RESULT UPDATE

Gujarat NRE Coke

MF Global SM

Private Client Group

MAINTAIN BUY **CMP Rs.33** **TARGET Rs.80**

As expected Gujarat NRE Coke came out with another strong quarter for Q2FY09.

- Net sales increased by 386% to Rs.4,961 mn driven by higher coke prices, which were up by 187% in Q2FY09 and volume growth of 108%. The company produced 165,127 ton of coke up by 108%. Coke business contributed 83.6%, against 60.3% last year to the top line.
- Standalone numbers don't include sales from Australian subsidiary, which grew by 7.4x in Q2FY09 to Aus $53.8 mn. Australian subsidiary mined and dispatched 213,000 ton of coal in Q2FY09 as compared to 127,000 ton last year. It sold coal at average realization of Aus $253 per ton as compared to Aus $58 per ton last year.
- Standalone EBIDTA increased by 739.2% to Rs.1,464 mn in Q2FY09 and by 256% to Rs.2,728 mn in H1FY09.
- EBIDTA margin increased by 1,242bps to 29.5% in Q2FY09 and by 69bps to 31.2% in H1FY09 on account of higher coke price and low price coal inventory. Since the price of raw material i.e. coking coal is fixed for entire year while sells of coke happen in spot, we expect the company to face margin pressure here onwards.
- Depreciation and interest cost increased by 44.7% and 146.6% yoy to Rs.87 mn and Rs.175 mn respectively.
- Net profit grew by 716.8% to Rs.1,028 mn in Q2FY09 and by 255.9% to Rs.1,972 mn in H1FY09. The company reported EPS of Rs.2.2 in Q2FY09 and Rs.4.2 in H1FY09.

Sensex	9,734
Nifty	2,893

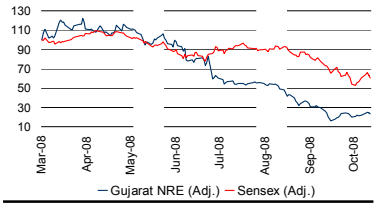
Stock Data

BSE Code	512579
NSE Code	GUJNRECOKE
Bloomberg	GNC@IN
Reuters	GJNC.BO
Shares Issued (mn)	337.1
Market Cap (Rs mn)	10,669
52 Wk H/L (Rs)	181/26
Face Value (Rs)	10
Avg. daily vol. (12-mths)	1,640,746

Absolute Returns (%)

	1 m	3 m	12 m
Absolute	(21.8)	(59.9)	(58.2)
Rel. to Sensex	0.5	(26.6)	(8.7)

Recommended Returns (%)



Coke production and realization

	Q2FY09	Q2FY08	YoY (%)	H1FY09	H1FY08	YoY (%)
Coke Production (ton)	165,127	79,280	108	319,530	202,626	58
Coke Sales (ton)	154,667	63,869	142	353,969	165,966	113
Coke Realization (Rs/ton)	26,250	9,136	187	20,228	10,364	95

Note: Standalone Gujarat NRE

Quarterly performance

Y/E, 31st March (Rs. mn)	Q2FY09	Q2FY08	YoY (%)	H1FY09	H1FY08	YoY (%)
Net sales	4,961	1,021	386.0	8,737	2,510	248.1
Total expenditure	3,497	846	313.2	6,009	1,743	244.7
Operating profit	1,464	174	739.2	2,728	766	256.0
OPM (%)	*29.5*	*17.1*	–	*31.2*	*30.5*	–
Interest	175	71	146.6	272	140	95.0
PBDT	1,289	103	1146.1	2,456	627	292.0
Depreciation	87	60	44.7	162	116	39.9
Other income	27	115	(77.0)	71	150	(52.5)
PBT	1,228	159	674.0	2,365	661	257.9
Tax	201	33	504.8	394	107	267.6
Profit after tax	1,028	126	718.7	1,972	554	256.1
Adjusted PAT	1,028	126	716.8	1,972	554	255.9
NPM (%)	*20.7*	*12.3*	–	*22.6*	*22.1*	–
EPS (Rs.)	2.18	0.37	483.4	4.18	1.64	154.2
Equity	4,719	3,370	40.0	4,719	3,370	40.0

Source: Company, MF Global PCG Research

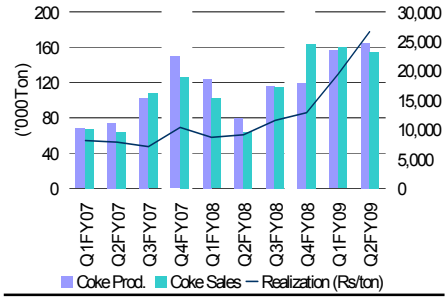
Jignesh Kamani jignesh.kamani@mfglobal.in +91 22 6655 1292

Expansion plans

The company's expansion plans are on schedule. It would commission 248,000 TPA coke plant with capex of $20 mn by Dec'08. The company is in the process of increasing its coke capacity to 2.5 mn ton by Dec'10. It has decided to put up a one mn ton coke oven plant in Andhra Pradesh with an investment of about Rs.4,500 mn, for which necessary land has been acquired and initial work has started. The company's mining operations in Australia are doing extremely well with one mn tons of hard coking coal expected to be shipped to India in the current fiscal. It is also developing its mines in Australia to further increase its production to seven mn ton within the next four years. However, we expect delay in expansion plan beyond 2010 on account of difficulty in financial closure.

