PHILEQUITY CORNER
By Ignacio Gimenez

Semirara Mining Corp – The Cheapest Stock In Town (3/7/2005)

In today's issue, we will discuss Semirara Mining Corp. (SCC), which we think is the best play to ride the mining sector boom. Unlike most other mining companies, SCC is already operating, delivering huge cash flows.

As a way of backgrounder, SCC is the largest coal mining operator in the country, producing more than 90% of the domestic supply. Its mining operations are located in Semirara Island in the Visayas. Other local coal mining companies operate only small-scale mines around the country. It is estimated that 30% of the country's total coal consumption in 2004 was supplied by SCC, while the rest were sourced through coal imports (from China and Indonesia).

After years of losing money due to low coal prices, SCC finally turned around last year after undergoing capital restructuring and benefiting from the improvement in coal prices. The company recently undertook as placement of shares with parent DMCI selling 58m secondary shares and SCC issuing 47m new shares.

After the share placement, SCC had a sizzling debut last Feb. 4, which saw its share price rising as much as P52.0 or 44% from its offer price of P36.0. However, from that day's closing price of P48.5, SCC has gradually declined to P42.5 (as of Mar. 4). There are a couple of reasons for this decline:

1) The negative publicity brought about by the HGL court case regarding pasture land inside SCC area.
2) The big jump in SCC price on its debut caused many investors to realize the instant gain and run.
3) The seemingly uneven distribution of shares as evidenced in the way that only one or two brokers cornering the big chunk of selling.
4) Foreign brokers has so far sold around 30m shares and turned out to be the ones with a short-term horizon (a.k.a. chupiteros), while the locals were the ones buying for the long-term. It was unfortunate that the bigger share of the offer, around 86%, went to the foreign tranche, while the locals only got 14%.

Despite the apparent setback, we must remember that the counter is still up 19% from its offer price of P36.0. The pullback in price is viewed as a chance for those who were not able to participate in the offer to take a position in the counter. Current valuations are very attractive :

1) Using relative valuation and comparing SCC to regional and global coal companies, SCC is cheap and is trading at 4.8x P/E '05 and 2x P/BV. Regional coal companies trade at a range 6x to 16x P/E '05 and 2x to 4x P/BV. Global coal stocks (listed in the New York Stock Exchange) command an even higher valuation of 17x to 26x P/E and 2x to 8x P/BV.

	P/E '05 (x)	P/BV (x)	EPS Gr. (%)	PEG (x)
Regional Coal Stocks				
Bumi Resources Ltd	5.75	3.70	146%	0.04
Yanzhou Coal	9.80	2.80	26%	0.38
Centennial	11.40	3.22	6%	0.59
Excel	15.60	2.00	21%	0.74
Macarthur	11.20	3.19	400%	0.03
Regional Average	**10.75**	**2.98**	**120%**	**0.36**
Selected Global Stocks				
Peabody Energy	18.51	3.68	91%	0.20
Massey Energy	24.85	4.22	769%	0.03
Arch Coal, Inc.	25.69	2.49	118%	0.22
Consol Energy	17.49	8.42	n.a.	n.a.

Global Average	**21.64**	**4.70**	**3.26**	**0.15**
SEMIRARA MINING CORP.	**4.79**	**2.04**	**70%**	**0.08**

Source: Bloomberg

2) SCC trades at a discount to the market which is valued at 12x P/E. Our earnings per share (EPS) forecast for '05 is P8.90/shr. At 8x P/E, SCC should trade at P71.0. At 10x P/E, SCC should trade at P89.0.
3) A more conservative valuation is to use the Discounted Cash Flow (DCF) method. Our DCF estimates points to a fair value of P54.0, which implies an upside of 27% from current prices.

In our DCF valuation, our assumption calls for the average selling price of coal to peak at $44/MT this year and gradually decline to $38/MT by 2008.

However, global coal players continue to have a bullish outlook for coal prices. Fording Canadian Coal Trust, for example, believes that coal prices will likely double in 2005. In fact, global coal stocks are the market's latest darlings and are currently trading near their highs and have gained an average of 20% since the start of the year.

