



GNAM Investment Competition

SOM-e CAPITAL

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Rating	BUY
Target Price	35.9
Upside	32%
Price (11/10/17)	27.18
52-wk range	15.10-28.00
Market cap (\$ mm)	1,452
Float	54%
Short interest	11%

NYSE: HCC

- Engages in mining and exporting metallurgical coal for the steel industry
- Operates two underground mines in Alabama
- Key markets in Europe and South America
- Also sells natural gas – a byproduct from the underground coal mine
- IPO in April 2017 after acquiring assets from bankrupted Walter Energy



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Our buy recommendation is based on 3 investment theses

1. HCC is a cost leader in its key markets and has an ability to maintain EBITDA margin due to flexible costs structure even if coal price drops.
2. Shareholder-friendly management with a history of returning excess cash to investors.
3. HCC is traded at a cheap valuation of 4.3x Normalized FCF. Our analysis confirmed the stock is undervalued with 32% upside.



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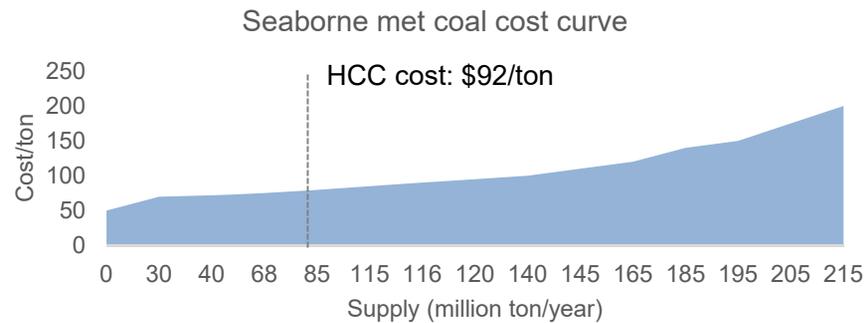
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Thesis #1: HCC is a cost leader in its key markets and has an ability to maintain EBITDA margin due to flexible costs structure

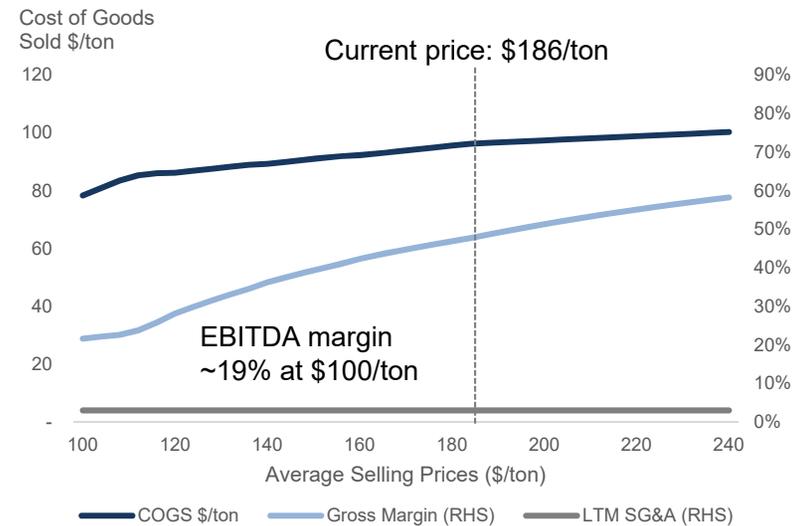
HCC cost is much lower than most U.S. producers due to the mine structure (thickness and long wall). Its mine produces some of the highest grade met coal in the world.

More flexible labor and freight costs tied to benchmark price – unique feature as a result of its predecessor’s bankruptcy – allows HCC to maintain positive EBITDA margin at low price.

Although cost is higher than Australian producers, HCC coal sell at a lower price in its key markets of Europe and LatAm due to lower transportation cost.



Producers in Australia, Russia, Indonesia, etc. Most U.S. producers



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Source: McKinsey, Morgan Stanley, HCC



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Thesis #2: Shareholder-friendly management with a history of returning excess cash to investors.

HCC's history points to strong shareholder return maximizing culture

- HCC was created to acquire core assets of Walter Energy – a bankrupted entity. Both HCC and Walter were controlled by creditors including Apollo, KKR and Blackstone who still own a substantial 38% of HCC.
- 100% of IPO proceed was returned to investors as HCC did not need extra cash for operation.
- HCC's senior management led the non-core asset disposal for Walter.

