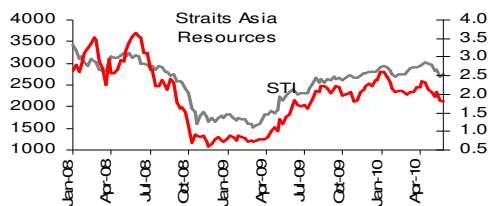


3 June 2010

Upgrade to

HOLD

Previous Rating: SELL

Current Price: S\$1.85
Fair Value: S\$1.82


Straits Asia Resources

Negatives priced in; Upgrade to HOLD

Negatives priced in; Upgrade to HOLD. Straits Asia Resources' (SAR) share price has fallen by 14% since we downgraded the stock, underperforming the Straits Times Index's 1.3% decline over the same period. The stock is now trading close to our fair value estimate and we are upgrading our rating to **HOLD** as we believe that the negatives have largely been priced in at current levels. While we continue to expect a lacklustre set of 2Q10 results, we are now ready to look beyond that in anticipation of earnings recovery in 2H10.

Expecting a recovery in 2H10. Management expects the worst to be reflected in its 1H10 results, but envisions a recovery from 2H10 onwards. This follows the group's strategy of laying the foundation in 1H10 for growth in 2H10. SAR will focus on replenishing its coal inventory and constructing Jembayan's replacement loading facility in 1H10, and these should contribute positively to the group's earnings in 2H10 and beyond. A lingering risk, however, lies in potential delays in obtaining the pinkam pakai mining approval for Sebuk. SAR expects to obtain the relevant approvals in 3Q10 and start drilling by the end of 2010, but the approval process could be delayed, as was the case for obtaining re-zoning permits last year.

Dislocation between oil and coal prices may lift margins.

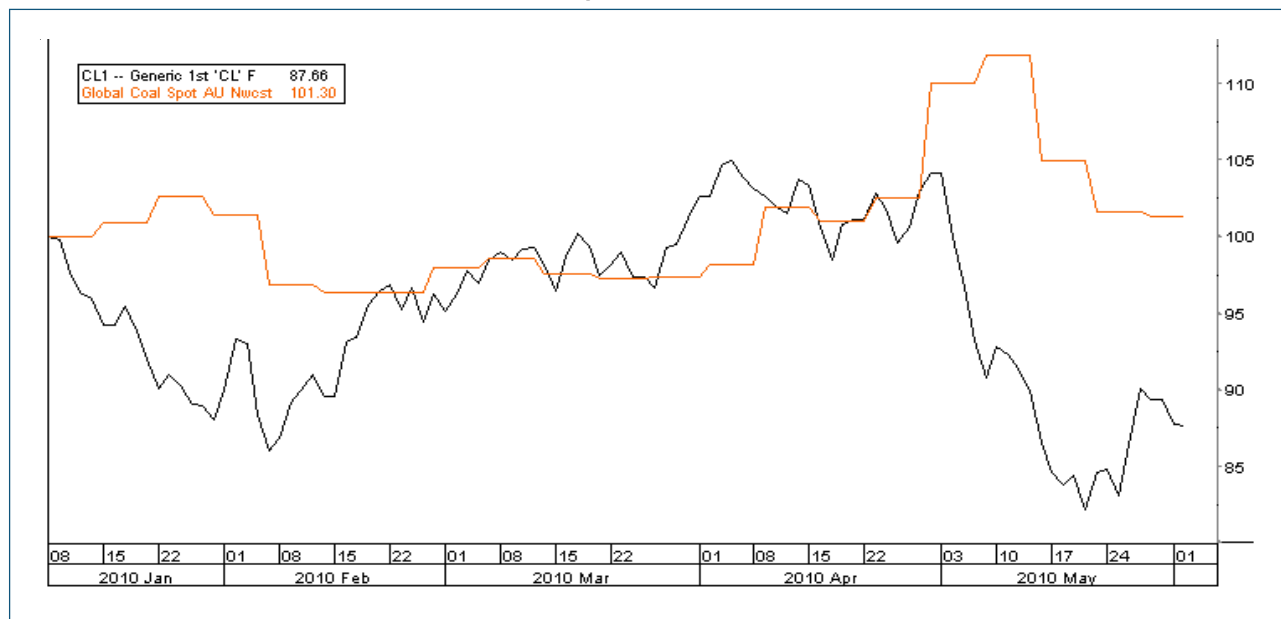
Since the start of the year, crude oil prices have fallen by 12% but Newcastle coal spot prices have remained relatively firm with a 1% gain. This pricing differential was magnified in May (exhibit 1). Depending on SAR's exposure to spot rates, the pricing dislocation could potentially boost the group's gross profit margins. Fuel is a major cost component at 35% of production costs, while selling prices tend to move in tandem with coal price indexes. Recall that SAR's gross profit margin dived by 27.7ppt to 19.7% in 1Q10 due to lower coal prices coupled with high fuel costs and stripping ratios. The recent decline in oil prices, coupled with sturdy coal spot rates, could potentially relieve cost pressure and bring about a sequential improvement in gross profit margins in 2Q10.

