Caledon Resources plc

CDN : AIM : £0.56

BUY

Target: £0.85 ↑

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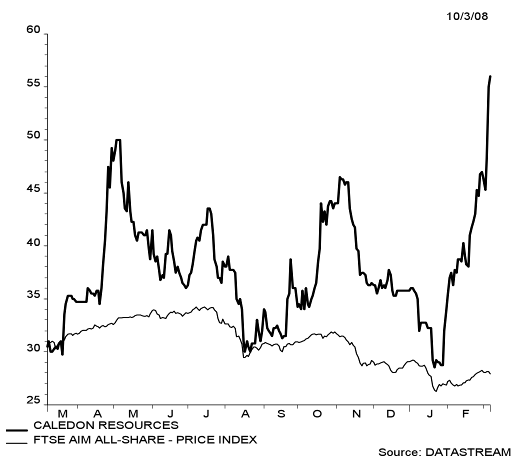
COMPANY STATISTICS:

52-week Range:	£0.27-0.56
Shares Out basic (M):	170.6
Market Cap (M):	£67

EARNINGS SUMMARY:

Year ending Dec		2007E	2008E	2009E
Coal sales	kT	53	1,100	1,100
Average coal price	US$/t	81	200	166
Average cash cost	US$/t	92	94	79
CFPS	£/shr	-0.07	0.24	0.14
EPS	£/shr	-0.07	0.18	0.14

SHARE PRICE PERFORMANCE:



COMPANY SUMMARY:
Caledon Resources is an AIM listed mining company that owns 100% of the Cook Coking Coal Mine and rights to 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 using an innovative continuous mining system. Sales are planned to be 1.1Mt in 2008.

All amounts in £ unless otherwise noted.
Share price data as at close 7 March 2008.

Metals and Mining -- Base Metals and Minerals

VALUATION UPDATE

Event

We update our valuation for revised coal price forecasts. We also adjust our valuation for guidance on production and costs.

Impact

Positive. The net effect of these changes is an increase in our estimate of the company's NAV from £0.79 to £1.06 per share.

Action

We continue to recommend Caledon as a BUY and have increased our target price from £0.60/share to £0.85/share.

Valuation

We base our target price on a risked NAV estimate, which assumes a discount rate of 8% and settlement prices for coking and thermal coal prices of US$250/t and US$120/t this year and long-term prices of US$100/t and US$60/t respectively. We have applied a target multiple of 0.8 to our revised NAV to derive our target price of £0.85 per share.

Investment risks

Our valuation is 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.

Aiming to complete commissioning by end April

The company continues to commission the new continuous mining system at the Cook Mine and expects this process to be completed by the end of April. Most recently, the commissioning process has focussed on resolving the issues with one of the roof-bolters mounted on the continuous miner. The company is optimistic that the resolution of this issue will allow the machine to operate at full capacity.

Once at full production, the new machinery is expected to have an annual capacity of 1.3Mtpa of run-of-mine coal, equivalent to 1.2Mtpa of coal product. In addition to the new machine, the company has access to two conventional continuous miner/shuttle car arrangements (one of its own and the other a rental unit), which together take the project’s total capacity to over 1.8Mtpa.

But sales constrained to 1.1Mtpa in 2008 by access to rail and port capacity

Although the company is ultimately targeting production of 1.8Mtpa from the current setup at Cook, sales for 2008 and the next few years are limited by access to rail and port capacity. For 2008, access to 1.1million tonnes of capacity has been allocated to the Cook Mine by Xstrata although this agreement expires at the end of the year.

The company is working to put in place agreements to cover its expected sales for 2009 and beyond and is confident that sales of 1.1Mtpa are sustainable. Recent company presentations stated that between 0.75 and 0.9Mt of sales are already covered for 2009 (0.5Mt from a direct allocation of rail capacity to the Cook Mine and between 0.25-0.4Mt from a third party). The company is negotiating with Xstrata and others for additional capacity.

