CAPITAL RESOURCE

Equity Research

13 Sept, 2013

COAL

COMPANY UPDATE

GUILDFORD COAL LTD | GUF

BUY

Mongolia update and commodity price revisions

Analyst | Craig Brown
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ASX code | GUF

Last price | $0.14

Fully diluted shares | 635M

Market cap | A$88M

52 week hi/low | $0.625/ $0.09

Price target | $0.50 ($0.90 Prev)

Valuation | $0.58 ($1.07 Prev)

Valuation methodology | SoP

EV/Reserve | na

EV/Resource | A$0.05/t

Key Catalysts|

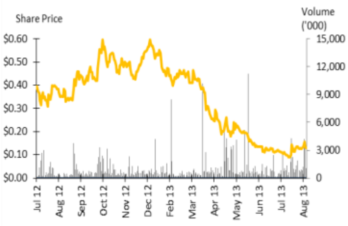
Road permitting Sign off Q313

Off-take agreements Q413

Final Inspection and sign off Q413

Production Mongolia Q413

Share price performance |GUF



Guildford held a site visit in Mongolia recently for major investors and institutions providing an update on the South Gobi project. The key milestones remaining are haul road permitting, mine site compliance inspection and additional financing during initial production stage.

We have revised our commodity price and fx assumptions for FY14 and FY15, as well as our long-term pricing assumptions to reflect the recent changes in AUD:USD and recent update from management regarding expected pricing, production targets and operational costs at South Gobi. We maintain our BUY recommendation with a revised price target of $0.50/sh ($0.90/sh prev).

- **Coal pricing at the bottom:** Current coal pricing in our view is at or near the bottom. Recent positive data out of China and recent improvements in China's coking market has seen Shandong's coking coal market price rise as much as US$5-$10/t since July. Mongolia appears to have bottomed after declining $6-9/t over the June quarter driven by higher than average stock piles with semi soft and coking products still in favor over thermal coal. GUF are targeting a low cost production model targeting premium coking coal from the North pit from Q4 2013 with which should provide insulation and upside exposure to any improvements in coal pricing. **We have revised our Mongolia 1/3 coking coal price assumptions for the FY14 & FY15 year to US$60/t (from $66/t and 62/t), as well as our LT price to $55/t ($67/t).**
- **Mine and Haul Road Progress:** Although GUF's Mongolian strategy has been straight forward; permitting of the road has been the most challenging impediment to see the South Gobi project come to fruition. We believe this is now imminent with contracts, appointment of independent engineering inspector and a planned ten week construction program about to commence. An in principal agreement with Noble will provide GUF with sufficient financial capacity to construct the unpaved road for an expected cost of US$17m which should increase GUF's debt commitments to ~$80m.
- **Current and future financing arrangements:** Management expects the initial startup at South Gobi including the construction of the unsealed road and initial box-cut to cost ~$30-35m. Management has also flagged an additional US$45-55m in financing by the end of the December quarter which will enable GUF to successfully move from developer to producer with a positive cash balance.
- **Remaining consideration for Terra Energy to be settled in shares:** GUF has indicated that the remaining deferred consideration for the Terra Energy acquisition will be settled via the issue of 20m shares on or before the 21st December 2013. This alleviates any future cash payments as a result of the GUF acquiring 100% interest in the South Gobi assets.
- **We maintain our BUY recommendation with a PT of $0.50/sh ($0.90 Prev).**

Key Metrics

Year to June	2012a	2013e	2014e	2015e	2016e
Revenue (A$m)	0.9	17.9	44.8	188.5	218.7
EBITDA (A$m)	-22.5	-3.4	-9.6	46.1	66.7
NPAT (A$m)	-23.7	-10.7	-38.0	12.1	34.5
EPS (¢)	-0.1	0.0	-0.1	0.0	0.1
FCF (A$m)	-15.5	-46.4	-62.3	27.2	53.4
EV/EBITDA	N/A	N/A	N/A	2.7	1.9
P/E	N/A	N/A	N/A	6.8	2.4

