EQUITY RESEARCH

Materials

23 November 2018

TerraCom Ltd (TER.ASX)

Production and price upgrades, BNU South looms on horizon

Event:

- **1QFY19 review; Production and price changes; Earnings and PT changes.**

Investment Highlights:

- **TerraCom Ltd's (TER) 1QFY19 EBITDA was $25.3M, 21% below our forecast of $32.0M.** The key reason for the miss was a poor performance from Mongolia, with lower than expected production due to flooding. Mongolia EBITDA was ($5.7M) vs our forecast of $4.0M. Blair Athol EBITDA was $32.7M as per our forecast, with ROM coal 0.63Mt, equivalent to a 2.5Mtpa rate.
- **Production forecasts upgraded for Blair Athol.** We raise forecast Blair Athol coal production by 14% to 2.5Mtpa (prior 2.2Mtpa) based on company guidance, production to date, strong coal demand, and existing infrastructure capacity.
- **We also raise Mongolian production estimates due to including BNU South.** We anticipate first coal beginning FY20e and ramp up to 1.5Mtpa by end FY20e. We increase Mongolia coal production 50% to 2.3Mt in FY20e and 100% to 3.0Mt in FY21e (previously 1.5Mtpa). We only factor a low margin and short mine life for BNU South, but expect to revisit assumptions post further details.
- **Conditions in place to move into production quickly.** BNU South lies only 12km from BNU North, likely requires minimal pre-strip, lies within the existing Mining Right, and existing BNU North infrastructure and contractor can be utilised. Existing customers are most likely to purchase offtake.
- **We upgrade our coal price forecasts maintaining these in-line with consensus.** Our hard coking coal benchmark increases 6%, 9%, and 8% to US$189/t, US$167/t, and US$152/t and Newcastle thermal benchmark 10%, 12%, and 8% to US$98/t, US$87/t, and US$78/t in FY19e, FY20e, and FY21e. Despite the recent fall in Newcastle price, our forecasts still remain below spot.
- **The Queensland Government recently passed the Mineral and Energy Resources (Financial Provisioning) Bill.** We view this as positive for TER, as it presents the company with an alternative avenue to provide surety, which could ultimately reduce net debt by $72M, or $0.19/share.
- **Appointment of CEO brings extensive coal experience.** TER appointed Mr Danny McCarthy as CEO, who has experience recently as COO of Mineral Resources, as well as having previously worked with Thiess and Wesfarmers.

Earnings and Valuation:

- **We upgrade our forecast NPAT 87% to $50M in FY19e, 47% to $81M in FY20e, and 110% to $40M in FY21e based on increased production from Blair Athol and introducing BNU South, and higher coking and thermal prices.** TER is trading at FY19e & FY20e P/E of 3.7x and 2.3x, at significant discount to peers. Our risked NPV_{10} valuation of TER increases to $0.97 from $0.73 previously, due to higher earnings resulting from increased production and pricing. We now estimate TER can fully service all its debt from operating cash flows.

Recommendation:

- **We maintain our Buy rating, raising our 12-month price target to $0.97 (prior $0.73) in line with our revised valuation (1.0x Price/Risked NPV_{10}).**
- **Catalysts for the share price include commissioning of BNU South; reducing net debt; and commissioning wash plant.**

Disclosures

The analyst owns 65,000 TER shares. Foster Stockbroking and associated entities (excluding Cranport Pty Ltd) own 2,065,000 TER shares and 1,500,000 options exercise price $0.60 expiry 31 August 2020. Cranport Pty Ltd owns 3,001,519 TER shares. Refer details at end of report.

Recommendation	**Buy**
Previous	Buy
Risk	High
Price Target	**$0.97**
Previous	$0.73
Share Price (A$)	**$ 0.48**
ASX Code	TER
52 week low - high (A$)	0.15-0.805
Valuation (A$/share) - risked	**$0.97**
Methodology	DCF
Capital structure	
Shares on Issue (M)	380
Market Cap (A$M)	**182**
Net (Debt)/Cash (A$M)	-191
EV (A$M)	**373**
Warrants and options (M)	14
Fully diluted EV ($M)	**380**
12mth Av Daily Volume ('000)	460

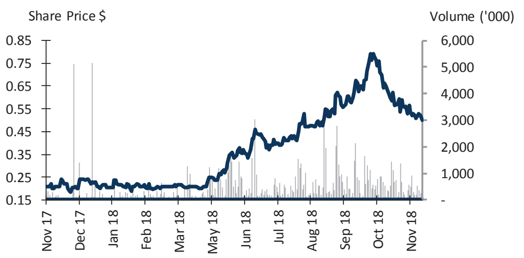
Y/e Jun (A$M)	2018a	2019e	2020e	2021e
Sales	147.1	382.9	486.6	463.7
EBITDA adj.	27.4	105.7	152.7	113.9
NPAT adj.	**-26.2**	**50.5**	**80.8**	**39.9**
NPAT rep.	-18.4	50.5	80.0	37.1
EPS diluted adj. $	**-0.07**	**0.13**	**0.20**	**0.08**
PER x diluted	**nm**	**3.7**	**2.3**	**5.3**
EV/EBITDA x	15.1	3.9	2.7	3.6

adj. = underlying estimate

Board	
Wal King	Non-Executive Chairman
Craig Wallace	Non-Executive Deputy Chairman
Michael Avery	Executive Director
Matthew Hunter	Non-Executive Director
Tsogt Togoo	Non-Executive Director
Philip Forrest	Non-Executive Director
Paul Anderson	Non-Executive Director
James Soorley	Non-Executive Director