Supply issues drive spot sales prices of hard coking coal to over US300/t

Recent supply disruptions have affected production of coking coal from Australia and China. This has led to severe shortages and rapidly rising prices for spot coking coal sales and increasing expectations for settlement prices. Current spot sales of hard coking coal are reportedly being made at over US$300 per tonne, compared to last year’s settlement price of around US$96 per tonne.

The supply disruptions due to flooding in Australia, in particular, have led a view that settlement this year will be delayed, perhaps into the summer months compared to the usual settlement period around early April.

Operating cost guidance revised upwards to A$70-75/t

During recent presentations the company stated that it expected operating costs, including A$14/t for port and rail, would be around the low A$70s per tonne FOB. Together with the 7% state royalty and the 3% marketing fee, this takes total cash costs to A$80/t on an FOB basis. At the current spot exchange rate, this is equivalent to US$75/t. The revised costs are 10% higher in local currency than previous steady state estimates of A$73/t. we also note the impact on costs expressed in US$ of the ongoing appreciation of the A$, which is now trading at 0.93US$:A$. Having traded in the US$0.70-0.80:A$ range from 2004 to 2006, the A$ has appreciated by 20% since the beginning of 2007 and 6% since the beginning of this year. Effectively all the Cook operation’s costs are denominated in A$ and appreciation of the currency directly affects operating costs when expressed in US$.

Updating coking coal prices

Given the rapid rise in coal prices and future expectations, we have decided to provide an interim revision to our coal price forecasts ahead of the usual quarterly update. The table below summarises these changes.

Figure 1: Revised coal price forecasts

Coal year April to March		2007E	2008E	2009E	2010E	2011E	LT
Coking coal OLD	US$/t	96	175	150	110	90	82
Coking coal NEW	US$/t	96	250	175	150	125	100
Change			43%	17%	36%	39%	22%
Thermal coal OLD	US$/t	90	90	80	70	60	60
Thermal coal NEW	US$/t	55	120	100	85	70	60
Change			33%	25%	21%	17%	0%

Source: Canaccord Adams estimates

We have adjusted our production forecast to reflect sales of 1.1Mtpa from 2008 to2011 inclusive, compared to an estimate of 1.2Mtpa previously.

Figure 2: Production forecast summary - current price scenario

Year ending Dec		H1/08E	H2/08E	2007E	2008E	2009E	2010E
Total coal produced	kT	415	685	90	1,100	1,100	1,100
Coking coal sales	kT	340	562	40	902	902	902
Thermal coal sales	kT	75	123	13	198	198	198
Total coal sales	kT	415	685	53	1,100	1,100	1,100
Hard coking settlement	US$/t	n/a	n/a	96	250	175	150
Avg hard coking price	US$/t	415	685	100	235	194	156
Cook coking coal price	US$/t	203	231	89	221	179	145
Thermal coal price	US$/t	87	120	68	108	105	89
Avg coal price	**US$/t**	**182**	**211**	**81**	**200**	**166**	**134**
Avg total cash cost	**US$/t**	**-106**	**-87**	**-92**	**-94**	**-79**	**-74**
Avg margin	**US$/t**	**76**	**124**	**-11**	**106**	**87**	**61**
Exchange rate	US$/A$	0.88	0.88	0.84	0.88	0.85	0.83

Source: Canaccord Adams estimates

Financials

The company has stated that it intends to raise £15 million in conjunction with its proposed listing on the Australian Stock Exchange in April/May. The proceeds will primarily be used to fund the final payments to complete the purchase of the Minyango license area, for which A$15.4 million remains payable.