Excess Cash is expected to return to investors

- Flexible cost structure plus \$2bn NOL tax shield will translate into high free cash flow for several years
- \$600 million in special dividends in Nov'17 (representing 40% of current capitalization)
- Low risk of involvement in negative NPV M&A projects in the future
- Quarterly dividend payout policy (\$0.05/share)

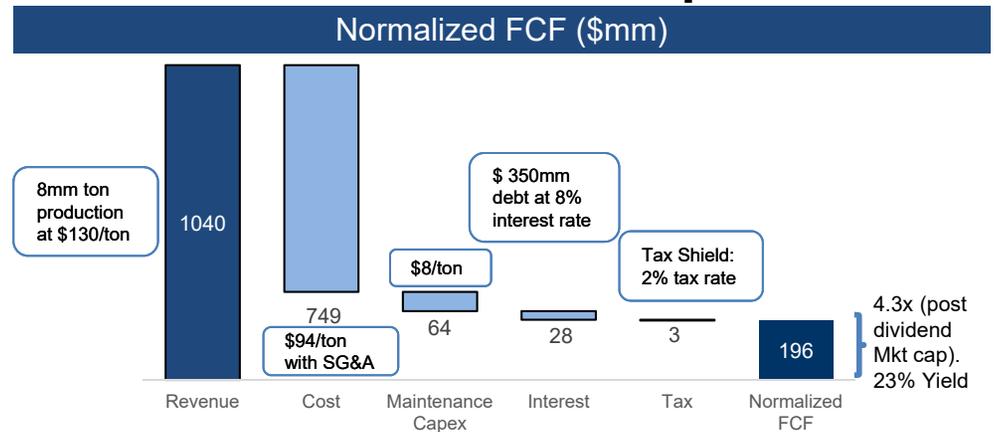
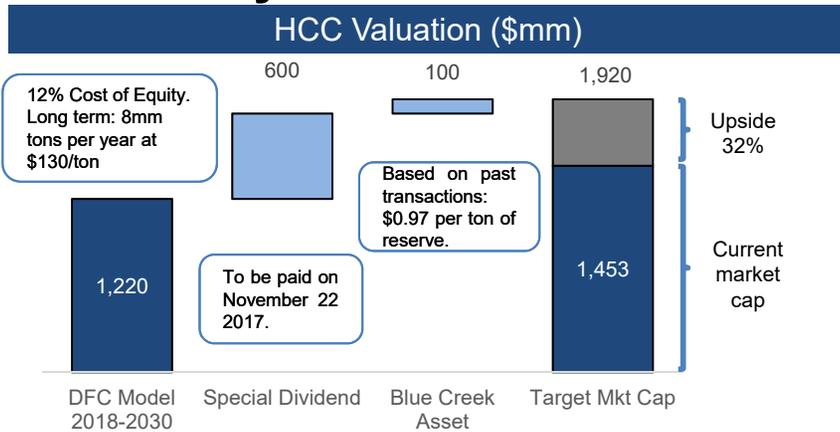


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Thesis #3: HCC is traded at a cheap valuation of 4.3x Normalized FCF. Our analysis confirmed the stock is undervalued with 32% upside.



- Target Price of \$35.9 that represents 32% upside.
- Post Dividend, market cap will be \$853, and upside of 54.8% (scale effect).
- Limited downside due to cheap valuation and conservative assumptions.

- Strong Cash generation.
- Healthy balance sheet (0.5x Net Debt/EBITDA post Dividend) allows the payment of future additional special dividends.
- Rise in \$1/ton in Met coal price, increases FCF in ~\$8mm

Long-term Met Coal Price \$/ton (2022)

Cost of Equity	100	115	130	145	160
10%	18.5	28.2	38.5	48.9	59.2
11%	18.6	27.5	37.2	46.8	56.4
12%	18.6	26.9	35.9	44.9	53.8
13%	18.7	26.4	34.8	43.1	51.5
14%	18.7	25.9	33.7	41.5	49.3

Target Price

Met Coal Price \$/ton

Total Cash Cost per Ton	100	115	130	145	160
84	4%	18%	32%	46%	59%
94	-5%	9%	23%	36%	50%
104	-14%	0%	13%	27%	41%

Normalized FCF Yield



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Key investment risks are related to fluctuation in met coal price and if HCC loses ability to utilize tax shield

1. *Valuation is highly sensitive to met coal price: \$1 reduction in per ton price will result in up to \$0.6 reduction in share price*

Risk Drivers	Mitigating Factor
<p>Loosening in China's coal mining policies can turn it into a net exporter (currently 20% of global import demand).</p> <p>Poor economic conditions in Brazil and Europe can push demand down as 90% of HCC's revenue comes from these markets.</p>	<p>HCC has a low breakeven point. Free cash flows are positive if metallurgical coal price is above \$90 per ton (vs. current \$186).</p> <p>At lower price ranges, impact on EBITDA is reduced.</p> <p>China is unlikely to loosen coal production restrictions.</p>