Substantial Shareholders	
OCP Asia	15.6%
Bonython Coal	14.8%
Noble Resources International	9.9%
Rasia	8.6%
Acecrests Investments	7.0%
TIGA Trading	5.0%

Share Price Graph



Analyst: Mark Fichera +612 9993 8162
mark.fichera@fostock.com.au

TerraCom Ltd (TER)

Full Year Ended 30 June.

Profit and Loss A$M	2018a	2019e	2020e	2021e
Sales revenue	147.3	382.9	486.6	463.7
Operating Costs adj.	119.8	277.2	333.8	349.8
EBITDA adj.	**27.4**	**105.7**	**152.7**	**113.9**
D&A	18.2	24.9	21.8	22.3
EBIT adj.	**9.2**	**80.8**	**130.9**	**91.6**
Net Interest exp / (income)	36.1	34.5	35.6	31.1
Profit before tax adj.	**-26.9**	**46.3**	**95.3**	**60.5**
Tax exp / (benefit) adj.	0.0	-2.8	16.0	22.0
NPAT before minorities	-26.9	49.1	79.4	38.5
Minorities loss (income)	0.7	1.4	1.4	1.4
NPAT adj.	**-26.2**	**50.5**	**80.8**	**39.9**
NRI loss (income)	-7.8	0.0	0.0	0.0
NPAT reported	-18.3	50.5	80.8	39.9
EPS diluted ($) underlying	**-0.07**	**0.13**	**0.21**	**0.09**

Cashflow A$M	2018a	2019e	2020e	2021e
Underlying EBITDA	27.4	105.7	152.7	113.9
Change in WC	10.3	6.9	-3.5	1.9
Tax paid	0.0	2.8	-16.0	-22.0
Other	15.4	2.4	0.0	0.0
Net interest	-19.1	-27.3	-28.6	-23.8
Share based expenses	0.3	0.3	0.3	0.3
Operating Cashflow	**34.3**	**90.8**	**104.9**	**70.2**
Purchase of PP&E	-47.6	-37.9	-3.9	-4.0
Exploration expenditure	-2.4	-2.0	-2.0	-2.1
Net asset sales/acquisitions	-0.1	0.0	0.0	0.0
Investing Cashflow	**-53.2**	**-39.9**	**-5.9**	**-6.0**
Equity raise	14.7	0.9	0.0	0.0
Debt proceeds	21.3	0.0	0.0	25.0
Debt repayments	-10.6	-26.8	-2.9	-181.3
Other	-1.1	0.0	0.0	0.0
Financing Cashflow	**24.2**	**-25.9**	**-2.9**	**-156.3**
Net Cashflow	**5.3**	**25.0**	**96.2**	**-92.1**

Balance Sheet A$M	2018a	2019e	2020e	2021e
Cash	16.3	41.3	137.5	45.4
Secured deposit	71.8	71.8	71.8	71.8
Inventory	16.3	3.2	15.0	14.7
Receivables	23.4	32.1	40.0	38.1
PPE	243.1	256.1	238.1	219.8
Capitalised exploration	40.8	42.8	44.8	46.9
Investment	1.4	1.4	1.4	1.4
Other	6.5	0.0	0.0	0.0
Total Assets	**419.6**	**448.7**	**548.6**	**438.0**
Accounts payable	80.3	69.8	77.3	77.3
Provisions	0.3	0.6	0.7	0.8
Debt	224.3	204.8	209.1	21.2
Rehabilitation liability	74.2	72.5	72.5	72.5
Other	13.0	20.7	26.6	62.6
Total Liabilities	**392.2**	**368.5**	**386.2**	**234.3**
Reserves and capital	200.6	201.5	201.5	201.5
Retained earnings	-176.5	-126.0	-45.3	-5.4
Attributable equity	**24.1**	**75.5**	**156.3**	**196.2**
Minorities	3.3	4.7	6.2	7.6
Total equity	**27.4**	**80.2**	**162.4**	**203.7**

Operations $M	2018a	2019e	2020e	2021e
Mongolia	64.7	90.3	225.4	229.2
Australia	82.6	292.6	261.2	234.5
Sales adj.	**147.3**	**382.9**	**486.6**	**463.7**
Mongolia	-5.3	-11.3	59.0	45.9
Australia	21.7	99.1	79.0	52.8
Corporate	-7.1	-7.1	-7.1	-7.1
EBIT adj.	**9.2**	**80.8**	**130.9**	**91.6**