13 September 2013
ASX Code: GUF

Guildford Coal Ltd (GUF.ASX)

Full Year Ended 30 Jun

Profit & Loss (A$m)	2012a	2013e	2014e	2015e	2016e
Revenue	**0.0**	**0.0**	**44.8**	**188.5**	**218.7**
Other Revenue	0.9	17.9	0.0	0.0	0.0
Revenue	**0.9**	**17.9**	**44.8**	**188.5**	**218.7**
Operating costs	0.0	0.0	42.1	132.0	141.4
Exploration	0.0	7.0	6.0	4.0	4.0
Corporate costs	23.4	14.3	6.2	6.4	6.6
EBITDA	**-22.5**	**-3.4**	**-9.6**	**46.1**	**66.7**
EBITDA margin (%)	nm	nm	nm	24.4	30.5
D & A	-0.2	0.0	19.1	22.6	23.3
EBIT	**-22.3**	**-3.4**	**-28.7**	**23.5**	**43.5**
EBIT margin (%)	nm	nm	nm	12.5	19.9
Net Interest (exp) / income	-0.9	-7.3	-9.2	-11.4	-9.0
Associates	0.0	0.0	0.0	0.0	0.0
Profit before tax	**-23.2**	**-10.7**	**-38.0**	**12.1**	**34.5**
Tax (exp) / benefit	0.5	0.0	0.0	0.0	0.0
NPAT pre minorities	**-23.7**	**-10.7**	**-38.0**	**12.1**	**34.5**
Minoritiy Interests	0.0	0.0	0.0	0.0	0.0
NPAT pre sig items	**-23.7**	**-10.7**	**-38.0**	**12.1**	**34.5**
Significant items	-0.7	-0.2	0.0	0.0	0.0
NPAT reported	**-23.7**	**-10.7**	**-38.0**	**12.1**	**34.5**
NPAT adjusted *	**-23.1**	**-10.5**	**-38.0**	**12.1**	**34.5**
WA # Shares Diluted (m)	413.5	635.0	655.0	655.0	655.0
EPS adj ¢/ps	-0.06	-0.02	-0.06	0.02	0.05

* NPAT adjusted for significant items and amortisation of intangibles
*WA #shares (FY 14 & 15) adjusted for potential equity raising

Cash Flow (A$m)	2012a	2013e	2014e	2015e	2016e
EBITDA	**-22.5**	**-3.4**	**-9.6**	**46.1**	**66.7**
Net Interest (exp) / income	-0.9	-7.3	-9.2	-11.4	-9.0
Tax	0.5	0.0	0.0	0.0	0.0
Other	0.0	0.0	0.0	0.0	0.0
Operating Cashflow	**-14.9**	**-10.7**	**-18.8**	**34.7**	**57.8**
Capex	-0.6	-35.7	-43.5	-7.5	-4.4
Net Acquisitions	-1.4	0.0	0.0	0.0	0.0
Asset Sales	0.0	0.0	0.0	0.0	0.0
Other	-35.7	0.0	0.0	0.0	0.0
Investing Cashflow	**-37.7**	**-35.7**	**-43.5**	**-7.5**	**-4.4**
Equity proceeds	33.3	0.0	0.0	0.0	0.0
Debt proceeds / (repayment)	0.0	58.6	60.7	-25.3	-25.3
Dividends paid	0.0	0.0	0.0	0.0	0.0
Other	0.0	0.0	0.0	0.0	1.0
Financing Cashflow	**33.3**	**58.6**	**60.7**	**-25.3**	**-24.3**
Net Cashflow	-19.3	12.2	-1.6	1.9	29.1
Free Cashflow	**-15.5**	**-46.4**	**-62.3**	**27.2**	**53.4**

