS (International Financial Reporting Standards).</p>

Recommendation proportions – For quarter ending 30 June 2008

	AU/NZ	Asia	RSA	USA	CA
Outperform	41.88%	66.96%	66.13%	50.82%	71.01%
Neutral	42.96%	16.30%	22.58%	44.26%	24.64%
Underperform	15.16%	16.74%	11.29%	4.92%	4.35%

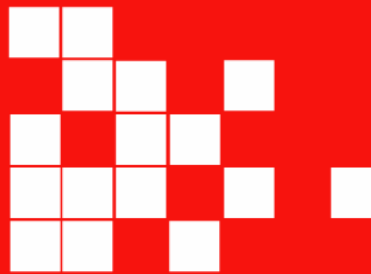
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