RESULTS COMMENTARY

WSL's latest results represent an improvement from that of the prior year, but challenging trading circumstances, compounded by the Covid-19 pandemic, resulted in the Group being unable to exit its loss-making position.

- Group revenue grew by 2.4% to R3.9bn. Revenue from the mining segment grew by 26.9% to R3.8bn while revenue from the trading segment decreased by 32.7% to R698.1m.

- EBITDA improved by 71.6% to R569.3m as a result of impressive ROM production, strong operational performance, improved sales and realised cost-saving initiatives.

- Net debt decreased by 17.6% to R1.0bn which decreased the gearing ratio to 55%.

- The headline loss per share improved to 2.9 cents from 32.7 cents in FY20. No dividend has been declared in order to prioritise the repayment of debt and ensure the completion and ramping up of the Moabsvelden Project.

OUTLOOK FOR NEXT REPORTING PERIOD

The once-booming South African coal mining industry continues to falter as the country's main export markets reduce their reliance on fossil fuels and explore alternative energy options. While coal prices may currently be at historic ZAR highs, decreasing capital investment and lower international demand continue to plague the industry. The price spikes are likely to provide temporary relief for coal miners, but the outlook for the long-term future of the South African coal mining industry remains subdued.

WSL have mitigated some of the risk surrounding the coal industry through entering into long-term Coal Supply Agreements (CSA) with Eskom. Eskom remains an essential long-term customer, contributing 70% to Group revenue. Eskom currently accounts for ~45% of the country's coal usage. South Africa's Integrated Resource Plan (IRP) has indicated that coal will continue to play a significant role in electricity generation, adding an element of sustainability. The energy mix is set to favour coal for at least the next decade and will only reduce to ~60% of total capacity past 2030 as storage capacity for renewable energies still needs to develop. However, the need for South African coal miners to diversify into renewable energy remains prevalent as the world becomes more environmentally conscious and more countries pursue net-zero emission targets.

WSL is in the integration phase of its environmental, social and governance (ESG) strategy, which will be underpinned by a strategy review of the Group as it broadens and transitions from being a coal miner to an energy company. Management is in the feasibility stages of the strategy review that would see WSL potentially diversifying into renewable and cleaner forms of energy. This will not only make the Group a viable investment option for financing institutions, but the Group will also benefit from efficiencies that new technologies bring, despite the high initial investment required. Management has advised that the Group will continue to explore opportunities to increase the supply of coal into local and other markets but will not be pursuing any acquisitive growth opportunities in the short to medium term within the coal space. A more focused strategic plan can be expected at the end of FY22.

An economy that continued to regress at the hands of the Covid-19 pandemic serves as the backdrop for WSL's FY21 results. While sales volumes did increase, the lower sales environment prevented the Group from achieving the returns it expected from the significant capital investment made into operations in the recent past. During the period, the Group managed to narrow its losses by implementing various cost-saving initiatives. The optimisation of costs remains a key focus for management, with the implementation of a new mining operating model centred around appointment of a single mining contractor for operations at Vanggatfontein (VGF), Elandspruit and Khanyisa expected to contribute to the Group reaching its target of turning a profit in FY22.

Similarly, in pursuit of returning to profitability, WSL signed a beneficiation agreement with Acrux Sorting Coal, a subsidiary of commodity resource specialist company Acrux Resources, to implement advanced sensor-based sorting technology at two WSL operations, namely VGF and Moabsvelden, to upgrade the quality of lower-grade coal. Not only will the deal increase sales volumes by upgrading coal resources to be included in saleable product, but it also contributes to the environmental aspect of the Group's ESG strategy by reducing their carbon footprint.

