# Caledon Resources plc

CDN : AIM : £0.29

**BUY**

**Target: £0.60**

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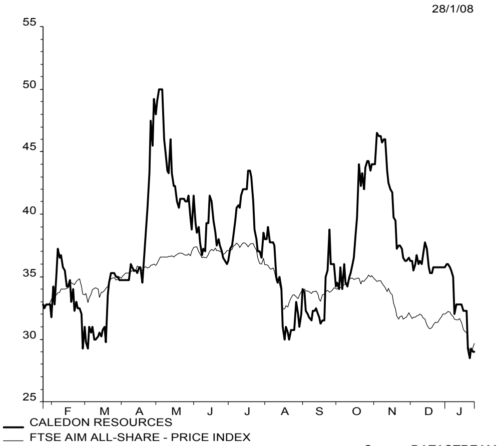
**COMPANY STATISTICS:**

| | |
|---|---|
| 52-week range: | £0.50-£0.27 |
| Shares o/s (basic): | 170.6M |
| Daily trading volume: | 1.1M |
| Market capitalisation: | £50M |

**EARNINGS SUMMARY:**

| FYE Dec | | 2007E | 2008E | 2009E |
|---|---|---|---|---|
| Coal sales | kT | 53 | 1,016 | 1,199 |
| Average coal price | US$/t | 80 | 110 | 107 |
| Average cash cost | US$/t | 92 | 67 | 63 |
| CFPS | £/shr | -0.07 | 0.04 | 0.10 |
| EPS | £/shr | -0.07 | 0.03 | 0.07 |

**SHARE PRICE PERFORMANCE:**




Source: DATASTREAM

**COMPANY SUMMARY:**

Caledon Resources is an AIM listed mining company that owns 100% of the Cook Coking Coal Mine and some associated infrastructure in Queensland's Bowen Basin. It also has an option to purchase the adjacent Minyango Coal Exploration License. Production has re-commenced at Cook, and the company plans to deliver sales of 1.2Mtpa in 2008.

All amounts in £ unless otherwise noted.
Share price data COB 29 January 2008.

**Metals and Mining -- Base Metals and Minerals**

## CONTINUOUS MINING AND HAULAGE SYSTEM OPERATIONAL

### Event

It was announced on 30 January 2008 that the Magatar integrated continuous mining and haulage system had commenced production. This is in line with guidance given in early December 2007. We have also updated our model for our revised coal price forecasts.

### Impact

Positive. This announcement marks the commencement of operations with the new system that the company has been working towards for over a year. Increases in our coking coal price forecasts have led to an increase in our valuation, although the impact of this was offset by the announcement that access to rail would be limited to 1.1-1.2Mt in 2008.

### Action

We reinforce our BUY recommendation and maintain our target price of £0.60 per share.

### Valuation

Our valuation is based on a risked sum-of-the-parts NAV estimate of Caledon's assets, assuming an 8% discount rate and a long-term realised coking coal price of US$80/tonne.

### Next catalyst

The expected conclusion of coking coal price negotiations during Q1 and the successful ramp up of the Magatar system at Cook to the planned 100kt per month production, within the first quarter of 2008.

### Investment risks

Our valuation is highly sensitive to assumptions of future coal prices and sales volumes. We also note the risks associated with implementing the new continuous miner-haulage system in-line with the targeted production level and cost structure.

### Cook Mine - Magatar system operating

Since the first coal was cut by the new custom-built Voest Alpine ABM25 continuous bolter-miner on 30 November 2007, the company has been commissioning the Prairie continuous haulage system. The process of taking this equipment underground was completed in the second half of January and, after a period of inspection by the mine's department, the machine was attached to the continuous miner and cut its first coal as an integrated unit by the end of January.

This marks the culmination of over a year's work to introduce the new system (jointly referred to as the Magatar system), a first for the Australian coking coal industry although similar systems are employed in South Africa. In common with other development projects in the industry the project has been frustrated by delays, much of which is attributed to the late delivery of equipment from the suppliers.

### Port and rail – limited to 1.1-1.2Mt for 2008 and constraining sales until 2012

We note that port and particularly rail capacity serving Queensland's coking coal production continues to face capacity constraints. The announcement notes that as a result of rail users having their allocations reduced by the rail authorities, the 1.5Mt allocation for 2008 that was negotiated with Xstrata at the time of the project's acquisition in late 2006 has been cut back to 1.1-1.2Mt, thereby constraining sales to this level, compared to our previous sales forecast of 1.5mt in 2008 and 1.8Mt in 2009.