JORC Resources Mt (attrib.)	Meas.	Ind.	Inf.	Total
South Gobi	15	9	59	83
Mid Gobi	0	32	189	221
Blair Athol	22	10	13	44
Northern Galilee	0	166	1,512	1,678
Springsure	0	15	53	68
Total	**37**	**232**	**1,826**	**2,095**

Financial Metrics	2018a	2019e	2020e	2021e
Sales growth %	555%	160%	27%	-5%
EPS growth %	nm	nm	60%	-56%
EBITDA margin	19%	28%	31%	25%
EBIT margin	6%	21%	27%	20%
Gearing (ND/ND+E)	58%	53%	41%	19%
Interest Cover (EBIT/net int)	0.3x	2.3x	3.7x	2.9x
Average ROE %	-119%	91%	65%	21%
Average ROA %	2%	19%	26%	19%
Wtd ave shares (M)	337	380	380	430
Wtd ave share diluted (M)	283	351	393	393

Earnings multiples	2018a	2019e	2020e	2021e
P/E x	**-6.4**	**3.7**	**2.3**	**5.3**
EV/EBITDA x	15.1	3.9	2.7	3.6

Company Valuation	A$M	A$/sh	A$M	A$/sh
DCF, WACC 10% nominal	**Unrisked**	**Unrisked**	**Risked**	**Risked**
Segment	**A$M**	**A$/sh**	**A$M**	**A$/sh**
South Gobi	415	$1.05	267	$0.68
Blair Athol	369	$0.94	329	$0.83
Mid Gobi	4	$0.01	1	$0.00
Northern Galilee	39	$0.10	8	$0.02
Springsure & Fernlee	8	$0.02	4	$0.01
Other Queensland	5	$0.01	1	$0.00
Other Mongolia	5	$0.01	1	$0.00
Corporate	-55	-$0.14	-42	-$0.11
Net cash (debt)	-191	-$0.48	-191	-$0.48
Cash from options & warrants	4	$0.01	4	$0.01
Equity	**603**	**$1.53**	**382**	**$0.97**
Ordinary shares M	380		380	
Options & warrants M	14		14	
Diluted shares used in valn. M	394		394	

Commodity Assumptions	2018a	2019e	2020e	2021e
Prices:				
Hard coking coal spot US$/t	201	189	167	152
Thermal coal Newcastle US$/t	100	98	87	78
A$:US$	0.78	0.75	0.75	0.74
ROM coal:				
Mongolia	0.9	1.2	2.3	3.0
Australia	1.6	2.8	2.9	2.9
Total Mt	**2.5**	**4.0**	**5.1**	**5.9**
Shipments:				
Mongolia	0.9	1.2	2.3	3.0
Australia	1.0	2.5	2.5	2.5
Total Mt	**1.9**	**3.7**	**4.8**	**5.5**
Coking coal Mt	0.3	0.4	1.0	1.0
Thermal coal Mt	1.6	3.3	3.8	4.5
Total Mt	**1.9**	**3.7**	**4.8**	**5.5**
Realised pricing:				
Mongolia US$/t	55.0	56.0	75.1	56.5
Australia US$/t	60.8	87.6	78.4	69.4
All-in-sustaining costs:				
Mongolia US$/t	49.1	53.6	50.5	41.4
Australia US$/t	32.7	54.2	52.6	51.8

FY2019e Quarter Splits Mt	1Q19e	2Q19e	3Q19e	4Q19e
Mongolia	9.0	24.8	29.9	26.6
Australia	80.0	76.4	69.8	66.4
Sales Revenue	**89.0**	**101.1**	**99.6**	**93.1**
Mongolia	-9.5	-1.2	1.2	-1.8
Australia	30.3	27.7	22.0	19.2
Corporate	-1.8	-1.8	-1.8	-1.8
EBIT underlying	**19.0**	**24.7**	**21.5**	**15.6**

FY Half Year Splits $M	1H18a	2H18a	1H19e	2H19e
Mongolia	30.8	34.0	33.8	56.5
Australia	14.4	68.2	156.4	136.2
Sales	**45.2**	**102.1**	**190.1**	**192.7**
Mongolia	3.5	3.5	-3.1	6.9
Australia	3.0	24.5	62.9	46.2
Corporate	-1.0	-6.1	-3.5	-3.5
EBITDA adj.	**5.6**	**21.8**	**56.2**	**49.5**
NPAT adj.	**-17.6**	**-8.6**	**29.4**	**21.1**

Capital structure	M
Ordinary shares	380
Warrants and options	14
Fully diluted	**394**

Source: Foster Stockbroking estimates.

1QFY19 RESULT SUFFERS FROM POOR MONGOLIA PERFORMANCE

- TER reported 1QFY19 EBITDA of $25.3M which was 21% short of our forecast $32.0M. The culprit was poor performance from Mongolia, with sales of $9.0M, 60% under our estimate of $22M. Blair Athol EBITDA overall came in as per our EBITDA forecast of $32.7M.