Balance Sheet (A$m)	2012a	2013e	2014e	2015e	2016e
Cash	**14.5**	**25.5**	**14.6**	**16.7**	**49.3**
Receivables	0.3	1.5	9.9	17.1	19.6
Inventories	0.0	0.0	0.0	0.0	0.0
PPE	0.6	2.8	30.8	27.4	24.0
Exploration & Development	121.6	137.1	127.4	111.7	92.2
Other	1.1	6.3	20.4	19.2	17.9
Total Assets	**138.2**	**173.2**	**203.2**	**192.2**	**203.0**
Payables	3.7	1.2	8.5	10.6	12.3
Tax liabilities	0.0	0.0	0.0	0.0	0.0
Debt	0.0	58.6	119.3	94.0	68.6
Other	0.1	0.0	0.0	0.0	0.0
Total Liabilities	**3.8**	**59.9**	**127.8**	**104.7**	**81.0**
Reserves and capital	150.1	150.1	150.1	150.1	150.1
Retained earnings	-26.7	-47.8	-85.7	-73.6	-39.1
Minorities	11.0	11.0	11.0	11.0	11.0
Total Equity	**134.4**	**113.4**	**75.4**	**87.5**	**122.0**

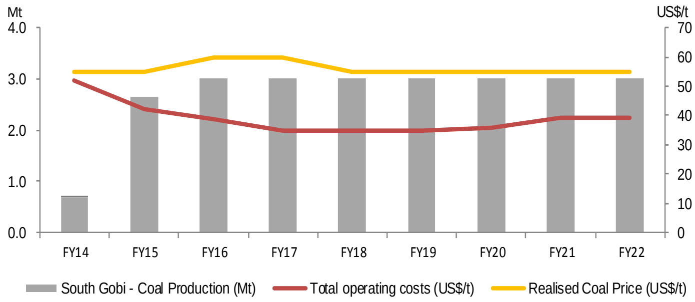
Recommendation: BUY

Price Target $0.50

Capital Structure	
Shares on Issue (m)*	655.0
Shares on Issue diluted (m)	655.0
Market Cap (A$m)	**81.9**
Net Debt/(Cash) (A$m)	43.5
EV (A$m)	**125.4**

Key Assumptions	2014e	2015e	2016e	LT
Coal - ThermalUS$/t	78	80	80	80
Semi-soft coking coalUS$/t	108	140	140	120
Hard coking coalUS$/t	133	123	123	160
Mongolia 1/3 coking coal price US$/t	55	60	60	55
AUD/USD	0.90	0.90	0.90	0.80

Production Summary (100% basis)	2014e	2015e	2016e	LT
Production profile (t)	0.7	2.7	3.0	3.0
Operating costs (US$/t)	52	42	39	39



Resource (100% Basis)	Type	Indicated	Inferred	Mt
Hughenden Project	JORC	133	1,076	1,209
South Gobi	JORC	40	72	112
Springsure Project	JORC		253	253
Clyde Park Project	JORC	51	677	728
Middle Gobi	JORC	32	189	221
Total		**255**	**2,267**	**2,522**

Valuation Summary	A$m	P/NPV	$/share
South Gobi	416	1.00	$0.63
Hughenden Project	30	1.00	$0.05
Clyde Park Project	23	0.64	$0.04
Springsure Project	13	0.51	$0.02
Corporate	-57	1.00	-$0.09
Net cash/(debt)	-43	1.00	-$0.07
Total	**381**		**$0.58**

Key Metrics	2013e	2014e	2015e	2016e
DPS (A$)	0	0	0	0
Dividend Yield (%)	N/A	N/A	N/A	N/A
EPS (A$)	-0.02	-0.06	0.02	0.05
FCF (A$m)	-46.4	-62.3	27.2	53.4
EV/EBITDA	N/A	N/A	2.7	1.9
P/E	N/A	N/A	6.8	2.4
Price/NPV	0.21			
EV/Resource (A$/t)	0.06			
EV/Reserve (A$/t)	N/A			
Net Profit Margin (%)	N/A	N/A	6%	16%
ROA (%)	N/A	N/A	6.3%	17.0%
ROE (%)	N/A	N/A	13.9%	28.3%
Gearing (%)	**0%**	**52%**	**158%**	**107%**

** includes Terra Energy Issue 20m shares*

Key Changes

We have revised our commodity price and fx assumptions for FY14 and FY15, as well as our long-term pricing assumptions to reflect the recent changes in the currency as well as recent guidance from management.

