

**COMPANY** Cuesta Coal Ltd| CQC | \$0.14/share

Date: 22<sup>nd</sup> February 2012

**RECOMMENDATION** Spec Buy | Very High Risk | \$0.30/share target (Previously –Spec Buy| \$0.32/share target)

**EVENT** Raises capital at premium to market | Accelerating Moorlands coal development work

#### KEY POINTS

- CQC has executed a Share Placement Agreement to raise \$12m by placing 66.67m shares at \$0.18/share at a 32% premium to its one month VWAP with its major China based shareholder, Beijing Guoli. The deal is subject to FIRB and Chinese Regulatory Approval, an Independent Expert Report and granting a Board seat to Guoli.

#### Use funds to reduce debt + accelerate Moorlands thermal coal project evaluation

- \$5m will be used to redeem half of the \$10m convertible note issued to vendors as part of an \$18.2m purchase of the Orion project, just north of CQC's Moorland's discovery located 14km west of the Blair Athol Coal Mine in Queensland's Western Bowen Basin.
- \$7m will be added to CQC's ~\$5.5m current cash to fast-track CQC's priority development project at Moorlands. We expect the program will include drilling to confirm coal qualities and expand the current 136.3mt total JORC Resource (14.6mt measured and 38.9mt Indicated status) and convert most to Indicated or higher status and conduct mine studies and infrastructure studies. The 85mt-plus exploration targets may also be tested.
- We are attracted to Moorland's open-cut low strip ratio resource, close to under-utilised rail and load-out infrastructure. The product may include portions of no-wash thermal coal that appears similar to Rio Tinto's recently shuttered Blair Athol mine that was near exhaustion. The project could support up to 4mtpa raw product

#### Major shareholder's commitment and added activity

- Beijing Guoli has committed a total of \$32m to CQC, demonstrating its confidence in the current management's impressive exploration track record and moving towards the development phase of a now expanded Moorlands Project. If approved, the placement would take Beijing Guoli's holding to ~47% of CQC from ~30%.
- CQC will actively pursue two other projects in 2013. **West Emerald** is a PCI coal target close to infrastructure and large finds made by Rio Tinto and Linc Energy. This could be drilled mid-2013. We also expect more work on CQC's Eastern Galilee Basin find where it plans to test resource extensions at **Yellow Jacket** discovery and release a maiden resource soon. **Hancock Prospecting** may initiate part of its \$3m farm-in in 2013 by drilling EPC2080, north of Yellow Jacket, following its award by the Queensland Government to CQC on 11<sup>th</sup> Feb 2013.
- CQC's other discoveries in the Surat (Thorn Hill) and Clarence Moreton (Amberley) Basins will see little activity or be opportunistically sold to help fund core projects.
- **Valuation adjustment** – if the Share Placement Agreement is approved, the extra shares issue would dilute our valuation from \$0.32 to ~\$0.30/share. Our Moorland's Project 60% confidence factor remains unaltered, though the extra funding to accelerate drilling can partially de-risk. We will wait until the mine studies are concluded.
- **Speculative Buy retained, price target moved to \$0.30/share.** Risks include drilling failure and poor markets.