The Group delivered strong operational performance during the year, recording ROM production of 7.7mt, its highest annual ROM on record. The 28.4% increase is the culmination of significant capital invested in the mining operations and the reduction of operational delays and interruptions, particularly at the VGF operation. During FY21, ROM production at the VGF complex improved by 68.5%, supplemented by contributions from VG5, an internal project brought online during the period. The Elandspruit operation has become a consistent performer for the Group, with the opencast section contributing 2.8mt to total ROM during the period. Due to low

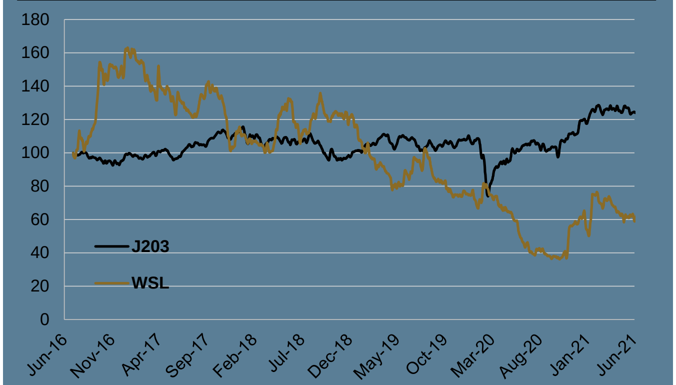
WSL – Wescoal Holdings Limited FY21 Results Equity Update

Valuation: Undervalued

WSL released full year results on 25 June 2021 for the period ended 31 March 2021

Price (R)			**1.27**
PE Fair Value (R)			**3.03**
DCF Value (R)			**3.11**
Upside(Downside) to DCF (%)			145.2%
DY %			0.0%
Price Performance			**Relative**
	Absolute		**to JALSH**
1 month	27.0%		4.5%
3 month	16.5%		-5.9%
YTD	38.0%		-4.1%
12 month	**High**		**Low**
(SA Rands)	1.29		0.52
No. of shares (m)	448	Price (R)	1.27
NAV per share	2.07	Mkt cap (Rm)	532
EV (Rm)	1555	Price/Book (x)	0.67

Financial Year	2020	2021	2022F	2023F
Turnover (Rm)	3811	3903	5598	5748
EBITDA	332	569	846	902
EBIT	-3	135	440	517
PAT	-137	-36	210	280
HEPS (cents)	-33	-3	51	68
P/E ratio	-2.0	-39.3	2.2	17
EV/EBITDA	4.6	2.7	18	14
EBITDA margin (%)	8.7%	14.6%	15.1%	15.7%
ROCE (%)	0.0%	6.0%	20.0%	23.0%
ROE (%)	-14.0%	-4.0%	22.0%	23.0%



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There are important disclaimers and disclosures which should be read carefully and completely at the end of this document demand, primarily caused by the Covid-19 pandemic, the restart of the underground mining section at Elandspruit has been delayed. Khanyisa was the only operation that recorded a decrease in ROM production, primarily caused by safety stoppages. However, above average production in Q4FY21 indicates that the operation is on track to return to consistent production performance in FY22.

Management's focus remains on the timely and cost-effective development of the Moabsvelden and Arnot projects. WSL owns 100% of the Moabsvelden mine and has a 50% equity stake in Arnot. Together, these mines have coal reserves of ~239mt. Moabsvelden, the Groups greenfield project, commenced in June 2020, with the first coal being blasted in Q3FY21 and the first delivery to Eskom taking place in Q4FY21, with which it has a long-term CSA in place. The project contributed 187kt to total Q4FY21 ROM production of 1.8mt. The restart of the Arnot operation is imminent, with the rehabilitation work as agreed upon with Eskom, set to be completed in Q2FY22. The Group is in an advanced stage of finalising a CSA with Eskom to supply 200kt per month. According to management, the agreement should be finalised during Q1FY22.

The construction of a pollution control dam and additional development workstreams is set to ramp up the Moabsvelden operation to 160kt of saleable product per month by the beginning of Q2FY21. Arnot is set to produce 2mt in FY22, of which 50% or 1mt is attributable to WSL. Management has advised that WSL is set to deliver between 9mt to 11mt of ROM production in FY22. Taking into account steady coal production expected from VGF, Elandspruit and Khanyisa, and the possibilities of delays, we believe that WSL is on track to achieve this, with our forecast set at 9.8mt of ROM production in FY22.