We have revised our Mongolia 1/3 coking coal price for the FY14 & FY15 year to US$60/t from ($66/t and $62/t), as well as our LT price to $55/t ($67/t).

Our AUD:USD forecasts have also been adjusted for the FY14 & FY15 year to $0.90($1.00) and $0.90 ($0.95), as well as our LT price to $0.80 ($0.90).

As a result, we maintain our BUY recommendation on Guildford Coal (GUF) with a revised price target of $0.50/share (0.85x NPV) ($0.90 previous) based off a base case DCF scenario assuming an average production rate of 3Mtpa over 10 years.

Figure 1: Production Summary – Base Case Scenario

Metric		Current	Previous	Change
LT A$/US$ Forecast	$	0.80	0.90	▼
2014 A$/US$ Forecast	$	0.90	1.00	▼
2015 A$/US$ Forecast	$	0.90	0.95	▼
LT Mongolia 1/3 coking coal price Forecast	$/t	55.00	67.00	▼
2014 Mongolia 1/3 coking coal price Forecast	$/t	60.00	66.00	▼
2015 Mongolia 1/3 coking coal price Forecast	$/t	60.00	62.00	▼
South Gobi	A$m	416	646	▼
Total Valuation	A$m	381	684	▼
12 Month PT	$/sh	$0.50	$0.90	▼
Recommendation		**BUY**	**BUY**	

Source: Capital Resource

INVESTMENT CASE

GUF's recent update on Mongolia sends a clear message to the market that production in Mongolia will take place in December 2013.

Although production has been delayed twelve months from GUF's original plan and budget for commercial production has been higher than expected, we believe the following key points form a compelling investment case:

- A near term coal producer with a large resource base (111Mt) at South Gobi with attractive coking qualities. We estimate this could grow with the potential replication of additional pits including Hovgunn (formely East pit), Central and West pits over time.
- Low operating cost option in Mongolia provides GUF with protection against the current coal price environment with current projections expecting first exports to commence in December 2013, with expected long-term margins of $10-$20/t.
- GUF's South Gobi project is well located in close proximity to the Chinese border crossing at Ceke providing good infrastructure and access to the Chinese markets.
- Strategic partnership with Noble to enable optimal pricing outcome for Asian export markets and a high quality coking product, differentiates GUF from its competitors. We expect this will improve overtime as distribution network in Mongolia is established.
- Potential large scale acreage in Queensland – Longer term GUF's Queensland assets have the potential to utilise the existing rail and port system between Pentland and Townsville.

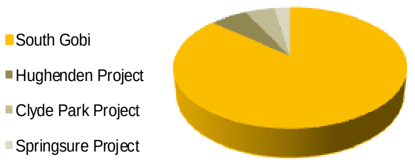
VALUATION

We have revised our valuation of GUF based on the changes in production targets (3Mtpa Vs. 3.6Mtpa previous), commodity pricing and changes in AUD forecasts Vs USD going forward.

We have discounted our FY14, FY15 and long term pricing for potential received coal prices out of Mongolia by -9.1%, -3.2% and -17.9% respectively, while our AUD equivalent prices for the actual change is reflected by +0.1%, +1.02% and -7.5% respectively.

As a result our total sum of parts valuation has lowered to $381m ($0.58/sh) from $684m ($1.07/sh).