Against this backdrop, the company continues to discuss securing port and rail capacity for 2009 and beyond with Xstrata and third parties. The company remains confident of a settlement that would provide access for the bulk of its product. We have assumed sales of 1.2Mt are made in years 2008 – 2011, then increase to 1.5Mt in 2012 and 1.66Mt from 2013.

### Coal price forecasts

As published in *Canaccord Adams' quarterly commodity price review* on 14 January 2008, we tabulate our revised forecasts for coking and thermal coal in Figure 1.

**Figure 1: Comparison of coking coal price forecasts**

| FYE Dec | | 2007E | 2008E | 2009E | 2010E | 2011E | 2012E | LT |
|---|---|---|---|---|---|---|---|---|
| Old coking coal | US$/t | 100 | 118 | 115 | 104 | 93 | 85 | 84 |
| New coking coal | US$/t | 100 | 125 | 124 | 112 | 101 | 89 | 86 |
| Change | % | +0% | +6% | +8% | +8% | +9% | +5% | +2% |
| | | | | | | | | |
| Old thermal coal | US$/t | 62 | 63 | 63 | 58 | 58 | 58 | 58 |
| New thermal coal | US$/t | 66 | 88 | 80 | 70 | 60 | 60 | 60 |
| Change | % | +6% | +40% | +27% | +21% | +3% | +3% | +3% |

Source: Canaccord Adams estimates

We note that our forecast for 2008 includes a price of US$134/t as a settlement price for the benchmark hard premium grade Goonyella coking coal by the end of the first quarter. This is reflected in our forecasts for the contract year, from March this year to April of next year.

We consider a settlement at a higher level than this to be likely. Not only has the market remained extremely tight, but the recent severe flooding in Queensland has led to force majeure being declared by some open pit producers. As a producer from underground, Cook has not been affected by the flooding. We note speculation in the press that miners are seeking settlement for the April 2008 to March 2009 year of anything from US$150-200/tonne of premium hard coking coal.

We expect that Cook coking coal will receive a discount to the top quality coking coal reference price for Goonyella hard premium coal (as quotes above) of between 5-10%, depending on market conditions. We also note that Cook is expected to produce approximately 80% coking coal and 20% thermal coal.

### Production outlook

We have adjusted the production profile of our model to reflect the constrained coal shipments of 1.2Mt for 2008-2011 and an increase to steady state shipments of 1.7Mt from 2013 onwards. We have also assumed a two-month lag from shipments made to recognition of sales.

Current plans are for the Magatar system to produce run or mine coal at a rate of 100kt per month, with the balance of targeted production from a conventional continuous miner/shuttle car set up. We note that the company has operated a number of older machines over the past year in this conventional set up although reliability issues have resulted in production falling significantly short of planned levels. However, another of the company's conventional continuous miner/shuttle car setups has been refurbished and is expected to be commissioned over the next few weeks and another machine is to be introduced from February, which the company believes will provide the targeted capacity.

**Figure 2: Production forecast summary**

| FYE Dec | | 2007E | 2008E | 2009E | 2010E | 2011E | 2012E |
|---|---|---|---|---|---|---|---|
| Total coal produced | kT | 90 | 1,199 | 1,199 | 1,199 | 1,199 | 1,500 |
| Coking coal sales | kT | 40 | 833 | 983 | 984 | 984 | 1,189 |
| Thermal coal sales | kT | 13 | 183 | 216 | 216 | 216 | 261 |
| Total coal sales | kT | 53 | 1,016 | 1,199 | 1,199 | 1,199 | 1,450 |
| Goonyella reference price | US$/t | 100 | 125 | 124 | 112 | 101 | 89 |
| Cook Coking coal price | US$/t | 87 | 115 | 113 | 101 | 91 | 83 |
| Thermal coal price | US$/t | 68 | 87 | 80 | 70 | 60 | 60 |
| **Average coal price** | **US$/t** | **80** | **110** | **107** | **95** | **85** | **79** |
| **Avg total cash cost** | **US$/t** | **-92** | **-67** | **-63** | **-61** | **-58** | **-58** |
| **Average margin** | **US$/t** | **-12** | **43** | **44** | **34** | **27** | **21** |
| Exchange rate | US$/A$ | 0.84 | 0.88 | 0.85 | 0.83 | 0.80 | 0.80 |

Source: Canaccord Adams estimates

Long-term assumptions include run-of-mine production of 1.8Mtpa, an overall yield to product of 92% at steady state and a coking/thermal coal product split of 80/20. The operation would produce 1.4Mtpa coking coal and 0.3Mtpa of thermal coal. Our forecasts show total cash operating costs of US$67/t in 2008, falling to US$63/t in 2009 and US$58/t from 2011.

