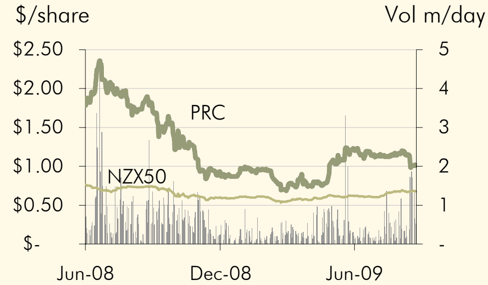
Thursday, 3 September 2009

Recommendation: HOLD



Financial Profile

Share Price	$1.01
12 Mth Price Perf.	-46.8% (NZX50: -8.7%)
Target Price	$1.61 (+59.9%)
Forecast Risk	Above Average
Market Cap	$350.6m
Ords on Issue	352.3m
Free Float	152.1m (43.2% of issued ords)
NZX50 Rank	36
12 Mth Low/High	$0.68 / $1.90
12 Mth Trading	$2.6m (2.3m ords) / wk

Financial Performance & Projections $m

30 June Years	FY08a	FY09a	FY10f	FY11f
Revenue	0.0	0.0	37.4	228.2
EBITDA	-5.8	-9.1	1.4	121.5
EBIT	-5.8	-11.2	-7.7	105.1
NPAT (reported)	-1.2	-13.0	-12.7	77.1
NPAT (norm.)	-1.2	-8.7	-8.6	73.0
Dividends Dec.	0.0	0.0	0.0	-30.7
Investment KPIs				
EPS (norm.)	-0.3c	-3.4c	-3.3c	20.1c
P/E	-	-	-30.6x	5.0x
DPS	0.0c	0.0c	0.0c	8.0c
Net Div. Yld	-	-	-	7.9%
Imputation	-	-	-	100%
Gross Div. Yld	-	-	-	11.3%
EV/EBITDA	-69.7x	-44.8x	n.m.	3.4x
EV/EBIT	-69.7x	-36.3x	-52.9x	3.9x
Growth (%)				
Revenue	-	-	-	509.6
EBITDA	-	-	-	>1000
NPAT norm.	-	-	-	-952.9
EPS	-	-	-	-707.7
DPS	-	-	-	-

Price Performance (%)

Performance	1 Mth	6 Mths	1 Yr	IPO
PRC	-11.4	45.7	-46.8	6.2
NZX50	0.9	27.2	-8.7	-28.8
PRC vs NZX50	-12.3	18.5	-38.1	35.0

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PIKE RIVER COAL (NZX/ASX:PRC)

ANOTHER DELAY, BUT THIS ONE WITH CONSEQUENCES

Key Points

- With its FY09 result announcement, PRC has confirmed another delay to production ramp-up.
- The delay will trigger convertible bondholder rights to renegotiate terms, exposing PRC holders to potential dilution risk. Delay-led funding pressure appears manageable.
- Coking coal macro drivers continue to strengthen, but until PRC's micro uncertainties are resolved and forward production rates are clarified, our recommendation moves to HOLD.

Announcements

PRC has released its full-year FY09 result and in a separate announcement confirmed a further delay to achieving full production rates. Key aspects of the announcements:

- Full-year post-tax loss of $13.0m, due largely to a $6.2m unrealised forex charge related to PRC's convertible bond facility, $3.5m of interest paid on the facility and $2.1m depreciation.
- A further delay to achieving full production rates while pit bottom development is completed and development roadways excavated. PRC now plans for its first 60,000 tonne export shipment to be sent during the January-March 2010 quarter (previously mid-November 2009). First coal from hydro mining is now expected in the April-June 2010 quarter (also previously November). The latest delay therefore effectively extends the ramp-up to full production by a further 3 to 6 months.
- As a result of the delay, PRC will not meet a condition of its convertible bond facility with Liberty Harbor to demonstrate a production capability of 800ktpa by 30 November 2009. PRC has advised of its intention to seek a six month extension of the condition from Liberty Harbor.

In the context of PRC's investment proposition, the FY09 result announcement is of very little importance. Of far greater significance is the second announcement confirming another delay to production ramp-up. In addition to geology (discussed separately below), PRC identifies three main factors as contributing to the latest delay:

1. Unanticipated downtime of its three coal cutting machines over the past month while repairs and modifications have been carried out, resulting in planned advance rates not being achieved.