Figure 2: Valuation Summary – Base Case Scenario



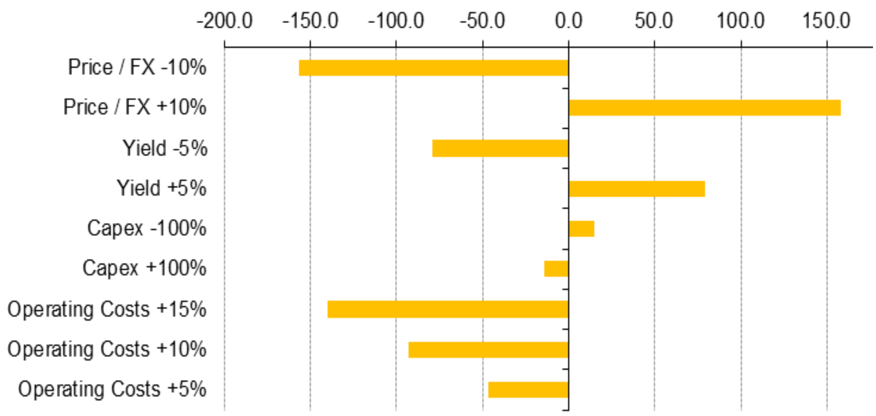
Valuation Summary	A$m	$/share
South Gobi	416	$0.63
Hughenden Project	30	$0.05
Clyde Park Project	23	$0.04
Springsure Project	13	$0.02
Net cash/(debt)	-43	-$0.07
Corporate	-57	-$0.09
Total	**381**	**$0.58**

Source: Capital Resource

SENSITIVITY

The South Gobi project and GUF valuation is sensitive to changes in coal pricing, exchange rates as well as changes in capex and operating costs. We have modeled the South Gobi project based on a base case scenario of 3.0Mtpa over a 10 year period with sensitivities charted below.

Figure 3: Sensitivity – Changes in NPV (A$m)



Source: Capital Resource

Pricing, FX and operating costs appear to have the most significant impact on GUF's earnings and NPV potential. For every 1% change in coal pricing, affects GUF's NPV by approximately $15.5m. Likewise, every 1% increase in operating costs will reduce GUF's NPV by approximately $9.6m.

SOUTH GOBI PROJECT UPDATE

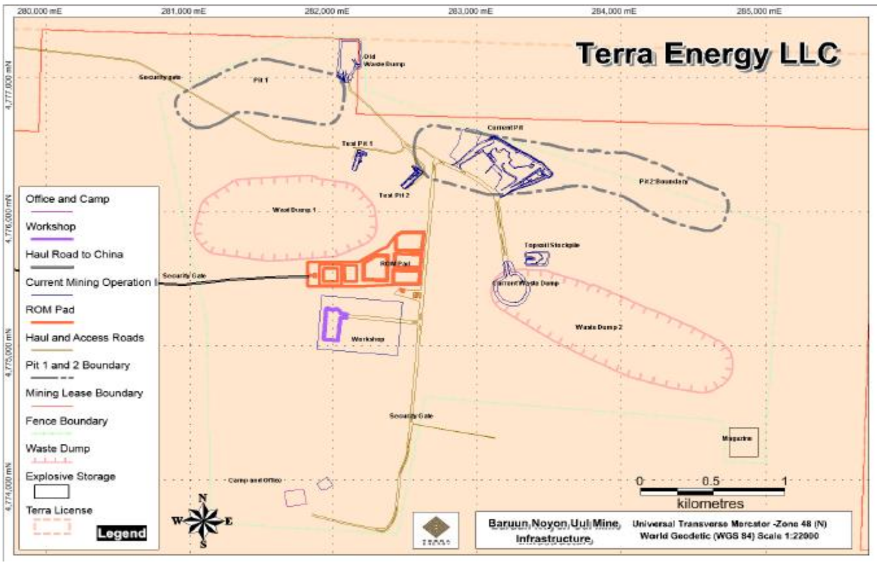
Guildford held an investor site visit in Mongolia this week providing an update on the South Gobi project.

The main outstanding issues to be addressed include the following:

- Government approval for construction of a 98km unsealed haul road,
- Final inspection and mine sign off by Mongolian Authorities; and
- Establish off-take agreements with customers.

Figure 6 below shows the initial mine layout for the BNU mine, including office camps, Haul roads, pit boundaries and waste dumps. The initial open cut excavation is 70% complete and mine infrastructure is being developed for final inspection and sign off. We anticipate this will happen by the end of October in time for first production schedule in December 2013.