Figure 1: TER 1QFY19 Result A$M

	1QFY19a	*1QFY18a*	*FSBe 1Q*	*Diff*
Blair Athol	80.0	*39.0*	*89.0*	*-10%*
BNU	9.0	*19.4*	*22.4*	*-60%*
Sales	**89.0**	***58.4***	***111.4***	***-20%***
Blair Athol	47.3	*20.7*	*56.4*	*-16%*
BNU	14.7	*15.4*	*1.1*	*-31%*
Corporate	-1.8	*-1.2*	*-1.8*	*-1%*
Cash costs	**60.2**	***34.9***	***75.9***	***-21%***
Blair Athol	32.7	*18.3*	*32.7*	*0%*
BNU	-5.7	*4.0*	*1.1*	*nm*
Corporate	-1.8	*-1.2*	*-1.8*	*-1%*
EBITDA	**25.3**	***21.1***	***32.0***	***-21%***

Source: Company; Foster Stockbroking estimates.

Blair Athol performance overall in-line

- Blair Athol achieved an EBITDA of $32.7M for the 1QFY19e, precisely as per our forecast. However revenue was less than our estimate due to lower shipments, while costs were also lower due to lower strip ratio. Shipments of 0.61Mt were lower than our forecast of 0.71Mt due to timing, while ROM coal was higher at 0.63Mt and equivalent to a 2.5Mtpa rate.
- Pricing was slightly better than we had forecast with US$95/t realised vs our estimate of US$92/t. Costs were less than we had forecast mostly due to a lower strip ratio achieved of 6.6x vs our estimate for LOM of 8.0x.

Figure 2: Blair Athol Performance

		1QFY19a	*4QFY18a*	*FSBe 1Q*	*Diff vs FSBe*
ROM	**Mt**	**0.63**	***0.72***	***0.48***	***31%***
Strip ratio	x	6.6	*5.4*	*8.0*	*-18%*
Production	**Mt**	**0.56**	***0.61***	***0.41***	***37%***
Yield	%	0.88	*0.84*	*84%*	*4%*
Shipments	**Mt**	**0.61**	***0.38***	***0.71***	***-14%***
A$	US$	0.73	*0.76*	*0.74*	*-1%*
Ave price realised	**A$/t**	**130.3**	***102.6***	***125.0***	***4%***
Ave price realised	US$/t	95.2	*77.7*	*92.0*	*4%*
Newcastle price	US$/t	107.0	*105.8*	*105.0*	*2%*
Discount to N'castle	%	11%	*27%*	*12%*	*-11%*
Unit operating cash costs*	US$/t	56.3	*54.5*	*58.5*	*-4%*
	A$/t	**77.0**	***54.5***	***79.1***	***-3%***
Revenue	A$M	80.0	*39.0*	*89.0*	*-10%*
Operating costs	A$M	47.3	*20.7*	*56.4*	*-16%*
EBITDA	**A$M**	**32.7**	***18.3***	***32.7***	***0%***
Margin	A$/t	53.3	*48.1*	*45.8*	*16%*

*Source: Company. Foster Stockbroking estimates. *C1 costs plus royalties.*

Severe weather impact swings Mongolia to loss

- Mongolian shipments were only 0.12Mt for the quarter vs our expectation of 0.32Mt and the 0.29Mt achieved in the prior quarter. The decline was due to interruptions to mining brought about by extreme weather including flooding.
- With costs mostly fixed, the low shipments resulted in EBITDA loss of -$5.7M vs the $1.1M we had forecast.

Figure 3: Mongolia Performance

		1QFY19a	*4QFY18a*	*FSBe 1Q*	*Diff vs FSBe*
ROM production	**Mt**	**0.10**	***0.29***	***0.32***	***-68%***
Strip ratio	x	9.2	*9.2*	*13.4*	*-31%*
Shipments	**Mt**	**0.12**	***0.27***	***0.32***	***-62%***
A$	US$	0.73	*0.76*	*0.74*	*-1%*
Coking coal spot b'mark	US$/t	188	*190*	*196*	*-4%*
Ave price realised	US$/t	54.8	*54.9*	*52.6*	*4%*
	A$/t	75.0	*72.2*	*71.0*	*6%*
Unit cash costs*	US$/t	89.5	*43.6*	*50.0*	*79%*
	A$/t	122.4	*57.3*	*67.5*	*81%*
Revenue	A$M	9.0	*19.4*	*22.4*	*-60%*
Operating costs	A$M	14.7	*15.4*	*21.3*	*-31%*
EBITDA	**A$M**	**-5.7**	***4.0***	***1.1***	***nm***
EBITDA	A$/t	-47.4	*14.9*	*3.5*	*nm*

*Source: Company; Foster Stockbroking estimates.. *C1 costs plus royalties.*

PRODUCTION FORECASTS UPGRADED FOR BLAIR ATHOL AND MONGOLIA

Blair Athol lifted to 2.5Mpta

- We have upgraded our forecast coal production from Blair Athol by 14% to 2.5Mtpa going forward from 2.2Mtpa previously, based on company guidance. In July, TER revised its FY19e production forecast for Blair Athol to 2.5Mtpa (2.9Mtpa ROM equivalent), over the prior target of 2.2Mtpa production (2.5Mtpa ROM). We see this as attributable to strong coal demand from customers, as well as Blair Athol's latent capacity to support much larger tonnage throughput. The ROM performance in the 1QFY19 has borne this out.

