

Stock Focus

Asciano Group (AIO)



EVANS & PARTNERS

Buying Time, Upping the Ante

RECOMMENDATION : NEUTRAL

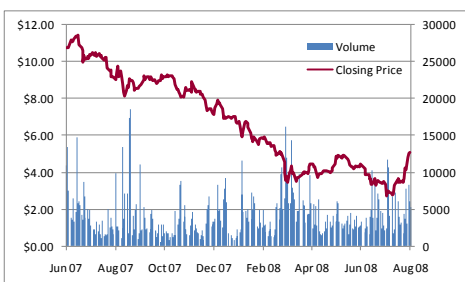
Trading Data

Last Price	\$5.08
12 month range	\$2.68-\$9.75
Market cap.	\$3,336m
Free Float	\$2,984m (89%)
Avg. daily volume	4.1m
Avg. daily value	\$23.6m
12m return (historical)	-28.5%

Earnings Forecasts

Yr to Jun	08A	09E	10E	11E
EBITDA (\$m)	678	684	796	908
Rep NPAT (\$m)	(182)	72	114	131
Adj NPAT (\$m)	38	72	114	131
EPS (¢)	18.2	17.1	22.0	23.9
EPS Gth (%)	141%	(6%)	29%	9%
PER (x)	27.9	29.7	23.1	21.3
PEG Ratio (x)	2.5	1.6	1.0	0.7
DPS (¢)	46.0	24.0	30.0	35.0
Yield (%)	9.1%	4.7%	5.9%	6.9%
Tax Def. (%)	80%	80%	80%	80%
Ent. Value/				
EBITDA (x)	11.8	12.7	11.6	10.4
Debt/				
EBITDA (x)	7.0	7.4	6.8	6.1
Int. Cover (x)	1.3	1.5	1.6	1.5
Valuation (blended)				\$4.92

Share Price History



VIEW

AIO is in play but the final outcome is far from clear. Consider:

- AIO needs \$0.8-1.0bn to fund its growth plans post-FY09.
- TPG/GIP's \$4.40 bid by has put a floor under share price.
- Board unlikely to embrace full takeover offer below \$6.50 (14x FY09 EV/EBITDA) with MD's 10.5% effectively a blocking stake.
- Partial asset sale to financial buyer with deep pockets/low cost of capital still creates ongoing management & immediate tax issues.
- Attraction of a hybrid issue increases in line with the share price.

Fundamentally we view AIO as fully priced at 12.7x FY09 EV/EBITDA. But AIO is now an event trade & if that's your game, the quality of its asset base/growth options favours being long. However, it is not a sufficient basis to change our NEUTRAL view.

RESULT

- "Underlying EBITDA" \$653m in line with guidance but includes \$28m in one-off profits. Continuing business EBITDA ~\$625m still aided by material provision releases (*ie.* GOCF was just \$571m).
- AIO backed away from +10% FY09 EBITDA growth target, ostensibly due to loss of 2%pts market share in Container Ports.
- Distributions moved to 100% cash coverage (24-30¢ps in FY09). Underwriting DRP & \$100m Share Purchase Plan sufficient to fund c.\$700m total capex in FY09 but not FY10 & beyond.

FORECASTS & VALUATION

- Immaterial changes to EBITDA forecasts - we still expect FY09 to be tough given cyclical headwinds. Hence FY09 DPS cut to 24¢.
- Blended valuation +13% to \$4.92 (1-for-3 rights issue assumption removed/Saudi investment included, offsetting higher capex).
- But key is eventual form of capital restructure - *eg.* Sale of 30% interest in Container Ports business unit for 15.0x FY09 EV/EBITDA would lift our SOTP valuation 12% to \$6.07 & drive a re-rating.

Paul Ryan
pryan@evansandpartners.com.au

August 6, 2008
+61 3 9631 9840



RESULT/EARNINGS FORECASTS

Given the messy nature of the reported result, we focus on Continuing Business EBITDA & cash flow.