We understand the main problem relates to substandard fabrication of machine track systems, work which was outsourced by the machine's German manufacturers to a new supplier. Although the manufacturer has since admitted liability and cost, the need for remedial work has delayed PRC's advance.

2. Needing to install more roof support (rockbolting) than planned along excavated roadways in pit bottom to manage geology that has been more fractured than expected.
3. Training of new staff taking longer than planned, partly because of unavailability of machinery.

Geology

In addition to these largely manageable factors, geological conditions encountered since moving beyond the Hawera fault have been more complex than mapped in the mine plan.

One of the mine's first coal roadways, which surface drilling had implied should contain a contiguous 8-10m thick coal seam over a length of at least 180m (the distance between two adjacent holes drilled from the surface which had indicated the same subsurface coal depth measurements) has instead delivered a mixed coal+stone drive. After intercepting the seam as expected (the initial driveage struck around 100m of continuous coal), the drive unexpectedly re-entered solid stone. In-seam drilling revealed a fault from which the seam between the two drill holes had dropped 20m from the corridor that surface drilling had mapped.

While PRC's initial assessment is that the feature is likely a graben (a block of land that has fallen between two faults, thereby spreading the seam across multiple depths), it is representative of the West Coast's fundamentally complex geology. Structures should simplify as drilling moves further away from the Hawera fault (just 80m to the East), but until conditions do improve, geology will remain a risk to achieving full production rates over the next 6-12 months.

INVESTMENT VIEW

The delay brings with it two layers of potential implication for PRC holders. Firstly, non-performance against the 30 November 800ktpa milestone obligates PRC to renegotiate terms with Liberty Harbor. Although PRC has reported initial discussions with Liberty Harbor as "favourable", the terms of any clawback that Liberty Harbor may seek to ensure its continued support are as yet unknown.

Countering this, PRC is now an operating coal mine, and as such can point Liberty Harbor to cash flow in waiting, which will strengthen its negotiating position.

Secondly, the deferral in dispatch of first coal and, therefore, receipt of first revenue, may bring pressure to PRC's FY10 cash position. Although any need for further funding is likely to be modest, this will ultimately depend on the actual delay incurred before production fully ramps up. PRC may have some ability to bring cash forward by loading a smaller (~30kt) consignment for its first shipment. PRC has around 10kt of produced coal already sitting at the coal preparation plant.

Funding

At 30 June, PRC had $21.7m cash on hand. PRC also has available to it two separate BNZ debt facilities, totalling $26m, both of which remain undrawn. Although there remain conditions precedent to be met before PRC is able to draw on the smaller ($10m) of the two BNZ tranches, we understand that satisfying these conditions should not be an issue.

$20m of PRC's capital development cost remains to be spent during FY10, which approximates PRC's cash on hand at balance date. This effectively means that the BNZ facilities can be utilised entirely to fund operating costs until PRC becomes cash-generating. With operational cash burn of around $3m/month, available facilities should be sufficient to see PRC through the Jan-Mar quarter 2010 when it expects to receive its first operational cash. At current-year contract pricing and forex, a single 60kt load of PRC coal would be worth more than $11m to PRC. When at full production, a ship will leave approximately every three weeks.

We do not rule out the possibility of PRC securing a more structured term debt facility in the lead-up to full production. We also note that the renegotiated terms of the Liberty Harbor facility afford PRC the right to repay the bonds in full providing PRC's share price does not exceed the NZ$ equivalent of US$0.70 (currently NZ$1.04) by 30 September 2009. In the following year to 30 September 2010 the redemption threshold moves to US$0.75 and for the final period to maturity on 11 March 2011 the threshold moves to US$0.80/share.

Clearly PRC's ability to invoke redemption would hinge on it being able to secure alternative funding, but with the option currently in the money, PRC has reason to at least consider alternatives to pay-down all or part of Liberty Harbor.

Under terms renegotiated after the rockfall, conversion at maturity in March 2011 of Liberty Harbor bonds to ords would be at the equivalent of NZ$1.08/share (NZ$1.17/share before renegotiation). Also with the renegotiation, the interest rate on the facility increased from 6.75% pa to 10.75% pa. Grounds for PRC considering options to redeem the facility therefore present as conceptually strong.