Mongolia production lifted on introducing BNU South

- We have also upgraded our Mongolian coal production forecasts for FY20e and FY21e based on the introduction of mining from BNU South.

Group production lifts

- The net result is that our TER total production forecast slightly falls by 2% to 3.6Mt in FY19e (the weak 1Q Mongolian production offsetting the upgrade to Blair Athol).
- However for FY20e and FY21e production increases 28% and 49% to 4.8Mt and 5.5Mt due to Blair Athol upgrade and the introduction of BNU South.

Figure 4: Revised TER Coal Production Forecasts

	FY19e			FY20e			FY21e		
	new	*old*	*chng*	new	*old*	*chng*	new	*old*	*chng*
Blair Athol	**2.4**	***2.3***	***6%***	**2.5**	***2.2***	***14%***	**2.5**	***2.2***	***14%***
BNU North	1.2	*1.4*	*-15%*	1.5	*1.5*	*0%*	1.5	*1.5*	*0%*
BNU South	0.0	*0.0*	*0%*	0.8	*0.0*	*nm*	1.5	*0.0*	*nm*
Mongolia	**1.2**	***1.4***	***-15%***	**2.3**	***1.5***	***50%***	**3.0**	***1.5***	***100%***
Total	**3.6**	***3.7***	***-2%***	**4.8**	***3.7***	***28%***	**5.5**	***3.7***	***49%***

Source: Foster Stockbroking estimates.