- "Underlying EBITDA" at \$653m in line with guidance but included \$28m in one-offs & material provision releases, *ie.* Gross operating cash flow of \$571m compared to \$678m headline EBITDA.

ASCIANO - CASH FLOW ANALYSIS

54 Weeks to June 2008	\$m	Comment
Reported EBITDA	678	
Working Capital Investment	(34)	
Associates profit	(11)	
Investment dividend	(18)	Brambles
Non-Recurring Items	(35)	Asset sales, Grain restructuring costs
Other Non-Cash Items	(9)	Release of prior year provisions
Gross Operating Cash Flow	571	
GOCF/EBITDA	84%	

Source: Company data, Evans & Partners Research estimates

- Our FY09-10 EBITDA forecasts are basically unchanged, with Continuing Business EBITDA growth of 9% in FY09 (off FY08 base of \$625m) entirely driven by the Rail division:
 - ⇒ We remain of the view that cyclical headwinds mean Container Port market volume growth will soften to 2% & also impact Auto volumes. Coming on top of AIO losing 2%pts market share due to shipping line consortium changes, this drives flat Ports EBITDA outlook in FY09.
 - ⇒ So Rail division must step up in FY09 and deliver 18% EBITDA growth via contract wins & removal of capacity constraints in Coal/Intermodal. Whilst 2H08 momentum was strong, a softening economic backdrop/high fixed costs/reliance on 3rd parties to remove Coal supply chain bottlenecks creates a high degree of risk to this forecast.
 - ⇒ Must capture high proportion of \$50-55m in cost savings identified by the Efficiency Review.

ASCIANO - UNDERLYING BUSINESS PERFORMANCE*

Year to 30 June	2007A			2008A			2009E			2010E			Chg on pcp (%/bp)				
	1H	2H		1H	2H		1H	2H		1H	2H		08/07	09/08	10/09		
Ports	566	593	1159	631	610	1240	1269	1353		11%	3%		7%	2%	7%		
Rail	792	734	1526	782	823	1605	1807	1956		(1%)	12%		5%	13%	8%		
Queensland Coal								60							n/a		
Group Revenue	1358	1327	2685	1412	1433	2845	3076	3369		4%	8%		6%	8%	10%		
Ports	145	135	280	164	155	319	319	359		13%	15%		14%	0%	12%		
Rail	147	146	293	162	166	328	387	435		10%	14%		12%	18%	12%		
Queensland Coal								15							n/a		
Corporate				(15)	(17)	(33)	(34)	(36)						5%	5%		
Consolidated EBITDA	291	281	572	311	304	614	672	773		7%	8%		7%	9%	15%		
Associates	5	4	9	5	5	11	11	23		7%	37%		20%	5%	98%		
Group EBITDA	296	285	581	316	309	625	684	796		7%	8%		8%	9%	16%		
Ports	25.6%	22.8%	24.1%	26.0%	25.4%	25.7%	25.2%	26.5%		45	263		158	(56)	138		
Rail	18.5%	19.9%	19.2%	20.7%	20.1%	20.4%	21.4%	22.3%		221	26		125	100	83		
Queensland Coal								25.0%									
Consolidated EBITDA/Sale	21.4%	21.2%	21.3%	22.0%	21.2%	21.6%	21.9%	23.0%		55	(0)		27	27	111		

* Continuing businesses only on a 12 month basis

Source: Company data, E&P Research estimates



CAPITAL RESTRUCTURE - BUYING TIME, UPPING THE ANTE

AIO's debt position/cash flows to FY10 post the initial capital restructure measures announced today is:

ASCIANO - DEBT & CASH FLOW PROFILE DEBT PROFILE

Period ending 30 June (\$m)	Maturity	2008A		2009E	2010E	Comment
		Drawn	Undrawn			
Syndicated term loan	May-12	2250				
Syndicated term loan	May-10	2250				
Syndicated capex facility	May-10	154	396			
Bank Debt Outstanding		4654	396			
Bank g'tee/working capital facilities	May-09	189	69			
Total Debt Outstanding		4843	465			
Cash on Hand			120			
Available Liquidity at 30 June 2008			585			
Operating Cash Flow				334		
Provisions Utilised				(32)		Grain/Efficiency Review restructuring, onerous contracts
Maintenance Capex				(146)		
Expansionary Capex				(549)		Qld coal expansion ramps up, Saudi investment
Distributions Paid				(230)		But fully underwritten
Equity Raised/(Debt Repaid)				330		Underwritten SPP/DRP
Available Liquidity at 30 June 2009				293		
Operating Cash Flow					413	
Restructuring Payments					0	
Maintenance Capex					(251)	Replacement of PacNat train sets
Expansionary Capex					(411)	Qld coal expansion final spend
Distributions Paid					(198)	But FY09 final distribution underwritten
Equity Raised/(Debt Repaid)					115	DRP; must refinance \$2.8bn syndicated facilities
Available Liquidity at 30 June 2010					(39)	Need to raise \$0.8-1.0bn to fund FY10+ capex

Source: Company data, Evans & Partners Research estimates

Leaves AIO needing \$0.8-1.0bn by the end of CY09 to fund its growth plans and be in a reasonable negotiating position vis-a-vis the \$2.8bn debt refinancing due by May 2010.

Hence AIO is to commence a process to partially monetise one or more operating businesses, either by way of a partial sale or a hybrid issue. By its own admission, this aims to buy time and up the ante:

"This initiative will allow us to take advantage of the strong demand for high-quality infrastructure assets by 'unlisted' investors, whilst maintaining management control of our businesses. With our funding requirements for 2008/09 already secured, we have the benefit of time to ensure that we structure the monetisation appropriately".

VALUATION & ASSET SALE SCENARIO

This **lends an air of unreality** to our forecasts beyond FY09 and to fundamental valuations. For what it's worth, our **blended valuation** has increased 13% to \$4.92 driven by removal of our 1-for-3 rights issue assumption & inclusion of the Saudi investment, offsetting higher capex.

ASCIANO - BLENDED VALUATION SUMMARY

Methodology	Key Inputs	Value (\$ps)
Discounted Cash Flow	10.1% WACC	\$4.86
Dividend Discount Model	14% Cost of Equity	\$5.12
Capitalisation of Earnings*	11x FY09E EV/EBITDA	\$5.47
Free Cash Flow Yield	5.0% FY09E Yield	\$4.26
Average		\$4.92

* Includes Qld Coal/Saudi NPV as no FY09 EBITDA contribution

Source: Evans & Partners Research estimates



VALUATION & ASSET SALE SCENARIO (cont.)

Setting out our **sum-of-the parts valuation** in more detail:

ASCIANO - FY09 SUM OF THE PARTS VALUATION

Division	FY09 EBITDA	EV/EBITDA (x)		EV (\$m)		Comment
	\$m	Low	High	Low	High	
Container Ports	229	12.0	14.0	2752	3211	Leader in rational duopoly but facing 3rd entrant post-2012
Auto, Bulk & General Ports	91	11.0	12.0	1002	1093	Strong market positions but Auto (~55% of revenue) is cyclical
PortLink	10	5.0	6.0	51	61	Remaining exposure to agricultural volatility
Intermodal Rail	199	9.0	11.0	1789	2186	Market leader but road competition/3rd party track owner
Bulk Rail - Coal/Industrial	158	10.0	12.0	1582	1898	Leader in Hunter Valley duopoly
Bulk Rail - Grain/General Freight	10	5.0	6.0	48	58	Take or pay contract underpins but still assume 1.0x asset value
Rail Engineering/Procurement	21	5.0	6.0	103	124	Purely internal customers - being devolved back to operations
Corporate	(34)	9.0	11.0	(308)	(377)	
Group	684	10.3	12.1	7019	8255	Global peer averages are 9x (Rail) to 11x (Ports)
Mid-Point Enterprise Value		11.2		7637		
Net Debt at 30 June 2009				(4834)		Unable to fund growth capex beyond FY09
Equity				2803		
Shares on Issue (m)				731		Post underwritten DRP and \$100m Share Purchase Plan
Value per Share (\$)				\$3.83		
Growth Options (NPV)						
Queensland Coal				\$0.40		Initial 7% market share via take-or-pay contracts, upside to 25% Management rights lift IRR to >30% on US\$100m investment
Saudi Landbridge				\$1.21		
TOTAL VALUE (\$ps)				\$5.44		