The company had installed 12 windmills with capacity of 18MW in Mar'08, 26 windmills with capacity of 39MW in Sep'08 and further 2 windmills with 3MW would be installed by Nov'08. Put together the company would generate 87.5 MW of green power from windmills located in Gujarat. In addition, the company is also in the process of setting up co-generation facilities in all its plants, which will provide the company with 60 MW of free power. These should reduce its power cost and give some comfort to operating margins, which may come under pressure on account of downturn in commodity cycle.

Production and realisation



Concerns

The company is planning to invest Aus $500 mn over next four year to develop the mines, it has already invested close to $180 mn till date, balance would be spent over next three years. The company was planning to finance the capex with $100-125 mn via fresh equity in the books of Gujarat NRE minerals, Australia and rest with internal cash flow and debt. Based on the current market condition raising money through equity route will be difficult and company is exploring opportunity to finance this trench with debt leveraging the parent's balance sheet. We expect delay in expansion plan beyond 2010 on account of difficulty in financial closure.

The steel industry announcing production cuts, we expect pressure on the raw material prices, thus there may be risk of lower coking coal prices and met coke prices. We expect sharp fall in coke price from $300 per ton in 2008, to $150 per ton in 2009 and $130 per ton in 2010 and stabilized at $110 per ton by 2013 approximately.

DVR (Differential Voting Right shares)

In order to increase promoter's voting right above 50%, board has proposed to issue DVR (Differential voting rights) share in ratio of 1 DVR for 450 existing equity shares. Each DVR comprising of 100 votes of normal equity share, these would lead to only 0.2% dilution but it would increase promoter stake above 51%. DVR is priced at Rs.1000 and promoter should infusion of Rs.70-800 mn by subscribing to DVR, however on account of stiff fall in share price, we foresee DVR may be reset at lower price.

Mining schedule

The company is planning to increase production from its NRE no 1 mines from 0.5 mn ton in FY09E to 4 mn ton by 2012. The company has also started mining from its Elouera mines this year itself and gradually increase its production from 0.5 mn ton in FY09E to 2 mn ton by 2013.

	FY09E	FY10E	FY11E	FY12E	FY13E	FY14E	FY35E
NRE no 1	0.5	0.8	1.3	2.5	3.5	4.0	4.0
Elouera Mine + Avondale	0.5	0.8	1	1.5	2	2	2
Coke realization ($/ton)	260	150	130	130	110	110	110

Sensitivity analysis

Coking coal markets have undergone tremendous upheaval in early 2008. Massive flooding in Queensland, the largest exporting region globally lead to 200% rise in coking coal price to $300 per ton, a truly landmark settlement. However, we expect as production in Queensland recovers to normal level and curtailment of production target by metal bourses would lead to sharp fall in coal prices approximately to $150 per ton in 2009 and $130 per ton in 2010 and stabilized at $110 per ton by 2013.

Every $10 decrease in price could hamper mine valuation by 23.8%. On account of turbulence and lack of clarity on coal prices it makes sense to revisiting the sensitivity and its impact on price target.

Sensitivity analysis on varying coal prices

		Value per share							Mine value ($ bn)						
	Coal price ($/ton)	80	90	100	110	120	130	140	80	90	100	110	120	130	140
WACC (%)	12.1	27	50	72	95	117	139	162	0.4	0.7	1.0	1.3	1.6	1.9	2.2
	12.3	27	49	70	92	114	136	158	0.4	0.7	1.0	1.3	1.6	1.9	2.2
	12.5	26	47	69	90	111	133	154	0.4	0.7	1.0	1.2	1.5	1.8	2.1
	12.7	25	46	67	88	109	130	151	0.4	0.6	0.9	1.2	1.5	1.8	2.1
	12.9	25	45	65	86	106	127	147	0.3	0.6	0.9	1.2	1.5	1.8	2.0
	13.1	24	44	64	84	104	124	144	0.3	0.6	0.9	1.2	1.4	1.7	2.0
	13.3	23	43	62	82	101	121	140	0.3	0.6	0.9	1.2	1.4	1.7	1.9

Source: Man Financial PCG Research

Future outlook and valuation

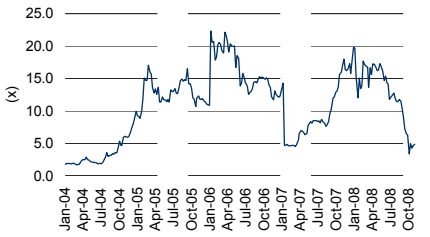
The company reported net profit of Rs.1,972 mn in H1FY09 against our guidance of Rs.3,018 mn for entire year. The company has presold its entire production of FY09E and part production of H1FY10, these should give some comfort to the company. We expect the company to meet our guidance in midst of global turbulence and downturn in commodity cycle. We maintain our guidance FY10E. The stock was hammered a lot in anticipation of downturn in commodity cycle and liquidity constrain from FIIs. We foresee all negatives are already priced in the current price. The company has allotted 134.8 mn equity shares of Rs.10 each as bonus shares in the ratio of 2:5 held by the members of the company.