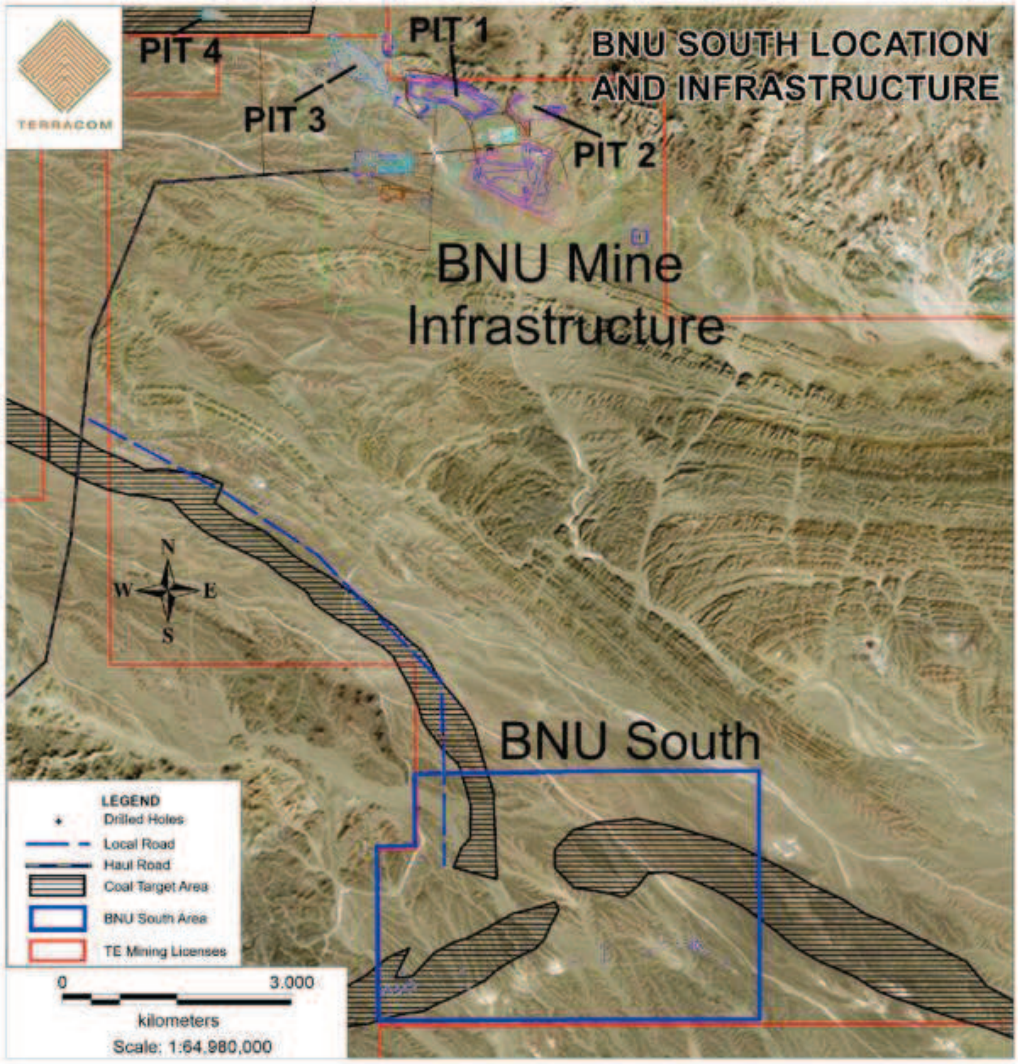
BNU South

- In October the company announced a plan to develop the BNU mine complex to produce up to 3Mtpa, double the current 1.5Mpta, by opening at least another pit. BNU South was identified as the next mineable pit and is located only 12km south of the existing BNU North mine and associated infrastructure.
- BNU South drill intersections of up to 122m gross coal have been achieved with down hole vertical strip of 0.35 to 1. 42 holes were drilled in a Phase 1 campaign drilling, and a high priority area of 600m x 400m identified where intersections are especially thick, averaging 46m gross, and outcropping exists.

Conditions in place for moving into production quickly

- We believe TER can bring BNU South reasonably quickly into production given the inherent advantages the deposits it has including:
  - Located only 12km from BNU North and associated infrastructure;
  - Extensive drilling of deposit;
  - Minimal pre-strip to reach first coal due to relatively low strip ratio;
  - Located wholly within an existing Mining Right;
  - Ability to mobilise existing mine contractor;
  - Ability to utilise existing BNU North customers for some or all of BNU South coal offtake.
- We expect coal from BNU South will be trucked to BNU North, which is where customers will take delivery of coal under a mine gate sale agreement as occurs for BNU North coal currently.
- We introduce the High Priority Coal area from BNU South into our forecasts but only for FY20e-FY22e, with low pricing and margin, short mine life (two years), and assuming coal is all thermal. We assume first production beginning FY20e, and ramp to 1.5Mtpa by end FY20e. We forecast 0.8Mt and 1.5Mt production in FY20e and FY21e.
- At this stage there remain key unknown factors such as amount of coal that can be mined, coal quality, net thickness, pricing, and costs. We expect that once more detail on coal quality and mine planning and size is revealed, including expect margins, that we will revisit our estimates.

Figure 5: BNU South Location



Source: Company

Wash plant - we now expect commissioning in FY20e

- We now expect commissioning of the wash plant to be at beginning FY20e (previously 4QFY19e). We expect TER will want to fully understand the coal characteristics of BNU South coal, washing requirements, and how that coal will be processed or blended with BNU North, if at all. We expect this data will need to be incorporated in the design of the wash plant to ensure optimal performance.

COAL PRICE UPGRADES

Coking and thermal prices increased

- We have upgraded our coal price forecasts maintaining these in line with consensus. This has followed through to increases in our forecast realised pricing for TER's operations. Hard coking coal benchmark increases 6%, 9%, and 8%, and thermal Newcastle benchmark 10%, 12%, 8% in FY19e to FY21e.

Figure 6: Commodity price changes, nominal

	FY19e	FY20e	FY21e	FY22e	LT
Hard coking coal, US$/t b'mark	**189**	**167**	**152**	**147**	**144**
old	*179*	*153*	*141*	*140*	*143*
chng	*6%*	*9%*	*8%*	*5%*	*1%*
Thermal coal Newcastle, US$/t	**98**	**87**	**78**	**74**	**73**
old	*89*	*78*	*72*	*72*	*72*
chng	*10%*	*12%*	*8%*	*3%*	*1%*
A$	**0.75**	**0.75**	**0.74**	**0.74**	**0.74**
old	*0.76*	*0.75*	*0.74*	*0.74*	*0.74*
chng	*-2%*	*0%*	*0%*	*0%*	*0%*

Source: Foster Stockbroking estimates.

- The net impact is an increase in realised pricing for Blair Athol. For Mongolia, the average realised price reduces in FY19e-FY21e due to dilutive impact of BNU South coal which we expect to be mostly thermal, and deferral of wash plant commissioning to FY19e. However we expect this to be more than offset by positive impact on earnings from the incremental BNU South tonnes.

Figure 7: Forecast TER realised pricing, nominal

	FY19e	FY20e	FY21e	FY22e	LT
Blair Athol, US$/t fob	**88**	**78**	**69**	**66**	**65**
old	*78*	*68*	*63*	*63*	*63*
chng	*13%*	*15%*	*10%*	*5%*	*3%*
Mongolia, US$/t mine gate	**56**	**75**	**57**	**83**	**88**
old	*60*	*100*	*83*	*82*	*85*
chng	*-6%*	*-25%*	*-32%*	*1%*	*4%*

Source: Foster Stockbroking estimates.

No direct impact from China coal import restrictions

- China recently tightened restrictions on coal imports until mid 1QCY19, mostly due to environmental and stockpile issues. Most of coal imported into China is thermal and relatively higher ash, lower calorific, and higher impurity than that of Blair Athol. While the diversion of coal destined for China has had some impact on thermal pricing, the spot price remains above our forecasts.