Source: Company data, Evans & Partners Research estimates

This is broadly consistent with AIO trading at a 15% premium to global comps for Ports at FY09 EV/EBITDA of 11x and Rail at FY09 EV/EBITDA of 9x (source: Bloomberg).

The permutations for a **partial asset sale** are numerous, but our "top picks" are:

- 25-30% stake in **Container Ports** (Ocean Terminals plus Landside Container Logistics).
 - ⇒ AIO's highest multiple business, yet also the one with the least certain long term competitive position given prospect of a 3rd stevedore entering the market progressively from 2013.
 - ⇒ 100% ownership, cf. Auto, Bulk & General with a number of JV relationships already in place.
 - ⇒ Unclear what the CGT implications of a sale would be, but we note the cost base was set when Toll paid \$5.1bn in goodwill for Patrick in 2006. Of this, \$2.78bn now sits in the Ports division and conceptually this would primarily relate to the Container Terminals unit.
- 49% stake in **Queensland Coal** expansion.
 - ⇒ AIO's most capital hungry business, with the initial \$580m capex over 3 years potentially <1/3rd of the eventual spend if AIO's ambitions to achieve 25%+ market share are realised.
 - ⇒ Discrete operation - no overlap with existing Pacific National operations.
 - ⇒ No CGT issues given new business.
 - ⇒ May involve lower up-front cash release but defrays a higher proportion of future capex.

By way of example (and ignoring any potential CGT tax leakage), we set out below the impact on our SOTP valuation under various **scenarios for a partial sale** of the Container Ports business unit:

ASCIANO - IMPACT OF CONTAINER PORTS SELLDOWN ON FY09 SOTP VALUATION

Interest Sold	FY09 EV/EBITDA	Gross Proceeds	Implied SOTP	Uplift to \$5.44 Base Case
%	x	\$m	\$	%
32.5%	14.0	1043	\$5.75	6%
30.0%	15.0	1032	\$6.07	12%
27.5%	16.0	1009	\$6.38	17%
25.0%	17.0	975	\$6.69	23%

Source: Company data, Evans & Partners Research estimates

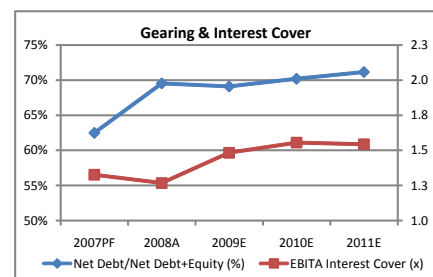
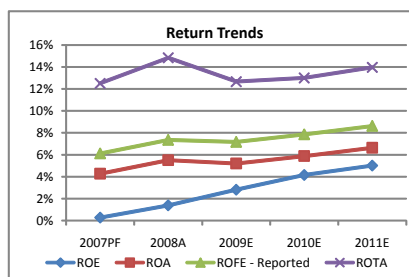
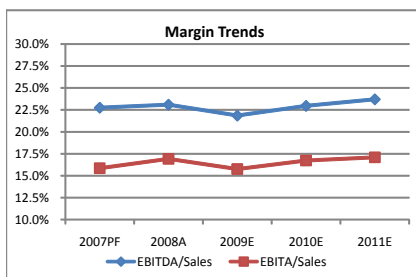