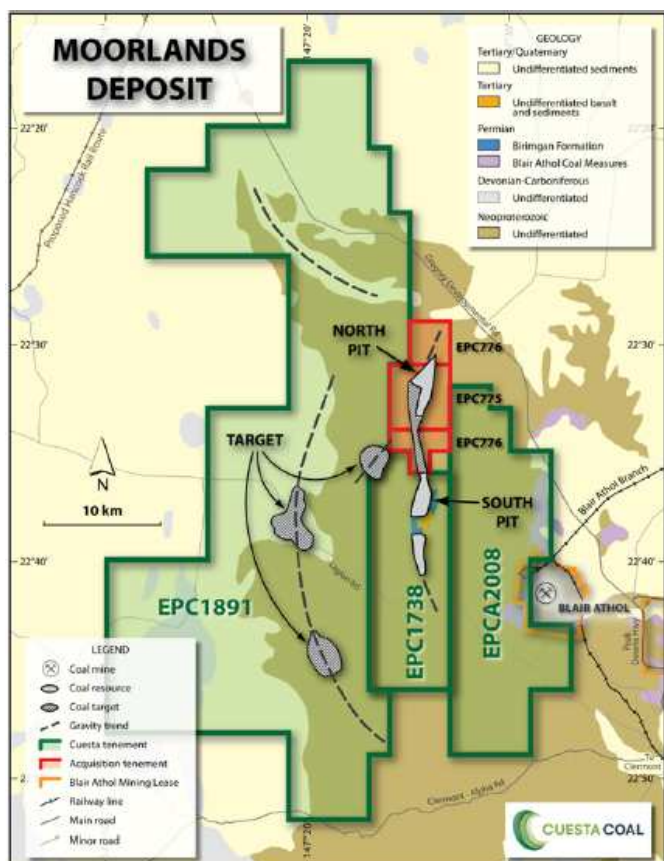
## Valuation assuming the Share Placement Agreement is approved

The capital raising was done at a premium to market price, but below our \$0.32/share valuation. Adjusting for the placement, should it take place, our valuation declines to \$0.30/share.

Valuation	CQC share	Coal Resource	Product Coal	Confidence Level	Riskd Value A\$/t product	Riskd A\$m	Value A\$ps	Unriskd A\$ps
Dil.shares	328.7	%	mt	mt	%			
Moorlands-Orion	100%	136	71	60%	\$0.56	40	\$0.12	\$0.20
		Resource	Target Size					
W.Bowen extended	100%	0	34	17%	\$0.11	4	\$0.01	\$0.07
Thorn Hill	90%	40	59	45%	\$0.09	9	\$0.03	\$0.06
Amberley	100%	55	3	95%	\$0.25	14	\$0.04	\$0.05
Yellow Jacket	100%	0	748	16%	\$0.05	38	\$0.11	\$0.71
West Emerald	100%	0	80	27%	\$0.08	6	\$0.02	\$0.07
Other Assets	100%	0	960	18%	\$0.00	4	\$0.01	\$0.06
Corporate Costs				100%		-17	-\$0.05	-\$0.05
Debt & Convert Notes			-10	100%		-10	-\$0.03	-\$0.03
Options exercise	0.0			100%		0	\$0.00	\$0.00
Cash - Jun'13e	10.7			100%		11	\$0.03	\$0.03
<b>Total Valuation</b>		<b>231</b>				<b>98</b>	<b>\$0.30</b>	<b>\$1.18</b>

