Wednesday, 29 September 2021

COMPANY REVIEW

CORPORATE CONNECT

TerraCom Limited

ASX Code: TER

Accelerating free cashflow secures funding; & boosts re-rating potential

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Company Data

ASX price	**$0.17**
Target price *(previously $0.24)*	**$0.31/share**
NPV based Valuation	**$0.37/share**
Market capitalisation	$120.6m
Shares on issue	753.6m
12-month price range	$0.08 – $0.20
ASX av daily turnover (90 day)	1.26 m shares

[1] Cash = Latest 4C balance + Raisings + Tax + 4C Expected outflows

Earnings Outlook [1,2]

Jun Yr	FY'20a	FY'21	FY'22	FY'23
Coal sales	3,922	5,841	6,170	7,006
Sales Revenue	316.9	549.0	881.7	835.1
EBITDA	5.4	25.0	306.7	231.5
NPAT	(25.2)	(90.3)	111.7	74.4
EPS	(4.5)	(12.0)	14.8	9.9
PE	(3.7)	(1.4)	1.1	1.7
Div. Yield	6%	0%	0%	0%
EV/EBITDA	*NM*	26.7	1.6	1.5

[1] Continuing operation excludes Mongolia.
[2] Enterprise value = Mkt capitalisation plus debt & ST liabilities minus cash

NPV-based Valuation after risking [1,2]

Asset or Liability	A$mil.	A$/share
Blair Athol	256.7	0.34
South African Mines	237.3	0.31
Development assets	44.9	0.06
Net Fees, Corp Costs	-40.2	-0.05
Net ST Liabilities	-22.4	-0.03
Net Debt	-199.3	-0.26
Total	277.0	0.37

[1] Valuation as @ 31 Dec 2020
[2] Aust assets discount rate 10.9% pa; 16.4% p.a. for South African assets

Price/Volume Chart – 1-year

Source: FactSet

In cashflow we trust – funding options expand

Increasingly carbon-conscious debt markets have reduced supply of credit to coal groups. In TER's year-long quest to refinance its ~US$170m Euroclear Bond it succeeded in extending the maturity from 30th June 2021 until 8th October 2021. TER is in advanced negotiations with a consortium to replace this Bond, and secure extra funds for TER to consider a new South African mine and potentially invest in Guinean bauxite and iron ore; at a cheaper ~10%pa interest cost. The Euroclear's cost is 12.5%pa plus 0.75% Blair Athol revenue.

Should this refinance not occur in October, an *Alternative Refinance Package (ARF)* is enacted requiring Euroclear Bond's principal and interest payments until 31Dec2022. These payments will be governed by TER's now increasing cashflows. *If coal prices maintain the recent forward curve which is ~25% above our estimates,* TER forecasts that at current cashflow the facility can be repaid by end of 2022. *TER's exceptional cashflow reduces its refinancing risks.*

FY21 a turbulent and yet transformational year

The fiscal year to 30 June 2021 was a tumultuous period for TER as export coal prices plumbed cycle depths with a JunH21 revival towards cycle highs. Also, its major domestic coal client, power generator Eskom experienced capacity outage issues. These contributed to a Total Comprehensive items' loss of $72.6m. However, FY21 started a corporate transformation in that revenue rose 73.3% to $549m and EBITDA rose 132% to $19.4m with a positive $2.4m in operating cashflow from a FY20 negative cashflow of $2.8m. Net equity coal sold rose 49% to 5.8mt for FY21 and we expect ~6mtpa net sales in FY22.

A recovery in export pricing and domestic coal sales to pre-pandemic levels, plus efficiency improvements in the JunH21 saw EBITDA of $46.9m versus the negative $27.5m recorded in DecH20, with earnings accelerating into FY22.