Global coking coal fundamentals continue to strengthen

Countering the obvious disappointment in PRC's latest announcement is the continued strengthening in global coking coal sector fundamentals. Steel metrics have rebounded strongly over the past couple of months, driven primarily by strength in Chinese steel markets. Spot prices are currently reported to exceed US$160/t, more than 25% above the US$128/t benchmark agreed in April.

VALUATION

We have assumed the three month delay to reduce our estimate for PRC's current-year production by 300kt, therefore lowering assumed FY10 production to 250kt. Other than the deferred 300kt, we have left our forward (post-FY10) production profiles unchanged.

For now we have also left our forward coal pricing curves unchanged, but consider that pressure to our assumed path (US$140/t in each of JFY10 and JFY11, US$125/t thereafter) to be building strongly to the upside. We have also added $5/t to mining opex.

We have not yet assumed any change to Liberty Harbor terms, the key aspect being the issuing of 31.6m ords on Liberty Harbor's conversion of its remaining 550 bonds (50 were converted in July 2008).

Lower FY09 production, higher opex and the rolling-forward of our modelling combines to reduce our DCF valuation to $1.61/share (previously $1.85/share).

RECOMMENDATION

Through the numerous delays PRC and its shareholders have endured over the more than two years since its IPO, we have maintained the same basic position: if and when PRC can demonstrate itself as a 1mtpa producer of hard coking coal, the company will be materially and in our view rapidly re-rated from its current level.

That view has not changed. However, with early mining conditions proving more difficult than anticipated, and with Liberty Harbor discussions yet to be completed, our current view is that PRC holders have an opportunity to pause and await developments on both fronts.

Until these uncertainties are resolved, our PRC recommendation moves from BUY to HOLD.

To clarify, we do not recommend that PRC holders reduce their positions, simply that they hold for the next few weeks while mine geology becomes clearer and discussions with Liberty Harbor are finalised. Some holders may be tempted to take profits available on the March 2009 rights, on which at current share price holders would already realise a handsome 70% return. While understandable, we recommend taking a longer-term view. We remain very upbeat about PRC's long-term operating model, and with a 19 year mine life ahead, the successful resolution of these early-life setbacks should return long-term value to holders. The presence of a separate coal seam below the primary Brunner seam also presents further potential upside.

Assuming no unpleasant surprises and that PRC can therefore progressively work its way towards a 1mtpa production capability over the next few months, substantial PRC upside should follow, with ample opportunity for holders to top up along the way at what would remain favourable entry prices. We will be watching closely and will be likely to move quickly to upgrade our view once one or both of the current uncertainties are put to rest.