Source: PhillipCapital research estimates

## Newly acquired EPC775/776 boosts Moorlands size PhillipCapital's preliminary view of Moorlands project



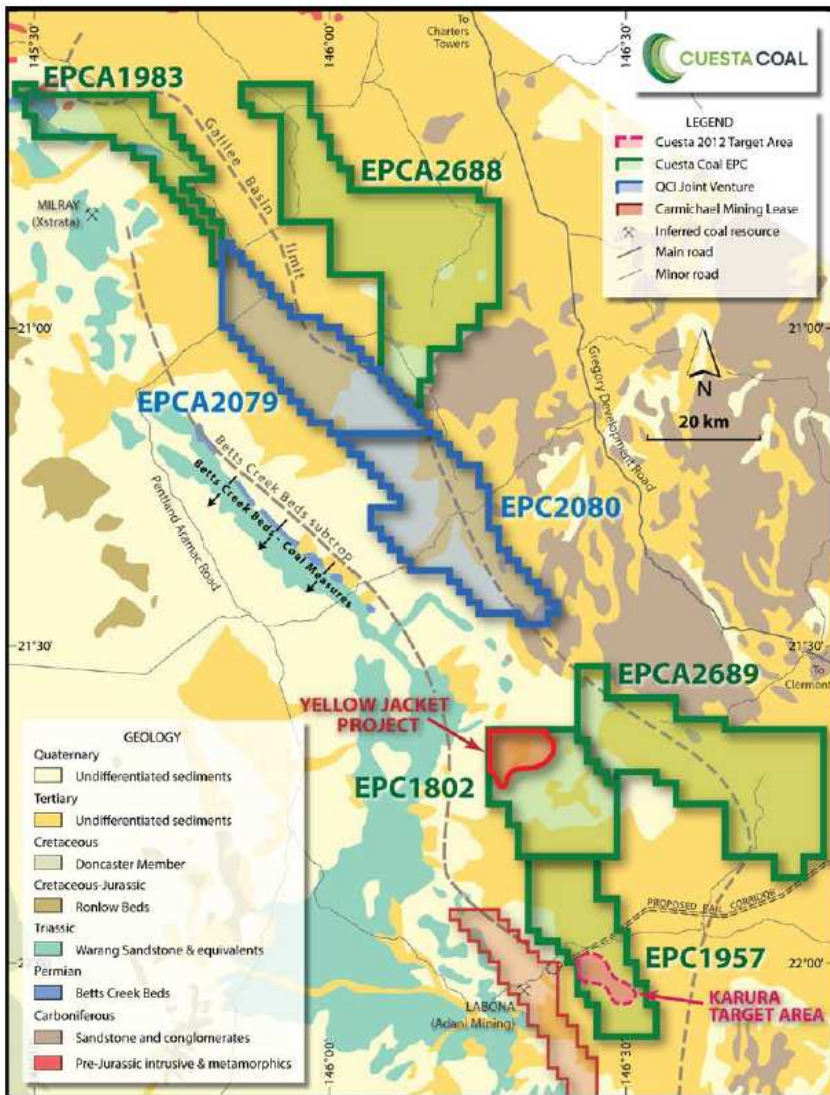
CQC's drilling expanded the South pit that contains low initial strip ratio (~4:1) coal. More upside in targets.

Moorlands-Orion			
Resources JORC: Meas. & Indic.	mt		53.5
Total JORC Resources	mt		136.3
Exploration target	mt		85.0
ROM coal	mt		84.8
Marketable coal	mt		70.8
Strip ratio - life of mine	x		7.2
Mine Life at start-up & plateau rate	Years	48	23
Start-up ROM rate	JunQ'17 mtpa	Initial	Plateau
Semi-soft Coking Coal	mtpa	0.0	0.0
Export Thermal - Premium	mtpa	0.6	1.2
Export Thermal - Standard	mtpa	0.9	1.8
Total Saleable Coal	mtpa	1.5	3.0
Capital Expenditure	A\$m	95	
SIB Capital expenditure	A\$m pa	1	
Expansion Capital expenditure	A\$m		45
Cash costs	A\$/t product		\$39
Transport Costs	A\$/t product		\$30
Total Cash Costs	A\$/t product		\$69
Initial Ownership	%		100%
Assumed Ownership	%		100%
Asset Sale realisation	A\$m		0
NPV	A\$m	A\$/t	A\$m.
Riskd NPV	A\$m	\$0.49	\$67
Discount Rate	11.5%		

The mine study could de-risk the project and cause us to re-assess our Speculative tag on our Buy recommendation

## Galilee Basin eastern extension

– Discovered and dominated by CQC – a longer term strategic asset



Yellow Jacket in EPC1802 is CQC's 100% owned Greenfield Galilee Basin extension discovery. Completed drilling has found thermal coal over 15km<sup>2</sup> at depths <130m and CQC expects to declare a Maiden JORC Resource estimate in March 2013. CQC's have an exploration target of 200mt plus, and with up to 1,000mt possible on further exploration in this or nearby blocks.

CQC's 90% owned EPC1957 is south of and adjoins the Yellow Jacket block. CQC has identified a similar signature coal exploration target called Karura, just south of Adani's proposed rail development.

We see CQC's Galilee Basin position potentially attracting the attention of Galilee mine developers including Hancock Prospecting and Adani. This may occur upon a solid resource announcement in EPC1802, a coal discovery in EPC1957 and/or more discoveries after the start of the \$3m work program at EPCA2079 & EPCA2080 with Hancock Prospecting carrying these expenses to farm-in for 51%.