South African DecH20 EBITDA of negative $4.5m swung to a JunFY21 EBITDA positive $31.2m. TER's conversion of Blair Athol mine to owner operated reduced costs by 16% to A$62.3/tonne that were offset in FY21 by a 17% fall in coal prices and 13% lower sales volumes. However, the re-sized ~2.2mtpa Blair Athol Mine margins are set to boom as export grade prices SepQtr-to-date are more than A$150/t compared to just A$70.9/t recorded for FY22

FY22 outlook – strengthening earnings & balance sheet

Thermal coal prices in export markets have continued to strengthen into the SepQ21 and producer currencies have weakened allowing record coal pricing in Australian dollar terms. Spot prices for Newcastle export coal index are currently near US$200/t and the average futures contracts price is ~US$181/t for FY22. Our FY22 price estimate is US$143/t – a still extraordinarily strong price!

Around half of TER's coal is export thermal coal and earnings are highly leveraged with a US$10/t rise for the remaining FY22, equating to ~13.7% rise on our base expectation of EPS in FY22 of $0.15/share.

Our NPV valuation after project risking is $0.37/share. Our 1-year target price is $0.31, conservatively excludes development assets. The target is up $0.07/sh from our Jun'21 report on higher coal pricing offset by delays in Eloff mine and extra interest costs on assumed retention of Euroclear *ARF*. *At our price target, estimated FY22 PE ratio is an attractive 2.1x.* While we see a likely pull-back in coal pricing, TER's balance sheet improvement will assist a positive re-rating.

Key risks to view

Risks include coal price falls and higher Australian dollar and South African Rand to the US dollar. A resumption of Eskom maintenance, strikes, severe weather and refinancing issues can see lower output/higher costs. A longer-term delay in Eloff mine start-up would reduce FY23 earnings and valuation.

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Corporate Profile – Australian & African coal operations, with diversification ambitions

TerraCom Ltd (*TER*) is an ASX-listed resource developer and export thermal coal producer at the Blair Athol mine, Queensland. In June 2020, TER completed the 100% acquisition of ASX-listed and South African thermal coal producer, Universal Coal (UNV). This was for an A$118m outlay following its per UNV share bid of $0.10/share in cash and 0.6026 shares in TER stock. TER's acquisition was strategically transformative in diversifying production to five operating mines spanning two countries and with a rough 55%/45% mix of domestic and export customers.

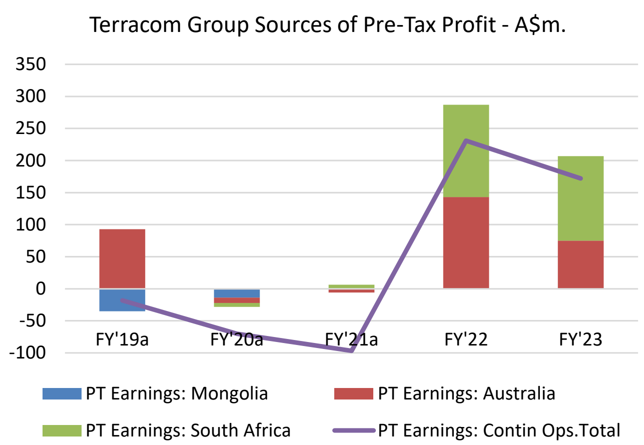
Management is also considering an acquisition in Guinea's bauxite industry. Anglo African Minerals PLC (AAM) – owner of three hi-quality bauxite resources in Guinea, has been the subject of TER's due diligence. If TER's involvement proceeds, it could accelerate development in around 13 months of the Forward Africa Resources 76mt project. Also in Guinea, TER announced in August 2021 an MOU to acquire from UK listed Bellzone Mining plc, the Kalia Mine and project 300 km from Konta Port. It has a conceptual resource of 4.7 billion tonnes of magnetite banded iron formation and 0.9 billion tonnes of oxide and supergene iron including ferronickel. TER's due diligence will include an early-stage project to produce ore for the domestic rebar steel makers and to assess a larger export project. *See Appendix – locations*

Coal assets profile

TER's Blair Athol thermal coal operation in Queensland is an opencut/dragline mine that is a low-cost supplier. Its product coal has lower energy value at ~5500kcal/kg compared to index 6000 kcal/kg Newcastle Index coal that typically fetches 20% discount. However, it has low contaminants and is a highly marketable power station coal with more interest coming from sponge iron producers. The chart on right sees Blair Athol generating around 50% of TER's operations pre-tax profit in FY22 aided by higher export prices. Blair Athol has a 10-year life of ~2mtpa.