Management has made good progress with implementing their long-term, three-pillar strategy comprising stability, sustainability, and scalability. Operational stability was achieved during FY21 with minimal production disruptions despite the challenging trading circumstances brought on by Covid-19. Management will continue to push operations to achieve production and sales targets, despite reduced offtake from the major customer. The sustainability pillar is centred around creating an optimal balance sheet and capital structure. During the period, net debt decreased by 17.6% to R1.0bn which decreased the gearing ratio to 55%. The repayment of debt remains a priority for management, with debt levels set to decrease to ~R1bn by the end of FY22 and ~R700m by the end of FY23. Significant progress was made on the scalability front with the fast-tracking of internal growth projects development, particularly the commencement of production at Moabsvelden and the imminent restart of operations at Arnot.

Post FY21, international coal prices have been on an exceptional rally driven by higher demand, particularly in Asia, just as several major suppliers faced production issues. South African coal exports have particularly benefited from increased demand from China as restrictions on Australian imports remain in place and local production remains limited due to production interruptions. Seaborne prices remain high, currently hovering around \$120/t to \$140/t. Prices are expected to continue on an upward trend until the end of 2021, in line with global economic recovery, driven by rising demand in Asia while supply remains limited. In 2022, prices are expected to stabilise.

WSL remains optimistic that local domestic demand for coal will recover as seen in the seaborne market where coal prices are at historic ZAR highs. Overall, we forecast revenue at R5.6bn in FY22 and R5.7bn in FY23. The substantial increase in FY22 is owing to an expected ~27% increase in production, supplemented by the first full contribution of Moabsvelden as well as the Arnot mine starting production. Furthermore, the trading division is expected to benefit from increased demand and a surge in coal prices. EBITDA is expected to increase to R845.7m in FY22 and R902.1m in FY23. Cost cutting initiatives, increased production volumes and fewer operational delays are expected to improve the overall EBITDA margin to 15.1% in FY22 and 15.7% in FY23.

We forecast WSL to return to profitability and produce a HEPS of 51.1 cents in FY22 and 68.3 cents in FY23. We expect the Group to increase production to ~9.8mtpa run rate in FY22 and ~10.5mtpa run rate in FY23, taking into account the possibilities of delays owing to unforeseen circumstances.

SEGMENTAL PERFORMANCE

Revenue from the **Mining** segment, excluding inter-segmental transfers, increased by 16.5% to R3.3bn. The increase in revenue was attributable to improved operational performance and thus steady coal production across all operations. EBITDA grew by an impressive 75.3% as a result of impressive ROM production, improved sales and the materialisation of cost-cutting initiatives. The EBITDA margin improved to 17.7% from 11.8% in FY20.

Despite recording an increase in sales, the Covid-19 environment prevented the segment from reaching internal targets amid reduced offtake from Eskom. While coal offtake to Eskom has improved, it is still lower than pre-pandemic levels. Management is in the process of consultations with Eskom to manage the impact of reduced coal offtake. Coal offtake to Eskom is expected to improve in FY22 with the contribution of the CSA's negotiated for Moabsvelden and Arnot.

Management has made substantial investment into this division to ensure sustainability and enhance its ability to meet current and future contractual demands. In addition, a new operating model which includes the appointment of a single contract miner at VGF, Elandspruit and Khanyisa, and the appointment of a single coal processing contractor, Acrux Sorting Coal, for VGF and Elandspruit has been implemented to improve profitability.

The segment has already noted an improvement in sales volumes in the first month of FY22. As such, coal production is expected to increase by ~27%, bolstered by the Arnot mine scheduled to start production and the first full year production contribution of Moabsvelden, thus increasing revenue by 44.5% to R4.7bn in FY22. Revenue is expected to grow by a further 5.4% to R4.9bn in FY23. We expect EBITDA margins to expand by 30bps to 18.0% in FY22 and a further 20bps to 18.2% in FY23 as the segment benefits from its new operating model and increased mining efficiency.

The **Trading** segment, which is a leading coal distributor, saw external revenue decrease by 36.1% to R650.8m as volumes were impacted by the national lockdown and a significant reduction in sales to a major customer. EBITDA decreased by 89.5% to R5.0m while the EBITDA margin shrunk to 0.8% (FY20: 4.7%) due to reduced pricing and extra coal availability.