HOLD, FV S\$1.82. SAR trades at 14.5x FY10F PER, in line with its peers' average of 15.2x PER. We upgrade our rating to HOLD as valuations appear more reasonable following the recent correction. We keep our projections intact but tweak our fair value estimate to S\$1.82 (previously S\$1.80) on a lower WACC assumption.

Reuters Code	STRLSI
ISIN Code	AJ1
Bloomberg Code	SAR SP
Issued Capital (m)	1,129
Mkt Cap (S\$m/US\$m)	2,088 / 1,488
Major Shareholders	
PTT Asia Pacific Mining	45.6%
Free Float (%)	54.4%
Daily Vol 3-mth ('000)	10,848
52 Wk Range	1.570 - 2.740

(US\$ m)	FY08	FY09	FY10F	FY11F
Revenue	585.2	748.4	742.5	987.5
Gross Profit	227.5	300.3	223.2	350.2
EPS (cts)	11.4	12.0	9.0	15.5
PER (x)	11.5	10.8	14.5	8.4
P/NAV (x)	3.8	3.1	2.9	2.5

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Exhibit 1: Crude oil vs. Newcastle Coal, Jan 2010 - present

Source: Bloomberg

Straits Asia Resources' Key Financial Data**EARNINGS FORECAST**

Year Ended 31 Dec (US\$m)	FY08	FY09	FY10F	FY11F
Revenue	585.2	748.4	742.5	987.5
Cost of sales	-357.7	-448.0	-519.3	-637.4
Gross profit	227.5	300.3	223.2	350.2
Other income	6.3	-1.0	3.7	3.7
Operating expenses	-37.8	-57.5	-57.2	-69.1
EBIT	196.0	241.8	169.8	284.8
Finance cost	-14.8	-22.9	-11.5	-11.4
PBT	181.2	218.9	158.3	273.3
Income tax	-56.8	-85.4	-57.0	-98.4
Net profit	124.4	133.5	101.3	174.9

BALANCE SHEET

As at 31 Dec (US\$m)	FY08	FY09	FY10F	FY11F
Cash and cash equivalents	170.6	31.8	55.2	52.1
Other current assets	72.3	139.5	158.2	207.2
Property, plant, equipment	110.1	121.8	246.1	275.0
Total assets	874.0	986.5	1,128.7	1,203.7
Debt	287.5	262.5	342.5	341.9
Current liabilities excluding debt	141.2	155.7	158.5	196.6
Total liabilities	498.2	514.4	616.0	621.1
Shareholders equity	375.7	472.1	512.6	582.6
Total equity	375.7	472.1	512.6	582.6
Total equity and liabilities	874.0	986.5	1,128.7	1,203.7

CASH FLOW

Year Ended 31 Dec (US\$m)	FY08	FY09	FY10F	FY11F
Op profit before working cap.	180.1	131.1	168.6	209.6
Working cap, taxes and interest	11.4	49.7	0.6	-7.1
Net cash from operations	191.5	180.7	169.2	202.5
Purchase of PP&E	-72.6	-82.3	-190.0	-100.0
Investing cash flow	-65.1	-154.4	-190.0	-100.0
Financing cash flow	15.0	-165.1	44.2	-105.6
Net cash flow	141.4	-138.8	23.4	-3.1
Cash at beginning of year	29.1	170.6	31.8	55.2
Cash at end of year	170.6	31.8	55.2	52.1
Cash and cash equivalents	170.6	31.8	55.2	52.1

KEY RATES & RATIOS

	FY08	FY09	FY10F	FY11F
EPS (US cents)	11.4	12.0	9.0	15.5
NAV per share (US cents)	34.4	41.8	45.4	51.6
PBT margin (%)	31.0%	29.3%	21.3%	27.7%
Net profit margin (%)	21.3%	17.8%	13.6%	17.7%
PER (x)	11.5	10.8	14.5	8.4
Price/NAV (x)	3.8	3.1	2.9	2.5
Dividend yield (%)	5.2%	5.4%	4.1%	7.1%
ROE (%)	33.1%	28.3%	19.8%	30.0%
Net gearing (%)	31.1%	48.9%	56.0%	49.7%
Interest cover (x)	13.3	10.5	14.8	24.9

Source: Company data, OIR estimates

SHAREHOLDING DECLARATION:

The analyst/analysts who wrote this report holds NIL shares in the above security.

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- For companies with less than S\$150m market capitalization, OIR's Buy = More than 30% upside from the current price; Hold = Trade within +/- 30% from the current price; Sell = More than 30% downside from the current price.

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For OCBC Investment Research Pte Ltd



Carmen Lee
Head of Research

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