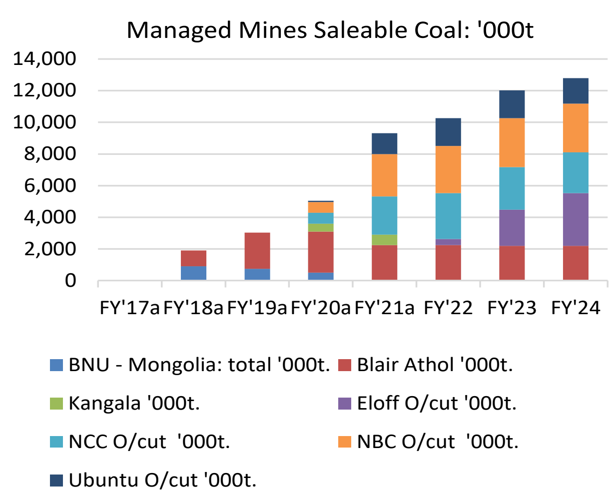
TER's three operating coal mines in South Africa produce predominantly domestic power station coal. Once it has secured contracts with Eskom, TER hope to commission the Eloff mine – which is an extension of the depleted Kangala mine. This provides growth and earnings diversification from the more volatile export coal pricing. Export grade coal forms ~30% and growing, of the NCC and NBC mines' output. TER has invested to facilitate higher exports with tangible results starting in the DecQ of FY22.

Two-country coal operation diversification benefits



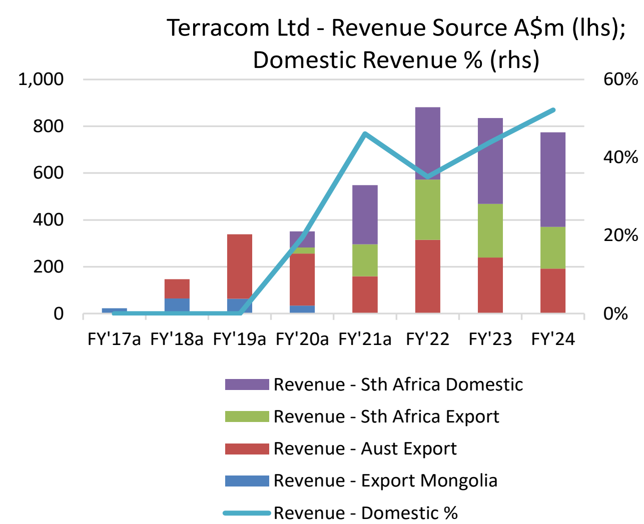
Source: TER announcements, CorporateConnect ests.

Blair Athol steady state, South African growth



Source: TER announcements, CorporateConnect ests.