Regional Coal Stocks	**Year-to-date**	**From Feb. 4**
Bumi Resources Ltd	6.3	(2.3)
Yanzhou Coal	6.3	2.6
Centennial	11.0	10.5
Excel	38.1	5.7
Macarthur	61.7	8.4
Regional Average	**24.7**	**5.0**
Selected Global Stocks		
Peabody Energy	19.5	10.2
Massey Energy	23.6	8.0
Arch Coal, Inc.	26.7	17.2
Consol Energy	10.4	3.7
Global Average	**20.0**	**9.8**
SEMIRARA MINING CORP.	**n.a.**	**(12.4)**

Source: Bloomberg

Coal analysts also predict that prices will hold for 2006 and perhaps into 2007 due to the shortfall of supply and the big demand in China and the U.S. This trend in global coal prices is positive for SCC since it benefits from an import parity pricing mechanism with Napocor, which adjusts SCC's selling price to Napocor equal to most recent landed cost of Napocor coal imports.

The market has not appreciated this, so far, as SCC has declined by more than 12% from its Feb. 4 closing price. In addition, the market has not appreciated the fact that SCC currently enjoys a strong competitive advantage against coal imports. We expect coal consumers to source more from SCC given the high freight costs of imports and the strategic location of SCC which allows for a more reliable and faster delivery times.

To sum it up, we like SCC because of the ff:

1) its ***low valuation*** compared to regional peers and the market,
2) its ***competitive strengths*** of location and lower freight costs,
3) huge ***Free Cash Flows*** of over P3bn per year starting 2006,
4) the ***favorable trend in coal prices*** which could provide an upward surprise to our earnings estimates,
5) attractive dividend yield of at least 4% following the company's announcement of paying dividends of at least 20% of its net profit.

We estimate that more than 40m shares have been sold since Feb. 4. After all these profit-taking, the stock should start trading at a valuation similar to its regional peers. From our experience, after 50% of the share placement has changed hands (from short-term punters to long-term investors), the stock price should start moving higher.

DMCI Hldgs. (DMC)

As an aside, we also like DMCI Hldgs. (DMC), the parent company of SCC. DMC owns 60% of SCC after the share placement last February. DMC is expected to earn P3.5bn this year, with the bulk coming from its equity earnings in SCC and one-time gains from the placement of SCC shares.

DMC's valuation is also very cheap at current levels. Our fair value estimate for its 60% stake in subsidiary SCC is already worth P4.70 per DMC share. DMC is supposed to have wiped out all their debts and already is in a net cash position after the SCC share placement (which raised P2bn for DMC). We have yet to factor in the contribution of its construction and real estate business.

DMC has successfully re-established itself as major player in the low- to mid- segment property market. Its property arm, DMCI Homes, is expecting sales to reach P2bn this year. The recent surge in demand for urban housing has inspired DMCI to develop affordable and quality homes. To date, DMCI Homes has 10 housing projects located in Metro Manila.

At these current levels DMC is trading of 4.9x P/E '05. Compared to the market's P/E of 13.3x, DMC is trading at a discount of 63% relative to the market. We assumed that DMC Homes would contribute P200m to P300m in net profits this year.

Discussion on P/E

In response to a reader's request, we will from time to time expound on the basic concepts normally used in stock investing.

For the past couple of articles, we have been using the P/E to determine if the stock is cheap or not. P/E is just the ratio of *Price to Earnings per share*. Thus, in the case of SCC, the current price of P42.5 divided by *Earnings per share* (EPS) of P8.88 results in a P/E of 4.8x. EPS is derived by dividing *Net Income* by the number of *outstanding shares*. Again, in the case of SCC, our Net Income forecast of P2.64bn for 2005 divided by 296.88m outstanding shares equals P8.88 EPS for 2005.

The use of P/E falls under the concept of ***relative valuation***. This means that we will be comparing a certain company's P/E with: 1) historical P/E or its P/E range throughout time; 2) relative to market, e.g. P/E of a market proxy such as the PHISIX; 3) relative to local or regional peer group/sector. In SCC's case, we used 2 & 3 in comparing its P/E with the market P/E and regional comparatives.

Quote for the Week

"The individual investor should act consistently as an investor and not as a speculator. This means… that he should be able to justify every purchase he makes and each price he pays by impersonal, objective reasoning that satisfies him that he is getting more than his money's worth for his purchase." ***Benjamin Graham.***

For comments and inquiries, you can email us at info@philequity.net.