CQC's Eastern Galilee prospects may in time aggregate to coal resources logistically too important for the Basin's coal mine developers, or the market, to ignore.

## Maintain Spec Buy, \$0.30/share price target – assumes placement completed

We are attracted to CQC's strong ability to cost effectively explore. It has discovered 152.7mt JORC compliant resource at three deposits. Amberley 54.7mt and Thorn Hill 44.6mt both have upside, though may be sold to assist development of the expanded Moorlands Project and increase its Galilee exploration effort as well as test a PCI coking target at West Emerald in 2013.

Note that coal exploration companies at an early stage of business development and should be viewed as speculative investments.

Should you have any queries, please do not hesitate to contact me on +61 2 9233 9635.

**Cuesta Coal Limited CQC**

 Recommendation  
Spec Buy

 Date 22-Feb-13 Price Target Shares Market Cap  
\$0.140 \$0.300 191.6 26.8

**PROFIT AND LOSS - A\$m**

Y/E June	FY'12	FY'13	FY'14	FY'15	FY'16
Sales Revenue	0.2	1.0	0.0	0.0	0.0
Other Revenue (incl hedge)	0.0	0.0	14.4	0.0	0.0
Operating Costs	0.0	0.0	0.0	0.0	0.0
<b>Gross Operating Profit</b>	<b>0.2</b>	<b>1.0</b>	<b>14.4</b>	<b>0.0</b>	<b>0.0</b>
Depreciation	0.0	0.0	0.0	0.0	0.0
Exploration and Royalties	0.0	0.0	0.0	0.0	0.0
Corporate and Other	4.3	2.5	3.2	3.1	3.1
<b>EBIT</b>	<b>-4.1</b>	<b>-1.6</b>	<b>11.2</b>	<b>-3.2</b>	<b>-3.2</b>
Less Net Interest Expense	0.6	-0.5	0.2	0.9	2.7
<b>Pre-Tax Profits</b>	<b>-4.7</b>	<b>-1.1</b>	<b>10.9</b>	<b>-4.2</b>	<b>-5.9</b>
Add Equity Profits	0.0	0.0	0.0	0.0	0.0
Less Tax	0.0	-0.3	3.3	-1.3	-1.8
Less Minorities	0.0	0.0	0.0	0.0	0.0
<b>NPAT (pre-Abs)</b>	<b>-4.7</b>	<b>-0.8</b>	<b>7.7</b>	<b>-2.9</b>	<b>-4.2</b>
Net Abnormals	0.0	0.0	0.0	0.0	0.0
<b>Reported Profit</b>	<b>-4.7</b>	<b>-0.8</b>	<b>7.7</b>	<b>-2.9</b>	<b>-4.2</b>
Tax Rate (%)	0.0%	30.0%	30.0%	30.0%	30.0%

**CASH FLOW ANALYSIS - A\$m**

Y/E June	FY'12	FY'13	FY'14	FY'15	FY'16
<b>Cash Flows From Operating Activities</b>					
Receipts from customers	0.0	1.0	0.0	0.0	0.0
Payments To Suppliers	(2.3)	(0.0)	(0.0)	(0.0)	(0.0)
Net Interest	0.1	0.5	(0.2)	(0.9)	(2.7)
Tax, Royalty and Other	0.0	(2.5)	(4.2)	(3.2)	(3.2)
	<b>(2.2)</b>	<b>(1.1)</b>	<b>(4.4)</b>	<b>(4.1)</b>	<b>(5.9)</b>
<b>Cash Flows From Investing Activities</b>					
Acq.of Property, Plant and Equip.	(0.0)	(23.4)	5.0	(22.2)	(31.7)
Exploration Expenditure	(8.3)	(5.4)	(3.0)	(0.8)	(0.3)
Other	0.0	0.0	0.0	0.0	0.0
	<b>(8.4)</b>	<b>(28.9)</b>	<b>1.9</b>	<b>(23.0)</b>	<b>(32.0)</b>
<b>Cash Flows From Financing Activities</b>					
Net Change in Borrowings	0.0	10.0	(3.8)	15.0	26.9
Dividends Paid	0.0	0.0	0.0	0.0	0.0
Other (Inc issues less buy backs)	25.9	11.4	0.0	19.2	0.0
	<b>25.9</b>	<b>21.4</b>	<b>(3.8)</b>	<b>34.1</b>	<b>26.9</b>
<b>Net Increase In Cash Held</b>	<b>15.3</b>	<b>(8.6)</b>	<b>(6.3)</b>	<b>7.0</b>	<b>(10.9)</b>
Cash At End of Year	19.3	10.7	4.4	11.4	0.4