Exports star in next 2-years with domestic sales growth to come



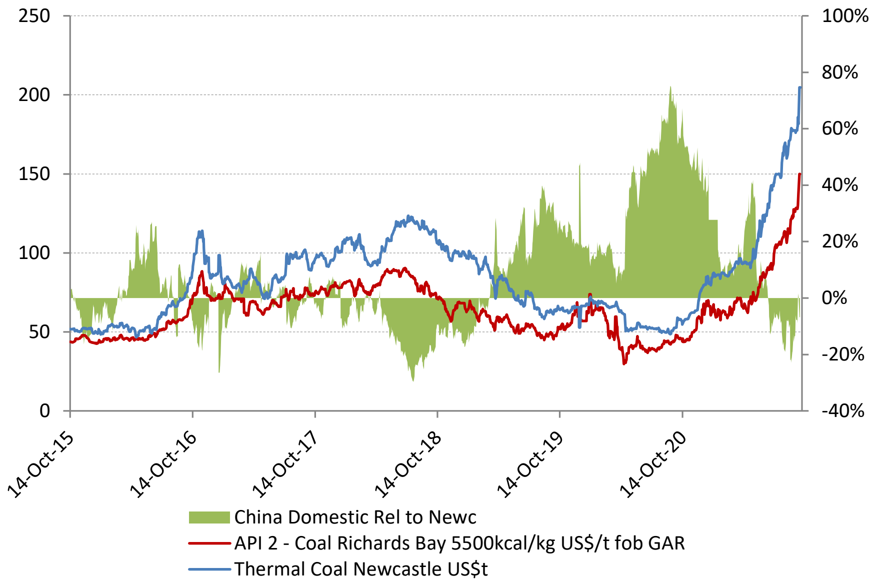
Source: TER announcements, CorporateConnect ests.

Export thermal coal prices – key earnings driver for TER

The DecH20 saw disruptions to industry demand for power from Covid-19 and China's stepped-up trade restrictions on Australian coal, resulting in thermal coal prices falling to lows not seen since 2015. Newcastle benchmark 6,000 kcal/kg thermal coal's usual big premiums to Richards Bay 5,500 kcal/kg coals shrank as Australian coals tried to find alternative markets than China. This hurt local producers, **but the pain has now turned to joy with Newcastle prices now far surpassing 2018 highs** and even trading at a premium to China's equivalent coal price.

The key driver has been a strong bounce back in China's economy and surge of demand globally by consumers pent-up demand and the ramping up of fiscal spending programs. There have supply and logistics interruptions in Colombia, Australia and South Africa leading to a lagged coal volume response to higher demand. Thermal coal prices strengthened further in the SepQ21, as Northern Hemisphere needed to restock, and combination of weather extremes are bolstering demand for thermal coal. The tightness also saw LNG prices rose to levels above US$25mmbtu, up from spot prices below US$3/mmbtu in mid-2020.

It remains to be seen if power demand growth cools with a developing slow-down in China's property and broader economy. The spread of the Delta-version of the Covid-19 virus and resumption of higher thermal coal exports may ease current extreme tight thermal coal markets.



Chart's source: FactSet

Export thermal coal prices – future contracts indicating well-above average prices.

CC price versus futures price		SepQ21	DecQ21	MarQ22	JunQ22	SepQ22	DecQ22	MarQ23	JunQ23
Newcastle Thermal coal price US$/t									
CorporateConnect	Base Case	162.5	160.0	132.5	115.0	107.5	102.5	97.5	92.5
Upside to Latest futures curve		1%	26%	44%	47%	47%	46%	41%	45%
Newc. Coal Futures	27-Sep-21	163.3	202.1	190.5	168.7	158.2	149.4	137.3	134.4
Newc. Coal Futures	27-Aug-21	171.0	159.6	141.4	123.2	115.0	108.9	104.5	103.8
Newc. Coal Futures	30-Jun-21	129.4	119.4	110.2	99.9	95.0	91.1	88.6	88.1
Average coal price since 2012		81.6							

Source: Corporate Connect estimates and FactSet

Since the 30th of Jun 2021, Newcastle Benchmark Thermal Coal prices have continued an extraordinarily rise. In the table above, we highlight in orange the futures market's monthly delivery price for the Newcastle Index thermal coal price on 27th Sept 2021. Below that line shows the coal prices on 27th Aug and over the same contract maturities on 30th June 2021.

Our own forecast Newcastle Thermal Coal forecast is shown highlighted in blue with upside to most recent futures curve. We acknowledge recent strength in coal markets particularly over the next few months contract maturities. This is because of the actual current and perceptions of ongoing shortages of power generation fuels in the lead up to the Northern Hemisphere winter.