- TER customers are mostly Japan and South Korea buyers, so the company is not directly impacted. The company recently announced a 3-year offtake agreement with a Japanese customer, and a 1 year offtake agreement with a South Korean client for 320kt at a fixed price for CY19e. Combined, the contracts represent up to 55% of Blair Athol's budgeted sales for CY19e.

APPOINTMENT OF CEO

To bring significant coal and bulk mining experience

- TER announced the appointment of Mr Danny McCarthy as CEO, who is scheduled to commence in the role in December 2018. He has held the role of COO for Mineral Resources Ltd (MIN), a company experienced in the processing and mining of bulks, notably iron ore, as well as being highly innovative and astute in commercialising, developing, and operating assets. This includes extracting cost efficiencies and ensuring infrastructure access to deliver bulks to market. Prior to MIN Mr McCarthy held senior roles at Thiess, Wesfarmers, and QCoal, with over 22 years in the resources sector, with significant exposure to coal.
- We believe his experience will add significant value to TER, both to the company's existing operations, as well as to greenfield and brownfield development opportunities.

QUEENSLAND GOVERNMENT CHANGES TO REHABILITATION SURETY

Change a positive for TER

- In October TER replaced its cash financial assurance for Blair Athol's rehabilitation with a bank guarantee. This month, the Queensland Government passed the Mineral and Energy Resources (Financial Planning) Bill 2018 legislation concerning financial provisioning for mining companies, whereby surety for rehabilitation can be provided by alternatives such as insurance bonds, as opposed to bank guarantees or cash deposits.
- We believe this offers TER the opportunity to enter into an agreement with, for example, an insurer, to provide surety in return for paying something akin to an annual premium. This form of surety would replace its bank guarantee.

Would reduce net debt by $72M, or $0.19/share

- While the rehabiltation liability would remain on the balance sheet, the cash previously restricted under bank guarantee would be unrestricted, effectively decreasing TER's net debt by the equivalent amount, with the company then being free to earn interest income or utilise the cash as it sees fit, for example reducing debt, investing in greenfield or brownfield development. This would in effect reduce TER's net debt by $72M, equivalent to $0.19/share. At this stage we have not factored this type of surety in our valuation, but will do so should TER come to some arrangement.

EARNINGS FORECASTS

Upgrades on higher prices and increased production

- We have upgraded TER's earnings, following our upgrades to coking coal and thermal prices and increase in our forecast production from Blair Athol Athol and Mongolia, the latter now including BNU South.
- Our NPAT forecasts have risen 87%, 45%, and 110% to $50M, $81M, and $40M in FY19e, FY20e, and FY21e.

Figure 8: TER Earnings Forecasts A$M

	FY19e	Old	Chng	FY20e	Old	Chng	FY21e	Old	Chng
Thermal Newc. US$/t	**98**	**89**	***10%***	**87**	**78**	***12%***	**78**	**72**	***8%***
Coking b'mark US$/t	**189**	**179**	***6%***	**167**	**153**	***9%***	**152**	**141**	***8%***
A$	0.75	0.76	*-2%*	0.75	0.75	*0%*	0.74	0.74	*0%*
Mongolia	1.2	1.4	*-16%*	2.3	1.5	*50%*	3.0	1.5	*100%*
Australia	2.5	2.3	*9%*	2.5	2.2	*15%*	2.5	2.2	*15%*
Coal sales Mt	**3.7**	**3.7**	***-1%***	**4.8**	**3.7**	***29%***	**5.5**	**3.7**	***50%***
Profit & Loss $M									
Mongolia	90	114	*-21%*	225	181	*25%*	229	168	*36%*
Australia	293	240	*22%*	261	197	*33%*	235	185	*27%*
Sales revenue	**383**	**354**	***8%***	**487**	**378**	***29%***	**464**	**353**	***31%***
Mongolia	86	101	*-14%*	151	126	*21%*	168	126	*33%*
Australia	184	161	*14%*	175	135	*30%*	175	134	*31%*
Corporate	7	7	*0%*	7	7	*0%*	7	7	*0%*
Cash costs adj.	277	269	*3%*	334	268	*25%*	350	267	*31%*
Mongolia	4	13	*-71%*	74	55	*34%*	61	42	*46%*
Australia	109	79	*38%*	86	63	*36%*	60	51	*17%*
Corporate	-7	-7	*0%*	-7	-7	*0%*	-7	-7	*0%*
EBITDA adj.	**106**	**84**	***26%***	**153**	**111**	***38%***	**114**	**86**	***32%***
Depr and amort	25	25	*0%*	22	22	*0%*	22	22	*0%*
Mongolia	-11	-2	*nm*	59	40	*47%*	46	26	*76%*
Australia	99	69	*44%*	79	56	*41%*	53	44	*20%*
Corporate	-7	-7	*0%*	-7	-7	*0%*	-7	-7	*0%*
EBIT adj.	**81**	**59**	***37%***	**131**	**89**	***47%***	**92**	**63**	***45%***
Net interest	35	34	*1%*	36	36	*-1%*	31	34	*-9%*
PBT	46	25	*85%*	95	53	*80%*	61	29	*109%*
Tax	-3	-1	*179%*	16	-0	*nm*	22	12	*84%*
Minorities loss(gain)	1	1	*0%*	1	1	*0%*	1	1	*0%*
NPAT adj.	**50**	**27**	***87%***	**81**	**55**	***47%***	**40**	**19**	***110%***

Source: Foster Stockbroking estimates.