FINANCIAL SUMMARY

ASCIANO GROUP		AIO				Recommendation: Neutral		Share Price \$5.08			
As at:		7/08/2008									
Year end	June	2008A*	2009E	2010E	2011E	Year end	June	2008A*	2009E	2010E	2011E
INCOME STATEMENT											
Sales Revenue	\$m	2887	3076	3369	3730	PER	x	27.9	29.7	23.1	21.3
Consolidated EBITDA	\$m	667	672	773	884	P/EG (2YR)	x	2.5	1.6	1.0	0.7
D&A	\$m	255	258	281	317	Dividend Yield	%	9.1%	4.7%	5.9%	6.9%
Consolidated EBIT	\$m	412	414	493	567	EV/EBITDA	x	11.8	12.7	11.6	10.4
Net Interest	\$m	386	327	363	413	EV/EBIT	x	19.1	20.7	18.3	16.2
Tax Expense	\$m	(1)	26	39	46	P/FCF	x	26.5	24.8	25.4	12.8
Associates/Minorities	\$m	11	11	23	24	P/BV	x	1.7	1.7	1.7	1.8
Adj NPAT	\$m	38	72	114	131	BALANCE SHEET					
NRIs	\$m	(221)	0	0	0	Assets					
Reported NPAT	\$m	(182)	72	114	131	Cash	\$m	120	120	120	120
Shares on Issue (end period)	m	657	731	754	764	Working Capital	\$m	486	507	548	598
EFPOWA	m	657	713	743	759	PP&E	\$m	2407	2804	3257	3425
EPS (pre amortisation)	c	18.2	17.1	22.0	23.9	Intangibles	\$m	4179	4108	4037	3966
DPS	c	46.0	24.0	30.0	35.0	Investments	\$m	13	128	140	152
Tax Deferred	%	80%	80%	80%	80%	Other	\$m	269	269	269	269
GROWTH/PROFITABILITY RATIOS											
Sales Growth	%	10.6%	6.6%	9.5%	10.7%	Total Assets	\$m	7474	7937	8371	8530
EBITDA Growth	%	12.3%	0.8%	15.0%	14.3%	Liabilities					
EBIT Growth	%	25.6%	0.5%	19.0%	15.0%	Debt	\$m	4661	4954	5285	5408
EPS Growth	%	140.8%	(6.0%)	28.6%	8.5%	Working Capital	\$m	646	644	715	801
EBITDA/Sales	%	23.1%	21.9%	23.0%	23.7%	Other	\$m	179	179	179	179
EBIT/Sales	%	14.3%	13.5%	14.6%	15.2%	Total Liabilities	\$m	5486	5777	6179	6388
EBITA Interest Cover	x	1.3	1.5	1.6	1.5	Equity	\$m	1988	2160	2191	2142
Tax Rate	%	(5.1%)	30.0%	30.0%	30.0%	Capital Employed	\$m	6529	6994	7356	7430
ROE	%	1.7%	3.5%	5.2%	12.0%	Net Debt/(Cash)	\$m	4541	4834	5165	5288
ROFE	%	6.4%	6.3%	7.2%	16.1%	Net Debt/Equity	%	228%	224%	236%	247%
CASH FLOW											
EBITDA	\$m	667	672	773	884	Net Debt/Debt+Equity	%	69.6%	69.1%	70.2%	71.2%
Change in Working Capital	\$m	41	(17)	(9)	(11)	Debt/EBITDA	x	7.0	7.4	6.8	6.1
Other	\$m	(137)	(32)	0	0	Working Capital/Sales	%	2.6%	3.0%	3.0%	3.0%
Gross Operating Cash Flow	\$m	571	623	765	873	D&A/PP&E	%	10.6%	9.2%	8.6%	9.3%
Net Interest Paid	\$m	(325)	(327)	(363)	(413)	DCF VALUATION					
Tax Paid	\$m	5	0	0	0	Risk Free Rate	6.5%	PV of Cash Flows	7183	\$9.82	
Net Operating Cash Flow	\$m	250	296	402	460	Market Risk Premium	6.0%	Investments	1054	\$1.44	
Maintenance Capex	\$m	(124)	(146)	(251)	(157)	Beta	1.20	Net Debt	(4834)	(\$6.61)	
Free Cash Flow	\$m	126	150	151	304	Cost of Debt (after tax)	5.6%	Franking Credits	149	\$0.20	
Dividends Paid	\$m	(151)	(230)	(198)	(241)	WACC	10.1%	DCF Valuation	3553	\$4.86	
Expansionary Capex	\$m	(229)	(439)	(411)	(258)	DIVISIONAL SUMMARY					
Acquisitions	\$m	(736)	(110)	0	0	Revenue					
Asset Sales	\$m	680	0	0	0	Ports	\$m	1276	1269	1353	1465
Dividends Received	\$m	5	6	11	12	Rail	\$m	1611	1807	1956	2095
Shares Issues/Buybacks	\$m	150	330	115	60	Queensland Coal	\$m	0	0	60	170
Other	\$m	(4326)	0	0	0	Group Sales Revenue	\$m	2887	3076	3369	3730
Increase in Net Cash/(Debt)	\$m	(4480)	(293)	(331)	(123)	Consolidated EBITDA					
GOFCF/EBITDA	%	86%	93%	99%	99%	Ports	\$m	342	319	359	409
Total Capex/Sales	%	12.2%	19.0%	19.7%	11.1%	Rail	\$m	339	387	435	466
Total Capex/Depreciation	x	2.0	3.1	3.2	1.7	Queensland Coal	\$m	0	0	15	47
						Corporate/Other	\$m	(15)	(34)	(36)	(38)
						Group EBITDA	\$m	667	672	773	884