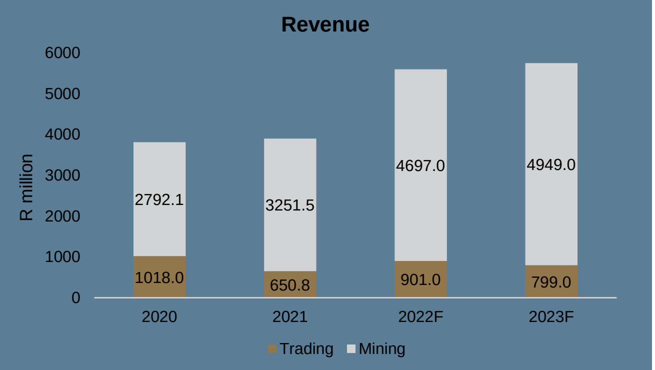
The lower sales environment was further compounded by increased competition as more coal producers targeted the domestic coal market supply to off-set the lower priced export market. This resulted in lower sales volumes driven by weak market demand. Management has indicated that coal prices will need to reach around $70-$75 for exporters to stop diverting coal into the inland market.

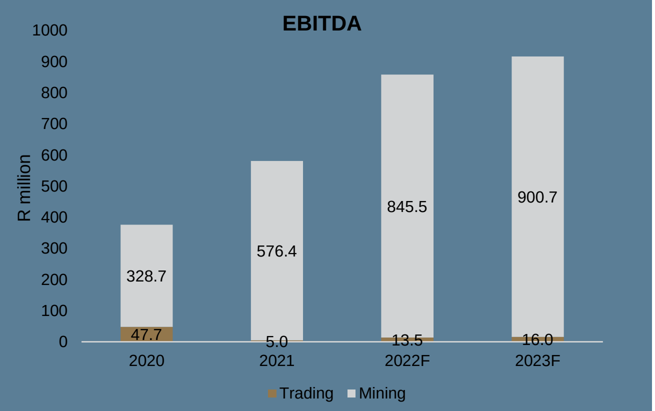
During the period, a review of the Trading business was undertaken, and a Section 189 process implemented in Q3 resulted in a 33% reduction of the workforce and the implementation of operational efficiencies. The EBITDA margin is expected to benefit from these initiatives.

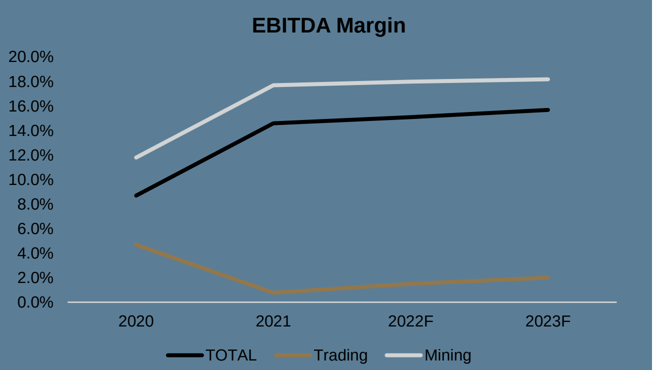
Prospects for the trading business appear to be more favourable. Post FY21, the business has seen some recovery with sales currently in line with expectations, subject to no further increases in COVID-19 infections and the consequential impact on the South African economy. The business is likely to benefit from increased demand as competitors revert to exporting coal to capitalise on high seaborne prices.

We have conducted a sensitivity analysis for FY21, as seen to the right, which forecasts trading revenue based on different production and coal price outcomes. We have selected a rather conservative range, with sales volumes expected to range between 0.69mt and 0.73mt at an average coal price of between $90/t and $110/t. We forecast revenue for FY22 at R901.0m, a 38.4% increase from FY21 and ~90% of FY20's revenue. While we acknowledge that coal prices are currently on an exceptional rally, we have selected a more conservative average coal price of $90/t for FY22 to account for the normalisation of supply. Sales volumes are expected to increase by 6.0% to 701kt as the oversupply of the local coal market subsides and demand begins to increase as the economy starts to recover.