PRC Valuation Summary

$m

PRC 30 June Years	2008a	2009a	2010f	2011f	2012f
PROFIT & LOSS					
Revenue	-	-	37.4	228.2	298.4
OpEx	5.8	9.1	36.0	106.7	143.0
EBITDA	(5.8)	(9.1)	1.4	121.5	155.4
Dep'n & Amort.	-	2.1	9.1	16.5	19.5
EBIT	(5.8)	(11.2)	(7.7)	105.1	135.8
Net Interest	2.6	0.6	(4.5)	(0.8)	7.2
Unrealised Forex Losses (Gains)	-	6.2	5.9	(5.9)	-
EBT	(3.3)	(16.8)	(18.1)	110.1	143.1
Tax	(2.1)	(3.8)	(5.4)	33.0	42.9
Reported NPAT	(1.2)	(13.0)	(12.7)	77.1	100.2
Adjusted NPAT	(1.2)	(8.7)	(8.6)	73.0	100.2
CASH FLOW					
Operating Cash Flow	(6.1)	(6.2)	(21.7)	89.3	109.8
Debt Servicing	3.5	(0.9)	(4.5)	(0.8)	7.2
CapEx	(99.4)	(79.8)	(20.0)	(1.6)	(1.6)
Other Investing Activities	(0.2)	-	-	-	-
Equity Raisings (incl Conv. Bond)	177.5	43.4	-	-	-
Debt Draw (Repayment)	(18.5)	1.3	-	-	-
Other Financing Activities	(0.3)	-	-	-	-
Dividends	-	-	-	(30.7)	(73.1)
Net Cash Movement	56.5	(42.2)	(46.2)	56.2	42.4
BALANCE SHEET					
Cash & Equivalents	63.9	21.7	(24.5)	31.7	74.1
Inventories	0.1	2.4	17.3	12.2	12.1
Other Current Assets	2.4	1.7	3.1	18.6	24.4
Fixed Assets	191.4	271.2	282.1	267.2	249.3
Other Assets	7.2	9.4	14.9	9.4	9.4
Total Assets	265.0	306.4	292.8	339.1	369.2
Bank, Current & Other Liab.	9.4	11.4	4.6	10.4	13.4
Convertible Bonds	37.8		48.0	3.5	3.5
Total Liabilities	47.2	11.4	52.6	13.9	16.9
Share Capital	218.0	266.1	266.1	304.7	304.7
Retained Earnings, ARR	(0.2)	(13.2)	(25.9)	20.5	47.6
Total Shareholders' Funds	217.9	252.9	240.2	325.2	352.3
Total Liabilities & SHF	265.0	264.3	292.8	339.1	369.2
KPI Metrics					
EPS, diluted (cps)	(0.3)	(3.4)	(3.3)	20.1	26.1
DPS (cps)	-	-	-	8.0	19.0
Net Yield @ current	-	-	-	7.9%	18.8%
Net Yield @ target	-	-	-	5.0%	11.8%
DPS/EPS	-	-	-	39.8%	72.8%
EBITDA/Sales	-	-	3.7%	53.3%	52.1%
EBIT/Sales	-	-	-20.6%	46.0%	45.5%
ROE	-0.2%	-1.4%	-1.3%	6.8%	7.4%
ROA	-0.8%	-1.0%	-0.6%	8.3%	9.6%
EV/EBITDA	-	-	290.4x	3.4x	2.6x
EV/EBIT	-	-	-52.9x	3.9x	3.0x
P/E	-	-	-30.6x	5.0x	3.9x
Key Operational Value Drivers					
Production (ktpa)	-	-	250	968	1,262
Sales Coal (ktpa)	-	-	175	968	1,262
NZ$/US$	-	-	0.625	0.625	0.625
PRC Prem. HCC JFY (US$/t, RT)	-	-	140	140	125
Mining & Capital Costs (NZ$/t, R	-	-	55	55	55
Transport Costs (NZ$/t, RT)	-	-	41	41	41
Other OpEx (NZ$/t, RT)	-	-	3	3	3

VALUATION	$m
Equity Value + Net Debt/Cash	619.9
Capital	**m**
Ords @ IPO	200.0
Rights Issues: Jan-08 & Mar-09	131.0
Convertible Notes: Converted	12.3
Convertible Bonds: Converted	2.7
Convertible Bonds: Unconverted	31.6
ESOP & Other	6.4
Fully diluted capital base (excl options)	383.9
Fully diluted $/share	$ 1.61

SENSITIVITIES

LT HCC	LT USD/NZD →				
US$/t ↓	0.575	0.600	0.625	0.650	0.675
$ 145	2.28	2.15	2.03	1.92	1.82
$ 135	2.05	1.93	1.82	1.72	1.62
$ 125	1.83	1.72	1.61	1.52	1.43
$ 115	1.60	1.50	1.41	1.32	1.24
$ 105	1.38	1.29	1.20	1.12	1.05

LT HCC	WACC →				
US$/t ↓	10.5%	11.0%	11.2%	11.5%	12.0%
$ 145	2.14	2.06	2.03	1.99	1.92
$ 135	1.92	1.85	1.82	1.78	1.72
$ 125	1.70	1.64	1.61	1.58	1.53
$ 115	1.48	1.43	1.41	1.38	1.33
$ 105	1.26	1.22	1.20	1.18	1.14

LT HCC	Mining Costs NZ$/t →				
US$/t ↓	$ 50.0	$ 52.5	$ 55.0	$ 57.5	$ 60.0
$ 145	2.11	2.07	2.03	1.99	1.95
$ 135	1.90	1.86	1.82	1.78	1.74
$ 125	1.70	1.66	1.61	1.57	1.53
$ 115	1.49	1.45	1.41	1.37	1.33
$ 105	1.28	1.24	1.20	1.16	1.12