Figure 4: BNU Mine Layout (North Pit) - Terra Energy



Source: GUF

Additional Coal testing, across the North pit during the June quarter was completed to validate coal quality and specifications to help determine saleable products from South Gobi. In summary figure 7 highlights coal specifications based on Pit 1,2 & 3 indicating potential for a premium quality coking coal, differentiating GUF from its Mongolian peers.

Figure 5: Coal Quality - Specifications

Spec.	Pit 1 (~2m)	Pit 2 (~4m)	Pit 3 Upper Seam (~2m)	Pit 3 Lower Seam (~1.5m)	Ceke 1/3 coking	Premium Coking
Ash %arb	5-10	10-14	5-9	16-20	10	<10.5
VM %daf	23-29	28-32	28-30	24-26	35-36	<28
Sulfur %arb	0.3-0.5	0.8-0.9	0.5-0.9	0.6-0.9	<1.0	<0.7
G Index	85-95	91-99	93-96	71-80	75	>80
CSN	5.5 - 7.5	3.5-5.5	4.5-5	2-4		

Source: GUF

MINE PRODUCTION SCHEDULE & COAL QUALITY UPDATE

Commercial production is scheduled to commence from 4Q13, with an initial 20kt in December and ramping up to 3Mtpa from 4Q14.

Management has provided initial guidance on production and sales schedule from December 2013 with a FY14 production target of 700kt as shown in figure 8 below.

Figure 6: Sales Schedule, 2014-2015

Month	'000 tonne
Dec 2013	20
Jan 2014	30
Feb 2014	40
Mar 2014	100
Apr 2014	130
May 2014	150
June 2014	150
Q3 2014	575
Q4 2014	725

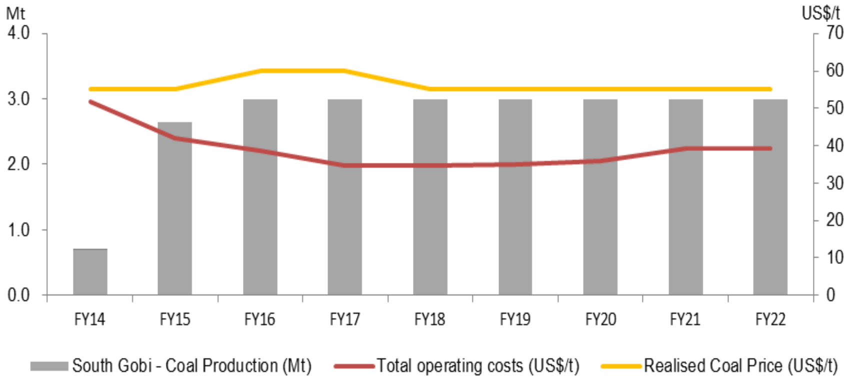
Source: GUF

Our assumptions for mine schedule including Revenue and operating cost assumptions are shown in figure 9 below.

Notwithstanding, approvals and final sign off, we anticipate a conservative margin of $10-15/t as a base case scenario from our financial model starting at 700kt for FY14 and ramping up to 3Mtpa from 2016.

Figure 7: Mine Schedule, Revenue and OPEX assumptions

Production Summary (100% basis)	2014e	2015e	2016e	LT
Production profile (t)	0.7	2.7	3.0	3.0
Operating costs (US$/t)	52	42	39	39