**BALANCE SHEET ANALYSIS - A\$m**

Y/E June	FY'12	FY'13	FY'14	FY'15	FY'16
<b>Current Assets</b>					
Cash and Liquids	19.3	10.7	4.4	11.4	0.4
Other	7.9	7.9	7.9	7.9	7.9
<b>Non-Current Assets</b>					
Receivables	0.0	0.0	0.0	0.0	0.0
Fixed Assets	0.1	23.5	32.9	55.1	86.7
Exploration & Other	12.9	18.3	21.3	22.1	22.4
<b>Current Liabilities</b>					
Borrowings	0.0	0.0	0.0	0.0	0.0
Creditors	2.7	2.7	2.7	2.7	2.7
Other	0.0	(0.3)	1.9	0.7	(1.1)
<b>Non-Current Liabilities</b>					
Borrowings	0.0	10.0	6.2	21.1	48.1
Other	0.0	0.0	0.0	0.0	0.0
<b>Minority Interest</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>
<b>SHAREHOLDERS FUNDS</b>	<b>37.5</b>	<b>48.1</b>	<b>55.8</b>	<b>72.0</b>	<b>67.8</b>

**PRICE ASSUMPTIONS**

Y/E June	FY'12	FY'13	FY'14	FY'15	FY'16
<b>FOB prices: US\$/t</b>					
<b>LT Real (2016\$)</b>					
Exchange Rate USD/AUD	0.84	1.03	1.04	0.99	0.91
Coking Coal - Premium	180.00	254.00	177.50	192.50	185.00
Semi Soft Coking Coal	119.89	169.15	106.72	114.75	122.50
Export Grade Thermal Coal	97.00	111.33	89.88	92.50	95.00
<b>Moorlands area Products</b>					
Semi-soft Coking Coal	126.99	179.18	113.05	121.55	129.76
Thermal Coal - Premium	88.21	101.24	81.73	84.12	86.39
Thermal Coal - Standard	85.20	97.79	78.94	81.25	83.44
Company Tax Rate	30.0%	Secondary Tax applicable: MRRT Applies			

**VALUATION PARAMETERS**

Y/E June	FY'12	FY'13	FY'14	FY'15	FY'16	
NPAT (pre-Abs)	\$m	-4.7	-0.8	7.7	-2.9	-4.2
EPS	eps	-3.8	-0.3	2.3	-0.6	-0.9
PE Ratio	x	-3.7	-48.6	6.2	-21.6	-15.8
EPS Growth	%	100.0	92.4	+>100.0	-->100.0	-37.1
Enterprise Value	\$m	2.3	36.1	42.9	70.0	106.1
EV / Sales	x					
EV / EBITDA	x	-0.6	-23.0	3.8	-21.8	-33.1
EV / EBIT	x	-0.6	-22.4	3.8	-21.6	-32.7
Price / NTA	x	0.7	0.9	0.8	0.9	1.0
Dividend	eps	0.0	0.0	0.0	0.0	0.0
Yield	%	0.0	0.0	0.0	0.0	0.0
Franking	%	0.0	0.0	0.0	0.0	0.0
CFPS	eps	-2.4	-0.3	2.4	-0.6	-0.9
Price / CFPS	x	-5.8	-55.5	5.8	-22.5	-15.7
NFPOS	mil.	191.6	303.0	317.0	462.7	462.7
Fully Diluted Shares	mil.	191.6	328.7	342.7	487.8	462.7

