



TerraCom Ltd (TER.ASX)

On the threshold

Event:

- Operations update; Management change; Price Target and earnings changes.

Investment Highlights:

- TER recently announced that BNU continued its ramp up of coal sales quarter by quarter, contracting 318kt in sales for the 1Q FY18a, equivalent to 1.3Mtpa run-rate, just shy of its targeted 1.5Mtpa. Production for the June quarter was 246kt, which exceeded our estimate of 210kt.
- Receipts of \$14.2M were below our forecast of \$16.8M despite higher shipments than forecast. We believe this was mostly due to higher proportion of non-coking coal being shipped than we had assumed. A major reason was mining of overburden coal, including that from Pit 3, which was opened during the quarter. While not disclosed, we estimate 28% of product was coking vs our forecast of 82%. We expect greater proportion of coking coal for FY18e.
- Blair Athol achieved first coal production and sales in August, and TER reported that 124kt was mined in 1QFY18a, implying a 1.2Mtpa rate for September. We expect the company to achieve 2Mtpa ROM rate by December. Wash plant will be operational in October, with bypass coal being shipped in the interim.
- Mr Wal King was recently appointed Non-Executive Chairman, with the heads of operation at Mongolia and Blair Athol now reporting directly to him. Former Chairman Cameron McRae has moved to Non-Executive Director and previous Vice President Operations has resigned. This introduces more direct reporting and flatter management, which we view positively.
- TER reported its FY17A result, the highlight being a \$45.7M gain on acquisition of Blair Athol, helping strengthen the balance sheet, and recognition of \$19.6M tax benefit with respect to Australian tax losses. The company made its first interest payments, including 50% of interest on the Euroclear bond. The US\$12M Super Senior Note A will be repaid during FY18e as we had anticipated.

Earnings and Valuation:

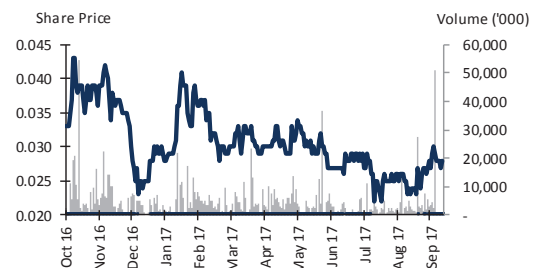
- We have downgraded NPAT for FY18e by 37% to \$67.2M and upgraded that of FY19e by 25% to \$46.8M. The former is due to a cut in forecast coking coal production, while the latter is due to higher coking coal prices. We still forecast TER will be able to service its interest and repay its debt out of cashflows.
- Our risked valuation of TER has reduced to \$0.082/share (previous \$0.11/share) due to the reduction in our forecast coking coal production from Mongolia and dilutive impact of issuing equity to repay most of fuel facility. We now forecast 77% of product coal from Mongolia to be coking (vs 84% prior).

Recommendation:

- We maintain our Buy recommendation with our 12-month share price-target reduced to \$0.082 from \$0.11, in line with revised valuation. TER is trading at only 1.3x P/E on FY18e earnings and needs to demonstrate its targeted volumes and export-linked pricing from Mongolia for a re-rating. We expect FY18e to be a turning point as earnings improve from Mongolia and start from Blair Athol.
- Catalysts for share price include 1) Increased coal production from Mongolia and Blair Athol; 2) Higher coking coal output and improved pricing from Mongolia; 3) Demonstrated earnings from Blair Athol; and 4) Reduction in debt.

Recommendation	Buy			
Previous	Buy			
Risk	High			
Price Target	\$0.082			
Previous	\$0.110			
Share Price (A\$)	\$ 0.027			
ASX Code	TER			
52 week low - high (A\$)	0.020-0.048			
Valuation (A\$/share) - risked	\$0.082			
Methodology	DCF			
Capital structure				
Shares on Issue (M)	3,013			
Market Cap (A\$M)	81			
Net (Debt)/Cash (A\$M)	-183			
EV (A\$M)	264			
Options (M)	30			
Warrants (M)	126			
Fully diluted EV (\$M)	269			
12mth Av Daily Volume ('000)	4,720			
Y/e Jun (A\$M)	2017a	2018e	2019e	2020e
Sales	22.5	348.1	351.0	331.9
Underlying EBITDA	-19.2	129.0	118.8	99.9
Underlying NPAT	-56.9	67.2	46.8	32.6
NPAT reported	5.0	72.3	46.8	32.6
EPS diluted adj. \$	-0.02	0.02	0.01	0.01
PER x diluted	nm	1.3	1.9	2.7
EV/EBITDA x	nm	2.6	2.8	3.4
Board				
Wal King	Non-Executive Chairman			
Craig Wallace	Non-Executive Deputy Chairman			
Michael Avery	Executive Director			
Cameron McRae	Non-Executive Director			
Tsogt Togoo	Non-Executive Director			
Philip Forrest	Non-Executive Director			
James Soorley	Non-Executive Director			
Substantial Shareholders				
OCP Asia	15.1%			
Noble Resources International	9.9%			

Share Price Graph				
OCP Asia	15.1%			
Noble Resources International	9.9%			



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 The analyst owns 650,000 shares in TER.

Foster Stockbroking was Sole Lead Manager in the \$4M placement of 133.3M TER shares at \$0.03 in December 2016, for which it earned fees.