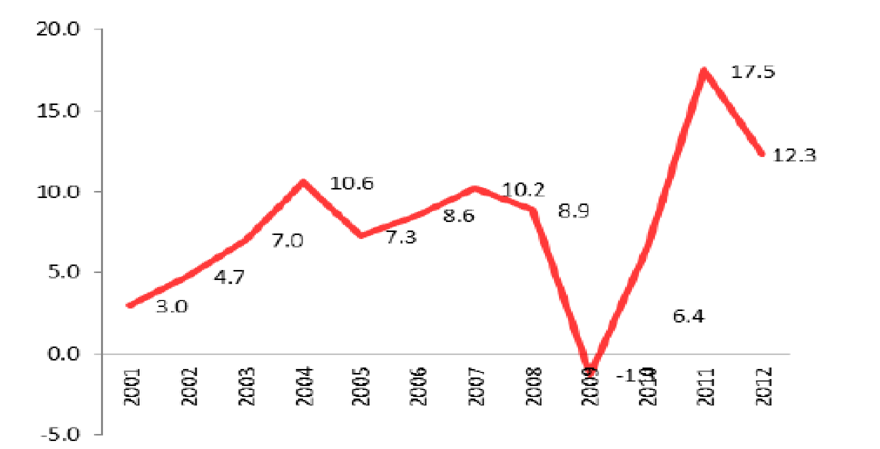
Source: GUF

MONGOLIA OUTLOOK

We expect Mongolia to continue to experience double-digit economic growth in 2013 despite weaker performance from its mineral exports. GDP growth in 2011 was 17.5% while 2012 reduced to 12.3% as shown in figure 2 below.

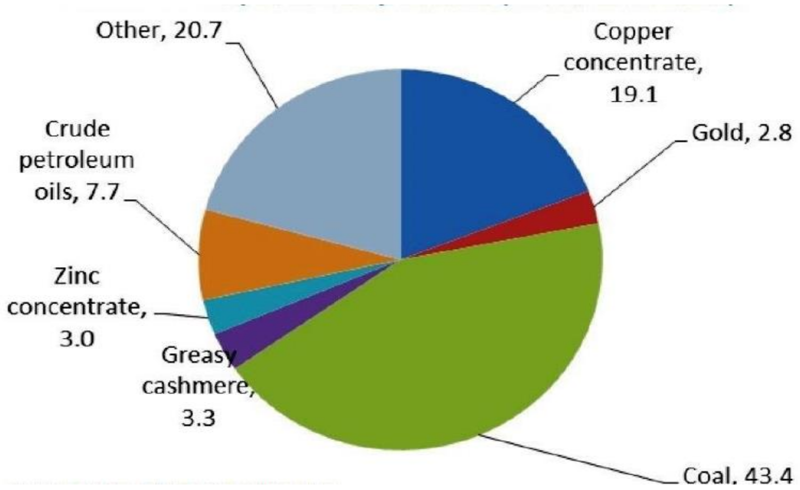
- In 2012, mineral exports (figure 3) accounted for almost 90% of total exports with coal, accounting for 43.4%, followed by copper (19.1%) and crude oil (7.7%). In 2013, we expect copper to take a significant share out of coal as RIO's Oyu Tolgoi project starts contributing to export markets and GDP. At this stage phase 2 underground expansion has been placed on hold, but we expect the Southern Oyu Tolgoi open pit to achieve RIO's production forecasts for FY14 & FY15.
- Coal production in Mongolia in 2012 was 7.7% lower at 28.6Mt from 30.9Mt in 2011 as a result of China's demand for mineral exports weakening. We expect coal exports from Mongolia to be between 25-30Mt for the 2013 year.
- Exports have been pivotal to Mongolia's economic growth in recent years. Mongolia is uniquely placed between Russia and China which gives it a logistical advantage in relation to exports. China made up more than 90% of total exports from Mongolia during 2012.

Figure 8: Real GDP Growth – (annual, %)



Source: Mongolian Authorities, World Bank estimates.

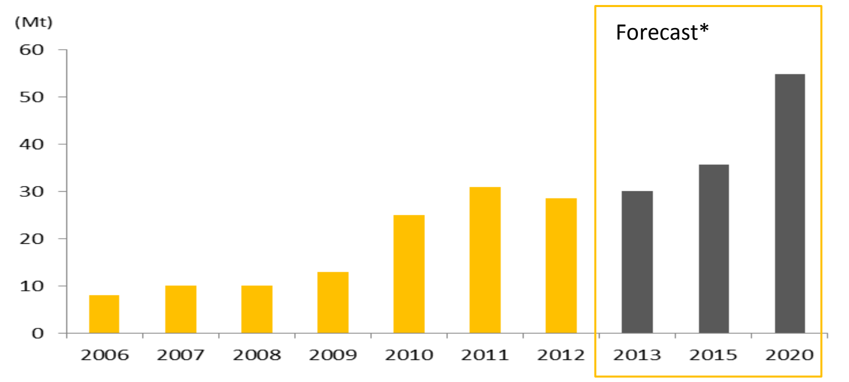
Figure 9: Mongolian Exports – 2012A (percentage terms %)



