



FOSTER STOCKBROKING

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## **\*\*SALES COMMENTARY\*\***

**TerraCom Limited (TER, \$0.028, Mkt Cap \$72M) – Well leveraged to coking and thermal coal renaissance – Speculative Buy.**

*TER is engaged by Foster Stockbroking to provide corporate advisory services. Foster Stockbroking also was Sole Lead Manager in the \$1M placement of 46.5M TER shares at \$0.0215 per share in August 2016, for which it earned fees, including 30M unlisted TER options.*

### **Coal Markets Continue Reaching New Highs...**

- Coal markets have turned around strongly year to date. **The coking coal price reached US\$181/t last Friday, up 138% year-to-date US\$76/t.** It suggests the current quarterly contract price is likely to increase markedly above the current contract price of US\$93/t. Exit of US supply in the past few years, stricter China environment controls, and increasing demand from Asia, especially India.
- Meanwhile the **thermal coal price has risen a more modest, but still healthy, 37% year to date, at US\$69/t.**

### **...Being Reflected In Shareprice Movements**

- Following the price movements, ASX-listed coal stocks have gathered steam and rallied. These encompass large producers right through to micro-cap explorers, with projects capable of leverage seaborne market pricing (e.g. Australia, Russia, Mongolia, Canada, and Indonesia). **Stocks such Realm Resources (RRP), Whitehaven Coal (WHC), East Energy (EER), Stanmore Coal (SMR), Nucoal (NCR), Tigers Realm (TIG) and Jameson (JAL) have all rallied > 150% YTD.**

### **TER Our Pick For Coal Leverage**

- **One stock that we believe has significant coal leverage, especially as it is a producer, is Terracom (TER).** Not only is the company producing, but it also has further leverage to near-term volume growth via production increase and project pipeline. It has both coking and thermal coal assets, across the major coal provinces of Australia, Mongolia, and Indonesia (pending acquisition). Additionally TER's new Executive Chairman has added value.

### **Blair Athol Thermal Coal Acquisition – Tier 1 Asset To Be Acquired For Just \$1**

- **TER has been astute by purchasing the tier 1 asset Blair Athol thermal coal mine for only \$1 in consideration from Rio Tinto and its JV partners, prior to the recent upswing in coal which is**

playing out in the resurgence in coal stocks. The reason for the bargain price is that for RIO and partners, Blair Athol had reached the end of its life, and that the process of mine rehabilitation would need to start.

- **However for TER, it saw an opportunity to extend the mine life significantly.** While the company has inherited responsibility for mine rehabilitation, it believes that the \$80M bond that it receives as part of the purchase will be more than sufficient to cover costs.
- **Production targeted for 4Q 2016 as approval is imminent. The company expects government and RIO JV partners approval by the end of the 3Q2016.** Given the existing mine infrastructure in place – Blair Athol had been in care and maintenance – TER is targeting production in 4Q2016, with an expected short mobilization and commissioning time. TER anticipates Blair Athol be cashflow positive as the mine ramps up to a 2Mtpa rate, providing a five year life at this rate.
- The \$1 purchase price includes a dragline and full suite of mining equipment with capacity to easily deliver the planned 2mtpa.
- **The Blair Athol infrastructure, is capable of supporting a 12Mtpa operation.** We believe it opens up opportunities for TER to consolidate other prospective coal ground in its surrounding areas.

### Coking Coal Production To Resume Mongolia As Destocking Runs Course

- **TER's current main producing asset is its hard coking coal producing BNU coal mine in South Gobi, Mongolia.** TER is targeting 1.5Mtpa for 1Q2017. South Gobi has 83Mt of resource and is close to the steel markets in northern China.
- **The company has made a number of productivity improvements including improving yield and quality of washed coal,** which has low sulfur and ash <10.5%, making a premium hard coking coal. TER expects to commission its own coal prep plant in 1Q2017, which is more bespoke for treating its coal than that of the third -party plant it has used at the China-Mongolia border. This should both improve yield and reduce costs.
- Mining was suspended earlier in the year to due to full ROM stockpiles. However following destocking, TER is expects production to recommence in 4Q 2016, amid a more buoyant market.
- **Achieving price increases.** While pricing of Mongolian coal has been markedly disconnected from seaborne markets in the past, we understand that more improved linkage is occurring as coal demand grows and Mongolian producers become more astute and aware of coal market dynamics.
- **TER achieved a price increase for the 2Q and is expecting a significant increase commensurate with the HCC market in 3Q/4Q.**

### Indonesian Opportunity Adds Another Bow

- TER is in discussions to acquire the Indomet hard coking coal mine in central Kalimantan with scrip. The company expects it to be immediately cash generative at 0.5-0.7Mtpa production. There also exists opportunities to acquire neighbouring mines and increase production to 1.2-1.5Mtpa. While only possessing JORC Resources of 3.5Mt, only 5% of lease has been explored.

### Suite Of Exploration Projects

- **In addition to its production assets, TER has a number of earlier stage coal projects that it can exploit as part of the commodity's improved market conditions.** These include Mid Gobi (221Mt JORC Resources, Mongolia) and Uvs (Mongolia), and a raft of Queensland projects totaling 2.1bt JORC Resources of coal across the Galilee, Bowen, and Maryborough Basins.

- **Uvs in particular is interesting as it is also prospective for potash and lithium**, and located in Northern Mongolia close to the Russian border with access to highway and power. Planned future rail links between China and Russia have the potential to open up the region.

### Well Experienced Management

- **Board and management have strong credentials** – Executive Chairman Cameron McRae has had 28 years at Rio Tinto, including CEO President of Oyu Tolgoi in Mongolia and CEO Richards Bay Minerals (RSA). ED Mick Avery's work includes with BHP and Rio both in Australia and offshore. Other key management have experience with major miners and service providers such as Glencore, Anglo America, and CIMIC.

### Whitehaven EBITDA Multiple Comparison Highlights Re-Rate potential

- **TER is targeting 5Mtpa rate by 2017 from its BNU, Blair Athol, and Indomet operations.** Assuming a conservative average margin of US\$15/t, we estimate TER could generate as much as A\$100M p.a EBITDA, placing it on a 2.6x EV/EBITDA multiple. In comparison, Whitehaven (WHC) is on 9.2x. This highlights the re-rate potential *should* TER deliver on completing its acquisitions and achieving the production target.

### Speculative Buy Recommendation

- **We recommend TER as a Speculative Buy.** While the company has yet to finalise acquisitions of Indomet and Blair Athol, as well as prove and extend resource life of these assets, we believe the shareprice more than compensates for these risks.

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