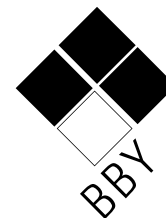


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## Linc Energy Limited Coking Coal Deposit to Help Fund LNC

# LNC

# A\$2.12 BUY

12 May 2008

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Linc Energy Limited (LNC) has announced that it will commence exploration drilling on its Emerald Coal Tenement EPC 980 known as "Teresa" within 7 days. Analysis shows that this block holds significant coking coal potential. The aim is to establish a resource in accordance with JORC code. It is the intention of the company to sell the asset to help finance LNC's commercial 20,000 barrel per day GTL facility. This is a positive development. We maintain our BUY on LNC increasing our base case DCF valuation to A\$2.95/sh due to: (i) increasing our long term WTI Oil Price assumptions to US\$65/bbl (prev US\$50/bbl) – in line with Jefferies & Co; and (ii) reducing our WACC to 14% (prev 15%) as a result of a reduction in financing risks. Our 12 month price target is also A\$2.95/sh (prev A\$2.10/sh).

### Emerald Coal Tenement EPC 980

- ▶ LNC will commence exploration drilling on the tenement within the next 7 days. The tenement is well placed from an infrastructure point of view as it has major highway access, has ready access to power and has an established rail line passing through the coal tenement.
- ▶ The tenement is adjacent to the Crinum Mine, which is owned by the BHP and Mitsubishi alliance (Figure 1).
- ▶ No further details were given as to the potential size of the coal asset. Once LNC has established a JORC resource, LNC will seek expressions of interest to subsequently sell the asset, with a view to having a sale agreement in place by the end of the year.
- ▶ This is a positive development for the company which could significantly help with funding the commercial 20,000 barrel per day plant. As a result, we reduce our WACC from 15% to 14%, to take into account the reduction in financing risk.

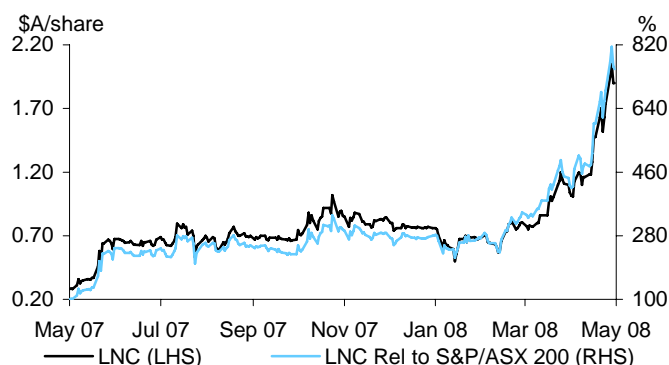
### Gas to Liquids (GTL) Commissioning Update

- ▶ Commissioning of LNC's GTL pilot plant is running 4-5 weeks behind schedule, primarily as a result of piping delays. This does not come as a surprise to us (flagged in our note on 28 April 2008). All of the main utilities have been commissioned.
- ▶ We expect the pilot plant to be fully commissioned by the second or third week in June.

### Company Data

Number of shares	389.6M
Market capitalisation	\$826.0M
12 month high/low	\$2.16 / \$0.28
Average monthly turnover	\$10.6M
All Ordinaries Index	5873
% All Ordinaries	n/a

### LNC versus S&P/ASX 200 Index



## Base Case Assumptions For Our DCF Valuation

Our Base Case DCF valuation for LNC is A\$2.95/sh. This is based on the following key assumptions:

- ▶ A WACC of 14%;
- ▶ A long term oil price of US\$65/barrel (in-line with the Jefferies WTI oil price assumptions); and
- ▶ LNC conducting an equity capital raising for its commercial plant at A\$2.00/sh (assuming a 70/30 debt to equity split). Note that we have not ascribed any value from the coking coal deposit to fund CAPEX requirements at this stage.

We provide sensitivity analysis to our DCF valuation based at different: (i) long term oil prices; and (ii) adjustments to the WACC:

**TABLE 1: SENSITIVITY ANALYSIS 1 – DCF VALUATION (A\$M)**

		Flat Long Term WTI Oil Price (per barrel)							
		US\$50	US\$60	US\$65	US\$70	US\$80	US\$90	US\$100	US\$110
WACC	10%	3.61	4.42	4.92	5.42	6.43	7.44	8.45	9.45
	11%	3.14	3.86	4.31	4.75	5.65	6.55	7.45	8.35
	12%	2.73	3.38	3.78	4.18	4.99	5.8	6.6	7.41
	13%	2.39	2.97	3.34	3.69	4.42	5.15	5.87	6.6
	14%	2.09	2.62	2.95	3.27	3.93	4.59	5.25	5.91
	15%	1.83	2.31	2.61	2.91	3.51	4.11	4.70	5.30

Source: BBY estimates

## How Much Could The Coking Coal Deposit Be Worth To LNC?

Very few details were given by the company as to the size and the quality of the coking coal. However, we provide sensitivity analysis as to how much this deposit could be worth to LNC's share price on a coking coal deposit basis alone. The key for LNC will also be to transfer as many tonnes of coking coal into the JORC resource category as soon as possible.