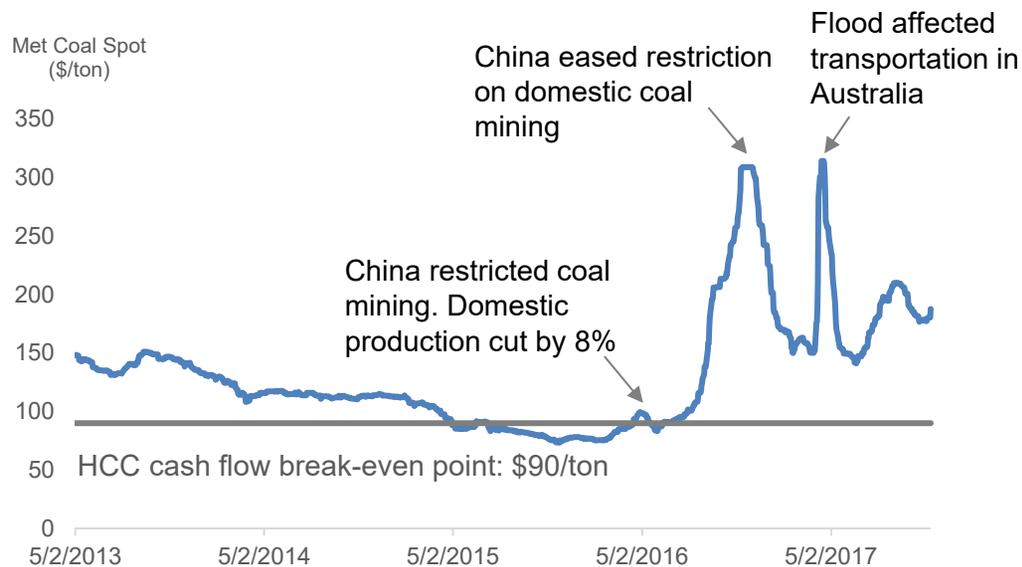
2. *NOL value is \$6.8 per share. Losing NOL would negatively impact stock price*

Risk Drivers	Mitigating Factor
<p>An ownership change prior to April 1st 2018 would reduce the NOL to zero.</p>	<p>Rights plan include anti-takeover measures, making ownership change unlikely</p>



We see a potential upside if coal price increased from our base case projection of \$130 / ton

Met coal supply curve is steep. A supply shock will result in material price increase.



Reintroduction of coal restriction policy is being discussed in China

HCC can bring underdeveloped Blue Creek mine online in response to price increase

Blue Creek's project NPV estimated at up to \$120M, contributing to \$2.26 per share.



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Annex: Financial Model

	2015	2016	2017E	2018E	2019E	2020E	2021E	2022E
Price \$/ton	93	104	218	162	117	121	128	130
Sales ton	5.64	3.49	6.70	7.00	7.70	8.00	8.00	8.00
Revenues	545	369	1,294	1,151	917	984	1,036	1,040
COGS	680	340	634	667	683	710	719	720
Gross Profit	-135	29	661	484	234	274	317	320
<i>gross margin</i>	<i>-24.8%</i>	<i>8.0%</i>	<i>51.1%</i>	<i>42.1%</i>	<i>25.5%</i>	<i>27.8%</i>	<i>30.6%</i>	<i>30.8%</i>
SG&A Ex D&S	70	30	31	29	29	29	29	29
EBITDA	-205	0	630	455	205	245	288	291
<i>EBITDA margin</i>	<i>-37.7%</i>	<i>0.0%</i>	<i>48.6%</i>	<i>39.5%</i>	<i>22.4%</i>	<i>24.9%</i>	<i>27.8%</i>	<i>28.0%</i>
D&A	124	59	79	90	108	123	134	134
EBIT	-329	-59	551	365	97	122	154	157
Net Interest Expense	0	2	2	28	28	28	28	28
Income Tax	-41	0	2	7	1	2	3	3
Net Income	-288	-61	547	331	67	92	123	126
<i>Net Income Margin</i>	<i>-52.9%</i>	<i>-16.6%</i>	<i>42.3%</i>	<i>28.7%</i>	<i>7.3%</i>	<i>9.3%</i>	<i>11.9%</i>	<i>12.1%</i>



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Annex: Valuation Model

	2015	2016	2017E	2018E	2019E	2020E	2021E	2022E
FCF								
EBIT*(1-t)	-288	-59	540	358	95	119	151	153
(+) D&A and Non Cash	124	59	79	90	108	123	134	134
(+/-) Change in WK	102	-18	-91	-5	22	-9	-4	0
(-) Capex			-86	-139	-137	-85	-85	-64
FCFF	-62	-18	441	304	88	149	196	224
(-) Interest	0	-2	-2	-27	-27	-27	-27	-27
(-) Change in debt			350	0	0	0	0	0
FCFE	-62	-20	789	277	61	121	168	196
Dividends			-798	-11	-11	-11	-11	-11
Beg Cash		80	170	161	143	114	123	129
End Cash	80	170	161	143	114	123	129	130
Total Debt	0	27	350	350	350	350	350	350
Market Cap 2018 NPV @ 12%		1,220						
Dividend		600						
Blue Creek		100						
Total Equity Value		1,920						
Current Market Cap		1,453						
Upside		32%						
Market Cap post dividend		853						
EV		1,310	1,072	1,011	924	938	953	954
Multiples Post Dividend				2018	2019	2020	2021	2022
EV/EBITDA				2.2	4.5	3.8	3.3	3.3
P/E				2.6	12.7	9.3	6.9	6.8
xFCF				3.1	14.0	7.0	5.1	4.3



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