At price of Rs.33, the stock is trading at 4.9x FY09E EPS of Rs.6.52 and 4.7x FY10E EPS of Rs.6.78. On EV/EBIDTA term, it is trading at 2.9x and 3.1x its FY09E and FY10E on standalone basis. We expect the company to sustain downturn in the industry on account of, captive coal mining supported by captive power plant. Based on 4x FY09E EPS of Rs.6.5 valuation of its Indian operation comes to Rs.26 per share. Based on DCF analysis, valuation of its coal mines comes to Rs.88, which we have further discounted by 40%. We maintain our **BUY** rating with revised price target of Rs.80 (from Rs.155 ex bonus) based on SOTP valuation.

Sum of the parts valuation (Rs/share)

	FY09E
Coal mines	54
Core Business	26
Total	**80**

1-year forward P/E multiple



MF Global

Financials

Income statement (Rs mn)	FY07	FY08	FY09E	FY10E
Net sales	**5,133**	**8,722**	**17,315**	**18,186**
Raw materials	3,383	5,089	11,335	11,614
Employee expenses	150	62	250	254
Other exp	578	1,209	990	1,124
Op profit	**1,022**	**2,363**	**4,739**	**5,195**
OPM (%)	*19.9*	*27.1*	*27.4*	*28.6*
Other income	203	467	260	273
Depreciation	207	234	377	473
Interest	271	329	497	704
PBT	**748**	**2,267**	**4,126**	**4,290**
Tax	190	539	1,050	1,092
PAT	557	1,729	3,075	3,198
Extraordinary item	1	–	–	–
Adj PAT	**557**	**1,729**	**3,075**	**3,198**
NPM (%)	*10.8*	*19.8*	*17.8*	*17.6*

Balance sheet (Rs mn)	FY07	FY08	FY09E	FY10E
Equity capital	**3,415**	**3,370**	**4,719**	**4,719**
Reserves	2,076	7,710	9,975	12,363
Networth	**5,491**	**11,080**	**14,694**	**17,081**
Total debt	7,655	6,327	6,627	9,027
Deferred tax	688	990	1,574	2,181
Total liabilities	**13,834**	**18,397**	**22,894**	**28,289**
Gross fixed assets	4,550	5,976	9,368	10,518
Less: Cum depreciation	436	669	1,046	1,519
Net fixed assets	4,114	5,307	8,322	8,999
Capital WIP	101	892	650	2,500
Investments	6,117	6,572	6,572	6,572
Net current assets	3,381	5,540	7,350	10,218
Total assets	**13,834**	**18,397**	**22,894**	**28,289**

Cash flow (Rs mn)	FY07	FY08	FY09E	FY10E
PBT & extraord. items	755	2,267	4,126	4,290
Add: Int, depn. & oth. exp.	280	137	874	1,178
Cash flow from op.	**1,035**	**2,404**	**4,999**	**5,467**
Net chg in w/c, tax, int.	(1,440)	(1,763)	(3,077)	(3,273)
Net cash flow frm op.	**(404)**	**641**	**1,922**	**2,194**
Capital expenditure	(712)	(2,218)	(3,150)	(3,000)
Sale/ purchase of inv	(1,195)	(311)	–	–
Net cash from inv.	**(1,907)**	**(2,529)**	**(3,150)**	**(3,000)**
Issue of eq/pref sh/warr.	2,566	3,899	1,151	1,696
Dividend paid	(74)	(501)	(810)	(810)
Net cash from financing	**2,492**	**3,398**	**341**	**885**
Net chg in cash	181	1,510	(887)	79
Op. cash bal	482	663	2,173	1,286
Cl. cash bal	663	2,173	1,286	1,365

Ratios	FY07	FY08	FY09E	FY10E
Growth (%)				
Net sales	(7.3)	69.9	98.5	5.0
Adj PAT	(55.0)	210.7	77.9	4.0
Adj EPS	(67.8)	214.8	27.1	4.0
Per Share Data (Rs)				
Adj EPS	1.6	5.1	6.5	6.8
Book value	16.1	32.9	31.1	36.2
DPS	1.1	2.9	1.5	1.5
Valuation (x)				
P/E	19.4	6.2	4.9	4.7
P/BV	2.0	1.0	1.0	0.9
EV/EBIDTA	11.4	3.5	2.9	3.1
Performance (%)				
RoCE	7.0	13.9	22.5	19.9
RoNW	10.5	20.9	23.9	20.1

BUY : > 20% **HOLD : > 5-20%** **SELL : < 5%**

Note: Ratings based on expected returns from current market price (on absolute basis).

MF Global Sify Securities India Pvt. Ltd.,
2ND floor, 'C' Block, Modern Centre, Mahalaxmi, Mumbai-400 011, India.