We expect prices to recover to historical levels in FY23 and forecast sales volumes of 750kt at a price of $75/t, resulting in revenue of R799.0m. We forecast the EBITDA margin to increase by 73bps to 1.5% in FY22 and a further 50bps to 2.0% in FY24.







Trading Revenue (R)									
	Sales Volumes (Mt)								
Coal price ($/t)	**0.65**	**0.67**	**0.69**	**0.71**	**0.73**	**0.75**	**0.77**	**0.79**	**0.81**
70	642	661	681	701	721	740	760	780	743
75	688	709	730	751	772	794	815	836	799
80	733	756	778	801	823	846	869	891	857
85	779	803	827	851	875	899	923	947	914
90	825	850	**876**	**901**	**926**	952	977	1003	971
95	871	898	**925**	**951**	**978**	1005	1032	1059	1028
100	917	945	**973**	**1001**	**1029**	1058	1086	1114	1085
105	963	992	**1022**	**1052**	**1081**	1111	1140	1170	1142
110	1008	1039	**1070**	**1101**	**1132**	1163	1194	1225	1200
115	1054	1087	1119	1152	1184	1217	1249	1281	1256
120	1100	1134	1167	1201	1235	1269	1303	1337	1314
125	1146	1181	1216	1252	1287	1322	1358	1393	1371
130	1191	1228	1265	1301	1338	1375	1411	1448	1428
135	1238	1276	1314	1352	1390	1428	1466	1504	1485
140	1283	1323	1362	1402	1441	1481	1520	1559	1542
145	1329	1370	1411	1452	1493	1534	1575	1616	1599
150	1375	1417	1459	1502	1544	1586	1629	1671	1656

VALUATION

Despite reporting bottom line loss in FY21, WSL remains a strong cash generative business. Strong production performance, improved sales and cost-saving initiatives are positioning the Group well to return to profitability in FY22. After streamlining operations and addressing inefficiencies, the Group enjoyed an impressive ROM production performance in FY21. We expect this momentum to continue with the mining sector doing much of the heavy lifting as the Trading segment navigates its way through recovery.

We believe the market has overreacted with regards to WSL's share price and although there is risk surrounding the Group at the moment, patient investors with a higher risk appetite may be rewarded with notable returns if WSL reaches their potential.

Both our DCF valuation and relative PE valuation indicate that the share is currently **Undervalued**.

With reference to the DCF table on the right, we have considered a discounted cash flow analysis and with cash flows forecast to FY24. Utilising a terminal growth rate of 6% to derive our sensitivity table, for which we used a discount rate of 23.1%[1], a value of R3.11 is yielded. WSL has large scale projects set to come online over the next few years, thus vastly increasing expected production and free cash flows. The DCF has, therefore, factored in this longer-term value.

With reference to the relative PE table on the right, we have compared WSL to other mining companies and applied a 20% discount to the peer group due to WSL's size and uncertain market conditions. The implied forward PE valuation of 5.3x places the share at a valuation of R3.03.

Growth rate	DCF Discount rate 19.1%	21.1%	23.1%	25.1%	27.1%
0%	3.03	2.69	2.42	2.19	1.99
2%	3.33	2.93	2.60	2.34	2.12
4%	3.71	3.22	2.83	2.52	2.27
6%	4.20	3.58	**3.11**	2.74	2.44
8%	4.88	4.06	3.47	3.01	2.66
10%	5.85	4.72	3.93	3.36	2.92
12%	7.37	5.66	4.57	3.81	3.25

Mining	Price	Mkt cap (m)	1 year fwd PE
Weziswe Platinum	0.50	812	15.8
Sasol	215.79	135925	7.6
Exxaro Resources	178.60	62861	3.5
Tharisa	23.25	6382	4.2
Wescoal Holdings	1.27	532	2.2
Average			**6.7**
*consensus forecasts used			-66%
Wescoal Holdings	**1.27**	**532**	**2.24**
Premium (Discount) applied to average:			-20%
WSL : Implied current gain/(loss):	3.03	138%	**5.3**

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[1] The discount rate is based on the average implied discount rate obtained from cash flow forecasts for companies with market capitalisations ranging from R301m to R10bn in our research universe