### Finances

Delays to commissioning the Magatar system have resulted in an increase in working capital and the below forecast production from the conventional mining machinery has placed additional pressure on cash resources.

We have assumed that Caledon's cash at the end of 2007 was approximately £10 million, or A$22 million. We note that, following the conversion of an outstanding convertible in November, the company's debt comprises £27.5 million of 8.5% convertibles outstanding that are due in 2010 and are convertible at £0.50 per share. We also note that the final payment of A$15 million (£6.7 million) for the purchase of the Minyango coal property is due at the end of March 2008.

We expect that the company will seek to defer part or all of the Minyango payment, which we estimate would otherwise put cash resources under pressure at the end of the first quarter after accounting for the ongoing costs of the operation, limited production and our assumption that revenues are received around two months after the coal is produced.

**Figure 3: Financial forecast summary**

| FYE Dec | | 2007E | 2008E | 2009E | 2010E | 2011E | 2012E |
|---|---|---|---|---|---|---|---|
| Revenue | US$M | 4 | 112 | 128 | 114 | 102 | 114 |
| Costs | US$M | -8 | -81 | -76 | -73 | -70 | -87 |
| Corp G&A | US$M | -13 | -8 | -4 | -4 | -4 | -4 |
| **EBITDA** | **US$M** | **-17** | **23** | **48** | **37** | **28** | **23** |
| DD&A | US$M | -1 | -2 | -2 | -2 | -2 | -3 |
| **EBIT** | **US$M** | **-17** | **21** | **46** | **35** | **26** | **20** |
| Interest | US$M | -3 | -5 | -5 | -2 | 0 | 0 |
| Tax | US$M | 0 | -5 | -12 | -10 | -8 | -6 |
| **Earnings** | **US$M** | **-20** | **11** | **29** | **23** | **18** | **14** |
| | | | | | | | |
| **Cash Flow** | | | | | | | |
| Operating cash flow | US$M | -22 | 14 | 39 | 33 | 26 | 15 |
| Invested cash flow | US$M | -35 | -20 | -3 | 0 | 0 | 0 |
| Cash flow from financing activities | US$M | 55 | 18 | 0 | -55 | 0 | 0 |
| **Net cash flow** | **US$M** | **-2** | **12** | **36** | **-22** | **26** | **15** |
| **Cash balance** | **US$M** | **20** | **32** | **68** | **46** | **72** | **86** |
| | | | | | | | |
| Avg shares in issue | M | 153 | 192 | 199 | 199 | 199 | 199 |
| **CFPS** | US$/shr | -0.142 | 0.071 | 0.196 | 0.164 | 0.132 | 0.075 |
| | £/shr | -0.071 | 0.036 | 0.098 | 0.083 | 0.066 | 0.038 |
| **EPS** | US$/shr | -0.132 | 0.055 | 0.145 | 0.115 | 0.091 | 0.071 |
| | £/shr | -0.066 | 0.028 | 0.073 | 0.058 | 0.046 | 0.036 |

Source: Canaccord Adams estimates

### Valuation

We continue to value Caledon on the basis of a risked sum-of-the-parts NAV of the company's assets, including the NPV of Cook assuming an 8% discount rate and long-term realised coking and thermal coal prices of US$80/t and US$60/t (previously US$78/t and US$58/t respectively). To account for the risks associated with the Magatar system achieving the targeted production levels and cost structure, we continue to apply a discount of 20% to our NPV estimate of that portion of our assumed 21-year mine life that is covered by current reserves. In recognition of the additional risks that we believe are associated with resource conversion, we also continue to apply a discount of 30% to our NPV of the remaining years of the modeled mine life.

We have adjusted our estimate of the company's cash and debt to reflect our estimate of its 2007 year-end position. The value of in-situ coal resources at Minyango is highly dependent on the split between coking and thermal coal, and on the potential economic scope of developing the resources. As no information has yet been provided regarding either of these issues, we continue to include Minyango in our valuation at cost.