Source: Company data, Evans & Partners Research estimates

* 2008 = 12.5 month period





RESEARCH RECOMMENDATION DEFINITIONS

Positive	Stock is expected to outperform the S&P/ASX 200 over the coming 24 months
Neutral	Stock expected to perform in line with the S&P/ASX 200 over the coming 24 months
Negative	Stock is expected to underperform the S&P/ASX 200 over the coming 24 months
Speculative	Stock has limited history from which to derive a fundamental investment view or its prospects are highly dependent on event risk, <i>eg.</i> Successful exploration, scientific breakthrough, high commodity prices, regulatory change, etc.
Suspended	Stock is temporarily suspended due to compliance with applicable regulatory and/or Evans & Partners policies in circumstances where Evans & Partners is acting in an advisory capacity.
Not Rated	Stock is not included in our investment research universe.

Research Criteria Definitions

Recommendations are primarily determined with reference to how a stock ranks relative to the S&P/ASX 200 on the following criteria:

Valuation	Rolling 12 month prospective multiples (composite of Price-to-Earnings Ratio, Dividend Yield and EV/EBITDA), or long-term NPV for resource stocks.
Earnings Outlook	Forecast 2 year EPS growth.
Earnings Momentum	Percentage change in the current consensus EPS estimate for the stock (rolling 1 year forward basis) over the consensus EPS estimate for the stock 3 months ago.
Shareholder Returns	Composite of forecast ROE (rolling 1 year forward basis) and the percentage change in ROE over 2 years.
Debt Servicing Capacity	Rolling 12 month EBIT Interest Cover ratio.
Cyclical Risk	Qualitative assessment of the 2 year outlook for a stock/industry's profit cycle.
Industry Quality	Qualitative assessment of an industry's growth/returns potential and company specific management capability.
Financial Transparency	If we don't understand it, we won't recommend it.