**KEY RATIOS**

Y/E June	FY'12	FY'13	FY'14	FY'15	FY'16	
EBITDA	\$m	-4.1	-1.6	11.2	-3.2	-3.2
EBITDA per Share	eps	-3.3	-0.6	3.3	-0.7	-0.7
EBITDA Margin	%					
EBIT Margin	%					
NPAT Margin	%					
ROE	%	-12%	-2%	14%	-4%	-6%
ROA	%	-12%	-1%	12%	-3%	-4%
NTA per share	eps	19.6	15.9	17.6	15.6	14.7
Eff Tax Rate	%	0%	30%	30%	30%	30%
Interest Cover	x	-7.5	3.5	51.0	-3.5	-1.2
Net Debt/Equity	%	-51%	-1%	3%	14%	70%
Net Debt/Net Debt plus Equity	%	-106%	-1%	3%	12%	41%

**DIVISIONAL VALUATION & RESOURCES**

	Risked	NPV A\$m	p sh	mt	Resource mt	Targets mt
Moorlands-Orion	60%	40	0.12	71	136	
W.Bowen extended	17%	4	0.01		0	34
Thorn Hill	45%	9	0.03		40	59
Amberley	95%	14	0.04		55	3
Yellow Jacket	16%	38	0.11		0	748
West Emerald	27%	6	0.02		0	80
Other Assets	18%	4	0.01		0	960
Corporate Costs		-17	-0.05			
Debt & Convert Notes		-10	-0.03			
Options exercise		0	0.00			
Cash - Jun'13e		11	0.03			
<b>TOTAL NPV (A\$m)</b>		<b>98</b>	<b>0.30</b>	<b>71</b>	<b>231</b>	<b>1884</b>
NPV per Share (Unrisked)		387	1.18			
<b>Target Price - 1 year</b>			<b>0.30</b>			

**COAL SALES**

Y/E June	FY'12	FY'13	FY'14	FY'15	FY'16
<b>By Project - mt</b>					
Net w.i.					
Moorlands-Orion	100%	0.0	0.0	0.0	0.0
Other 1	0%	0.0	0.0	0.0	0.0
Other 2	0%	0.0	0.0	0.0	0.0
<b>Total Shipments</b>		<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>
<b>By Product - mt</b>					
Export Thermal - Standard		0.0	0.0	0.0	0.0
Export Thermal - Premium		0.0	0.0	0.0	0.0
Semi-soft Coking Coal		0.0	0.0	0.0	0.0
PCL Low Vol Coking Coal		0.0	0.0	0.0	0.0
<b>Total Shipments</b>		<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>

**MARGIN ANALYSIS**

	FY'12	FY'13	FY'14	FY'15	FY'16
<b>Average Price Received (A\$/t)</b>					
Site & Transport Cash costs (A\$/t)					
<b>Total costs (A\$/t)</b>					
Incl interest (A\$/t)					
Incl Tax (A\$/t)					
<b>Net Margin (A\$/t)</b>					
<b>Price Received (US\$/t)</b>					
Cash costs (US\$/t)					
<b>Total costs (US\$/t)</b>					
Incl interest (A\$/t)					
Incl Tax (A\$/t)					
<b>Net Margin (US\$/t)</b>					

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**Recommendation Criteria**

**Investment View**

PhillipCapital Investment View is based on an absolute 1-year total return equal to capital appreciation plus yield.

Buy	Hold	Sell
> 20%	20% - 5%	< 5%

A Speculative recommendation is when a company has limited experience from which to derive a fundamental investment view.

**Risk Rating**

PhillipCapital has a four tier Risk Rating System consisting of: Very High, High, Medium and Low. The Risk Rating is a subjective rating based on: Management Track Record, Forecasting Risk, Industry Risk and Financial Risk including cash flow analysis.

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