Figure 3: Financial forecast summary

Year ending Dec		H1/08E	H2/08E	2007E	2008E	2009E	2010E
Profit and Loss							
Revenue	US$M	75	145	4	220	182	148
Costs	US$M	-44	-59	-8	-103	-86	-81
Corp G&A	US$M	-4	-4	-12	-8	-4	-4
EBITDA	**US$M**	**28**	**81**	**-16**	**109**	**92**	**63**
DD&A	US$M	-1	-1	-1	-2	-2	-2
EBIT	**US$M**	**27**	**80**	**-17**	**107**	**90**	**61**
Interest	US$M	-5	-5	-3	-9	-9	-7
Tax	US$M	-7	-23	0	-29	-24	-16
Earnings	**US$M**	**16**	**53**	**-20**	**68**	**57**	**38**
Cash Flow							
Operating cash flow	US$M	19	72	-21	91	56	29
Invested cash flow	US$M	-13	-6	-35	-20	-3	0
Cash flow from financing activities	US$M	28	0	54	28	0	-53
Net cash flow	**US$M**	**33**	**66**	**-3**	**99**	**53**	**-24**
Cash balance	**US$M**	**53**	**119**	**19**	**119**	**172**	**148**
Avg shares in issue	M	189	207	153	198	207	207
CFPS	£/shr	0.051	0.180	-0.071	0.236	0.140	0.073
EPS	£/shr	0.043	0.131	-0.067	0.178	0.140	0.094

Source: Canaccord Adams estimates

Valuation

We are revising our valuation to account for changes in production, costs and coal price forecasts, as outlined above.

Also, we had previously valued the Minyango license at cost. However, given the large-scale resources already outlined (240 million tonnes in the inferred category) and the increase in coal prices, we consider that it is appropriate to begin valuing the property on the basis of an in-situ-valuation. As key coal quality data and scoping parameters for a potential development have yet to be released, we have valued the resources at US$0.50/t.

As a result, our unrisked NAV estimate for the company has increased from £0.79 per share to £1.06 per share.

We continue to expect that Caledon will trade at a discount to its NAV, on account of the commissioning risks associated with achieving production and costs in line with revised expectations and also the risks associated with securing allocation to rail and port for 2009 and beyond. We have used a multiple of 0.8, as a result of which we have increased our target price from £0.60 per share to 0.85 per share.

Figure 4: Valuation summary

8% discount rate	A$M	US$M
Cook (yrs 2008-19)	374	347
Cook (yrs 2020-28)	77	71
Minyango	130	120
Enterprise Value	**581**	**538**
Cash (FD in the money)		22
Debt		0
Net Asset Value		**561**
Fully diluted in the money shares		**261**
US$ per share		2.14
£ per share		**1.06**
Target multiple		0.8
Target price £ per share		**0.85**

* Note includes issuance of 55M shares in exchange for 2010 convertible loan notes.
Source: Canaccord Adams estimates

Conclusion

The surge in coking coal prices this year has led to a resurgence of interest in Caledon, whose share price has almost doubled since the beginning to February this year. We note that Polo Resources (PRL : AIM : 13.25p | Not rated) announced on 6 March that it had purchased a 6.9% interest in Caledon. In our view, the attractions of the company to a third party are the emerging production at Cook and the large scale resource base at Minyango and also at Cook, which potentially underpin significant increases in production in the future.

We view the successful commissioning of the Magatar continuous mining system to be the most important near term catalyst for the company. Issues are being addressed as they arise and the company expects to be at planned rates of production before the end of April. We expect that the settlement of the coking coal contract price for the year from April to March will be delayed, but could be settled by mid-year. We view both of these events as having the potential to increase value in the company.

We continue to recommend Caledon as a BUY and we have increased our target price from £0.60 to £0.85 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 both upon the company's valuation 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 1 February 2008)

	Coverage Universe		IB Clients
Rating	#	%	%
Buy	313	60.3%	43.1%
Speculative Buy	62	11.9%	71.0%
Hold	128	24.7%	24.2%
Sell	16	3.1%	6.3%
	519	100.0%	

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BUY: The stock is expected to generate risk-adjusted returns of over 10% during the next 12 months.
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Company	Disclosure
Caledon Resources plc	1A, 2, 4, 5, 7

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