For stocks where Evans & Partners does not generate its own forecasts, Bloomberg consensus data is used. Analysts can introduce other factors when determining their recommendation, with any material factors stated in the written research where appropriate.



GENERAL RESEARCH DISCLAIMER, WARNING & DISCLOSURES

This document is provided by Evans & Partners ABN 85 125 338 785, holder of AFSL 318075. The information is **general advice only** and does not take into consideration an investor's objectives, financial situation or needs. Before acting on the advice, investors should consider the appropriateness of the advice, having regard to the investor's objectives, financial situation and needs. If the advice relates to a financial product that is the subject of a [Product Disclosure Statement](#) (e.g. unlisted managed funds) investors should obtain the PDS and consider it before making any [decision](#) about whether to [acquire](#) the product.

The material contained in this document is for information purposes only and does not constitute an offer, solicitation or recommendation with respect to the purchase or sale of securities. It should not be regarded by recipients as a substitute for the exercise of their own judgment.

Any opinions and/or recommendations expressed in this material are subject to change without notice and Evans & Partners is not under any obligation to update or keep current the information contained herein. References made to third parties are based on information believed to be reliable but are not guaranteed as being accurate.

This document is provided to the recipient only and is not to be distributed to third parties without the prior consent of Evans & Partners.

EVANS & PARTNERS DISCLOSURE OF INTERESTS

Evans & Partners and its respective officers and associates may have an interest in the securities or derivatives of any entities referred to in this material.

EVANS & PARTNERS CORPORATE RELATIONSHIP DISCLOSURE

BHP: A director of Evans and Partners Pty Ltd Advisory Board is a director of BHP Billiton Ltd.

BOQ, BOQPA, BOQPB, BOQPC: A director of Evans and Partners Pty Ltd Advisory Board is a director of Bank of Queensland.

FGL: A director of Evans and Partners Pty Ltd Advisory Board is a director of Fosters Group Ltd.

LLC: A director of Evans and Partners Pty Ltd Advisory Board is a director of Lend Lease Corporation Ltd.

MIR: A director of Evans and Partners Pty Ltd is a director of Mirrabooka Ltd.

HSP: A director of Evans and Partners Pty Ltd is a director of Healthscope Ltd.

PPS: Evans and Partners Pty Ltd acted as a participating broker in the May 2008 raising of \$8mn for Praemium Ltd and will receive fees for acting in this capacity.

SEV, SEVPC: Evans and Partners Pty Ltd expect to receive or intend to seek compensation for financial and advisory services in the next 3 months from the company, its parent, or its wholly owned or majority owned subsidiary.

SUN, SUNPC: Evans and Partners Pty Ltd is a Participating Broker in the offer of Suncorp-Metway CPS and will receive a fee equal to 1% of its broker firm allocation in the issue.

MQG, MGCPA: Evans and Partners Pty Ltd is a Participating Broker to the offer of Macquarie CPS and will receive a fee equal to 1% of its broker firm allocation in the issue.

WBC, WBCPA, WCTPA: Evans and Partners Pty Ltd is a Participating Broker to the offer of Westpac SPS and will receive a fee equal to 1% of its broker firm allocation to the issue.

RESEARCH ANALYST CERTIFICATION

I, Paul Ryan, hereby certify that all the views expressed in this report accurately reflect my personal views about the subject investment theme and/or company securities. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed in this report.

RESEARCH ANALYST DISCLOSURE OF INTEREST

I, Paul Ryan, and/or entities in which I have a pecuniary interest, have an exposure to the following securities and/or managed products:

DISCLAIMER

Except for any liability which cannot be excluded, Evans & Partners, its directors, employees and agents accept no liability or responsibility whatsoever for any loss or damage of any kind, direct or indirect, arising out of the use of all or any part of this material. All information is correct at the time of publication; additional information may be available upon request.