**Figure 4: Valuation summary**

| 8% discount rate | Full value A$M | Full value US$M | Risk | Risked Valuation |
|---|---|---|---|---|
| Cook (yrs 2008-19) | 249 | 221 | 20% | 176 |
| Cook (yrs 2020-28) | 74 | 66 | 30% | 46 |
| Minyango | 25 | 22 | 0% | 22 |
| **Enterprise Value** | **347** | **308** | | **244** |
| Cash (FD in the money) | | 21 | | 21 |
| Debt | | -55 | | -55 |
| **Net Asset Value** | | **274** | | **210** |
| Fully diluted in the money shares | | **174** | | |
| US$ per share | | 1.57 | | 1.21 |
| **£ per share** | | **0.79** | | **0.61** |

Source: Canaccord Adams estimates

As a result of the revisions, our estimate of Caledon's unrisked NAV has increased marginally from £0.78 to £0.79 per share and our risked NAV remains unchanged at £0.61 per share. We note that this represents 6 times our forecast 2009 operating cash flow, or 8 times our forecast 2009 earnings. As a result, we maintain our target price of £0.60 per share, which is equivalent to a multiple of 0.77 times our unrisked NAV.

Given the potential for a contract coking coal price settlement higher than the US$134/t that we have forecast for Goonyella, we note that if we assumed a settlement price of US$175/t for Goonyella premium hard coking coal for a single year from April 2008 to March 2009, our NAV would increase to £0.85 per share and our risked NAV to £0.66 per share.

### Conclusions

The commencement of production using the new Magatar continuous integrated mining and haulage system represents a significant milestone in the redevelopment of the Cook coking coal mine. Although the late delivery of equipment to site has largely been responsible for the delay in reaching this point, the task is now to ramp up production from the new machinery to the planned 1.2Mtpa rate of production, which we anticipate should be achievable within the first quarter of this year.

Given the very positive background to the current coking coal price negotiations that are underway, from a market perspective, the timing of the commencement of operations could hardly be better. We note that, although we expect cash to become tight towards the end of the first quarter, the deferral of the Minyango property payment would help that situation and we consider that the market should be increasingly supportive of the stock, given the tightness of the coking coal market and the re-emergence of Cook as a significant producer of coking coal.

Although the port and rail situation is likely to constrain shipments from the mine for the next few years, we note that it is also likely to support higher coking coal prices whilst the situation exists. With respect to allocations for this year and beyond, we note the considerable uncertainty surrounding the timing of rail upgrades and the additions to port capacity. We also note that the recent flooding in Queensland has affected a number of open pit coal mines and that these may take some time to build back to full capacity. This could lead to additional capacity becoming available and would provide further upside to the company.

We continue to recommend Caledon as a BUY and maintain our target price at £0.60 per share.

**Investment risks**

The following risks are associated with the share price achieving our target price and financial forecasts. Metal prices may not match our forecasts; as with any mining company, there are operating risks involved in both underground and open pit mining operations; foreign currency exchange rate fluctuations will impact both the company's operating costs and its revenues. There are also numerous technical and environmental risks associated with the operation of a mining company that could have an impact on both our valuation of the company and our financial estimates.

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**Site Visit:** An analyst has visited the issuer's Cook Coal Mine in Queensland, Australia. Partial payment was received from the issuer for the related travel costs.

**Price Chart:***


| | Date | Analyst | Rating | Target Price |
|---|---|---|---|---|
| 1) | 01/27/05 | JT | Speculative Buy | N/A |
| 2) | 12/12/06 | JT | Buy | 12.00 |
| 3) | 03/22/07 | JT | Buy | 60.00 |

* Price charts assume event 1 indicates initiation of coverage or the beginning of the measurement period.

**Distribution of Ratings:**
Global Stock Ratings
(as of 2 January 2008)

| | Coverage Universe | | IB Clients |
|---|---|---|---|
| Rating | # | % | % |
| Buy | 294 | 61.8% | 43.9% |
| Speculative Buy | 57 | 12.0% | 70.2% |
| Hold | 112 | 23.5% | 33.0% |
| Sell | 13 | 2.7% | 0.0% |
| | 476 | 100.0% | |

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| Company | Disclosure |
|---|---|
| Caledon Resources plc | 1A, 2, 4, 5, 7 |

| | |
|---|---|
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