VALUATION – INCREASES TO $0.97 FROM $0.73

Upgrades drive valuation increase

- Following our earnings upgrades, our DCF NPV_{10} valuation of TER has increased to $0.97/share from $0.73/share. We also remove any requirement to raise equity in future to repay the Euroclear bond, as we now estimate that TER can service the repayment out of operating cash flow and existing cash.

Figure 9: TER Valuation NPV_{10}

	Unrisked		Risked		
Project	**A$M**	**A$/share**	**A$M**	**A$/share**	**risk factor**
South Gobi	415	1.06	267	0.68	64%
Blair Athol	369	0.94	329	0.84	89%
Mid Gobi	4	0.01	1	0.00	20%
Northern Galilee	39	0.10	8	0.02	20%
Springsure & Fernlee	8	0.02	4	0.01	50%
Other Queensland	5	0.01	1	0.00	20%
Other Mongolia	5	0.01	1	0.00	20%
Corporate	-55	-0.14	-42	-0.11	76%
Net cash (debt)	-191	-0.49	-191	-0.49	100%
Cash from options & warrants	3	0.01	3	0.01	100%
Equity	**602**	**1.53**	**381**	**0.97**	**63%**
Ordinary shares M	380			380	100%
Options & warrants M	13			13	100%
Diluted shares M	**393**			**393**	**100%**

Source: Company; Foster Stockbroking estimates.

Trading at overall discount to peers

- In terms of peer valuation, TER is trading at discount to peers on P/E and EBITDA multiples in FY19e and FY20e, with the exception of FY20e EBITDA multiple. We believe the overall general discount gives support to our DCF valuation. Key to re-rating includes delivering on increased production and wash plant.

Figure 10: Coal stock multiples

Company	**FY19e**		**FY20e**	
	P/E x	**EV/EBITDA**	**P/E x**	**EV/EBITDA x**
New Hope (NHC)	6.9	3.6	10.5	4.9
Stanmore (SMR)	3.6	2.0	4.3	2.4
Whitehaven (WHC)	6.5	4.1	3.8	2.9
Average	**5.7**	**3.2**	**6.2**	**3.4**
TER	**3.7**	**3.9**	**2.3**	**2.7**
Disc/(Prem) to peers	**35%**	**-21%**	**63%**	**20%**

Source: Bloomberg consensus for peers; Foster Stockbroking estimates for TER.

RECOMMENDATION – MAINTAIN BUY, 12-MONTH PT $0.97/SHARE

- We maintain our Buy recommendation and increase our 12-month price target to $0.97/share (from $0.73 previously), in-line with our revised valuation (1.0x Price/risked NPV_{10}).
- Major catalysts for the share price include:
  - Improvement in BNU and Blair Athol profitability;
  - Commissioning of CHPP at BNU;
  - Higher coal prices;
  - Reduction in net debt;
  - Reserve and resource upgrade;
  - Refinancing of debt; and
  - Progress on BNU South.

FOSTER STOCKBROKING DIRECTORY

Name	Role	Phone	Email
Stuart Foster	Chief Executive Officer	+61 2 9993 8131	stuart.foster@fostock.com.au
Martin Carolan	Head of Institutional Sales	+61 2 9993 8168	martin.carolan@fostock.com.au
Haris Khaliqi	Institutional Sales	+61 2 9993 8152	haris.khaliqi@fostock.com.au
James Gore	Institutional Sales	+61 2 9993 8121	james.gore@fostock.com.au
George Mourtzouhos	Execution & Dealing	+61 2 9993 8136	george.mourtzouhos@fostock.com.au
Mark Hinsley	Head of Corporate Finance	+61 2 9993 8166	mark.hinsley@fostock.com.au
Rob Telford	Corporate - Perth	+61 2 9993 8132	rob.telford@fostock.com.au
Mark Fichera	Head of Research	+61 2 9993 8162	mark.fichera@fostock.com.au
Matthew Chen	Research	+61 2 9993 8130	matthew.chen@fostock.com.au

Foster Stockbroking Pty Ltd
A.B.N. 15 088 747 148 AFSL No. 223687
Level 25, 52 Martin Place, Sydney, NSW 2000 Australia
General: +612 9993 8111 Equities: +612 9993 8100 Fax: +612 9993 8181
Email: contact@fostock.com.au
PARTICIPANT OF ASX GROUP

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Disclosure review. All the disclosures in the report have been reviewed and checked by Keith Quinn, Compliance Committee Member.