Source: Mongolian Authorities, World Bank estimates.

Figure 4 highlights actual and expected coal production from Mongolia to 2020. This is based off an annual growth rate of 9%p.a. from 2013 – 2020. We expect GUF to make up between 5-10% of Mongolian coal production during this period based off a base case scenario of 3.6Mtpa from 2015.

Figure 10: Coal Production Mongolia (Mt) – Actual & Forecast



Source: Mongolian Authorities, CR estimates.

Despite stronger GDP growth than most developing countries, Mongolia is experiencing a sharp decline in Foreign Direct Investment (FDI). In 2012, FDI declined by 17% to US$3.8b from $4.6b previously while in early 2013 FDI was approximately 42% lower than over the same period in 2012 according to world bank estimates (figure 4).

Figure 11: Net FDI Monthly Inflows ($USD, m)

Source: Mongolian Authorities, World Bank estimates.

The major contributor to a reduction in FDI in our view is driven by the political uncertainty surrounding strategic ownership issues as well as poor regulation and a failure of the Mongolian government to review the current minerals law.

Regulatory uncertainty started in June 2012 with the suspension of SouthGobi Resources mining licences when China's Chalco bid to buy a majority stake in the coal miner, followed by legislation looking to cap foreign ownership at 49 percent in strategic sectors, including mining (which hasn't occurred) has also contributed to a sharp decline in FDI.

The recent failure of the country's fifth-largest bank Savings Bank, which controlled about 8 percent of Mongolia's banking assets and stricter rules around future project financing for RIO's Oyu Tolgoi project, would in our view undermine government finances over the longer term.

The government has indicated that a review of the current minerals law is underway and a key policy test for president Ts Elbegdorj and the democratic party will be rewriting Mongolia's mining law and finding a solution to reduce political risk.

RISKS

Received Price

We see the longer-term pricing for Hard Coking, Thermal and PCI post 2013 a risk for GUF. Any substantial decline in the prices of coal or changes in industry factors such as supply and demand may affect GUF's projects.

Risks also relevant to received price include Mongolian Mine gate sales at the Ceke boarder, currently priced at 360 Yuan $65/t in July 2013.

Coal quality

Coal test pits in Mongolia, have been in line with or exceeded our expectations on the North pit. Potential Offtake partners site visits are ongoing and Marketing agreement with Noble should help optimise the sale price of coal in Mongolia.

Development and Funding

Future financing will be required by GUF to support potential development plans including road infrastructure. We see the risk for future financing as low in the immediate term.

Asset Acquisitions/Divestments

GUF from time to time may choose to participate or look at asset acquisitions or divestments in Australia or offshore. Any change, acquisition or divestment will be assessed on its merits and may impact on our valuation of GUF.

Exploration/operational

We see this as a risk factor for GUF. No assurance can be given that the company's exploration plans will result in significant minable coal reserves.

Sovereign

The new coalition government was appointed for a second term in June. The democratic party needs to send signals that it is in favour of foreign investors and does not intend to renegotiate key contracts or pass legislation to limit foreign ownership of mineral deposits.

GUF has late last year restructured its Mongolian subsidiary Terra Energy LLC with GUF head stock to align its Mongolian partner's interests with existing shareholders which should be beneficial to GUF over the long term.

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Research Ratings

Buy = return >10%; Hold = return between –10% and 10%; Sell = return <-10%. Spec Buy = return > 20% for stock with very high risk. All other ratings are for stocks with low-to-high risk.

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