**TABLE 2: SENSITIVITY ANALYSIS 1 – POTENTIAL VALUE PER SHARE (A\$/SH)**

		Coking Coal Indicative Selling Price (t)				
		A\$0.50	A\$1.00	A\$1.50	A\$2.00	A\$2.50
tonnes (M)	50	0.06	0.13	0.19	0.26	0.32
	100	0.13	0.26	0.39	0.51	0.64
	150	0.19	0.39	0.58	0.77	0.96
	200	0.26	0.51	0.77	1.03	0.77
	250	0.32	0.64	0.96	1.29	1.61
	300	0.39	0.77	1.16	1.54	1.85

Source: BBY estimates

## Potential Government Assistance?

From previous comments by the Federal and State Ministers, both are supportive of the domestic GTL industry, and in particular of LNC's project. The Federal Government has established a A\$500M clean coal fund. We understand more details will be revealed on Tuesday night's budget as part of the reported A\$2.3B climate change initiative. We await further details on this matter.

## Our View

LNC continues to be the dominant UCG/GTL player. We await successful commissioning of the company's pilot over the next few weeks.

## Financial Summary

### ANALYSIS OF INTEGRATED GAS PRODUCTION & GTL

#### Gas Production

Plant capacity	20,000 bbl/day		
Availability Factor	90.4 %	Plant Availability Time	7,920 hours / year
Gas Production	1,397,023 Nm <sup>3</sup> / hour	Total Gas Production	11,064,424,587 Nm <sup>3</sup> / year
Gas Calorific Value	5.23 MJ / Nm <sup>3</sup>	Total Energy Output	57,866,941 GJ / year

#### By-Product Production - Hydrocarbons

Hydrocarbon Production	15.27 g / Nm <sup>3</sup>	Total Hydrocarbon Production	168,996 tn / year
Sale Value of Hydrocarbons	100 \$ / tn	Total Hydrocarbon Revenue	16,899,589 \$ / year

#### By-Product Production - Naphtha

Naphtalene Production	10.16 g / Nm <sup>3</sup>	Total Naphtalene Production	112,415 tn / year
Sale Value of Naphtha	400 \$ / tn	Total Naphtalene Revenue	44,965,822 \$ / year

#### Diesel Production

GTL Plant Energy Efficiency	70 %	Diesel Calorific Value	6.137 GJ / barrel
Maximum Energy Output	40,506,858 GJ / year	Maximum Diesel Production	6,600,003 barrels / year
Availability Factor - year 1	85.0 %	Diesel Production - year 1	5,610,003 barrels / year
Availability Factor - year 2	90.0 %	Diesel Production - year 2	5,940,003 barrels / year
Availability Factor - years 3+	95.0 %	Diesel Production - years 3+	6,270,003 barrels / year
Diesel Selling Price * 65 US\$ / bbl	92.86 \$ / barrel	Total Diesel Revenue (Year 3+):	582,214,550 \$
Federal Tax Exemption	no	Federal Tax Rate	0.36 \$/litre

#### Economic Factors

Debt	70.0 %
Equity	30.0 %
Exchange Rate \$/US\$	0.7

#### WACC:

14.0 %

#### Capital Expenditure Details

Gas Process Plant	70,000,000 \$		
Clean Up Plant	180,000,000 \$	Total Capital Required	850,000,000 A\$
GTL Plant	600,000,000 \$		

#### Operating Costs

Gas Process Plant	28,900,000 \$ / year		
Clean Up Plant	14,200,000 \$ / year		
GTL Plant	50,000,000 \$ / year	Total Opex	93,100,000 \$ / year

#### Summary per year (no inflation)

Total Revenues (year 3+)	644,079,000 \$ / year
Total Opex	93,100,000 \$ / year
Total Site Admin Cost	4,000,000 \$ / year
Total HQ Admin Cost	7,000,000 \$ / year
Federal Tax Exemption	0 \$ / year

DCF @ 14 %	1,295,674,174 \$
Internal Rate of Return	37.65 %
Discounted Payback	7 years = 2013
Plant Capacity to Break Even	1,616 bbl/day

**EBITDA** ■ 539,979,000 \$ / year

Source: BBY, Company Reports

FIGURE 1: LOCATION OF LNC'S EMERALD DEPOSIT



★ LNC's Tenement

Source: [www.mining-technology.com](http://www.mining-technology.com)



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Contact with LNC has been made during the preparation of this report for assistance with verification of facts.

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