We are basing our analysis on a more conservative prices, and recent volatility in iron ore is instructive. We do see several factors enticing added supply of coal, liquefied natural gas and even fuel oil to meet *normal* season needs. The ramp-up of newly commissioned Russian piped gas supply to Germany plus added piped gas from Central Asia to China may reduce prices of thermal coal over time. An important moderating influence in energy markets, is the slowing pace of China's growth, in part policy induced and partly due to the impacts of re-structuring China's over-leveraged property developers. We are also mindful of the likelihood that in time thermal coal will trend back towards its average price that since 2012 has averaged US$81.60/tonne. That said, *thermal coal conditions are tight, and we refer readers to our sensitivity analysis for coal price upside on our valuation of TER*.

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Recent commodity and currency revisions are profit boosting

Compared to our June 2021 TER Corporate Connect review, we have revised down coal sales volumes are down around 2% largely on the missed sale from Blair Athol in FY21. In FY22 we have delayed the start-up of the Eloff mine by a 9months. In FY23 we assume the Eloff mine comes into full production with added output of export coals from NCC and NBC mines in South Africa.

The SepQ21 has seen the Australian dollar weaken to $0.72-.73 even with strong levels pf commodity prices including coal. This is a positive driver for TER's profitability. However, with Covid-19 vaccinations now rising, a bounce in the AUDUSD towards $0.75-0.77 is anticipated.

Our FY22 Blair Athol export price estimate is US$106/t revised up an astounding $33/t and in FY23 to US$83/t, up $15/t. This is a significant driver of unit profit benefits outlined below.

In our forecast deck is in the table on the right. Generally declining discount for both Blair Athol and South African export coals comes with TER's increased marketing capabilities that is seeking place its coals to best value-in-use customers. This may secure both higher pricing and access additional customers when coal markets are soft.

Recent Revisions since CC's June report

	Current Forecasts					Change since Jun21 Report		
Jun Yr A$m	**FY'20a**	**FY'21a**	**FY'22**	**FY'23**	**FY'24**	**Δ FY'21**	**Δ FY'22**	**Δ FY'23**
Coal sales kt.	3,922	5,841	6,170	7,006	7,385	-2%	-6%	2%
Australian $/USD $		0.75	0.75	0.77	0.77	(0.00)	(0.02)	(0.01)
SthAf.Rand/USD $		15.42	14.80	15.35	16.07	0.01	0.14	(0.20)
Blair Athol coal US$/t		54.91	105.90	83.20	67.38	(2.15)	33.05	15.56
SA Exports US$/t		61.39	109.56	81.13	64.24	(2.32)	34.18	12.42

Source: CorporateConnect estimates

New Commodity Price and Currency Assumptions

Y/E 30 June		**FY'21a**	**DecH'21**	**JunH'22**	**FY'22**	**DecH'22**	**JunH'23**
Australian $/USD $	A$/US$	0.747	0.740	0.763	0.751	0.765	0.765
SthAf.Rand/USD $	ZAR$/US$	15.42	14.74	14.86	14.80	15.18	15.53
SthAf.Rand/AUD $ Hedged	ZAR$/AU$	11.49	10.91	11.33	11.12	11.61	11.88
Coal price in US$/t unless stated							
Thermal Coal - Newcastle export		77.88	161.25	123.75	142.50	105.00	95.00
Th.Coal - Blair At. - Standard		54.91	116.98	94.83	105.90	85.45	80.96
Blair Athol Disc to Newc %		*-29%*	*-27%*	*-23%*	*-26%*	*-19%*	*-15%*
T.Coal Richards Bay 6000kc/kg US$/t fc		80.86	155.57	119.34	137.45	101.25	91.61
Av. Export Price - Sth Af.		61.39	124.57	100.09	109.56	85.21	77.06
Export Disc to Richards Bay 6000		*-24%*	*-20%*	*-16%*	*-20%*	*-16%*	*-16%*
Av. Domestic Price Sth Af.	ZAR/tonne	502	547	552	550	557	569
Av. Domestic Price Sth Af.	US$/tonne	32.57	37.14	37.14	37.15	36.72	36.63

Production and sales – growth resumes

After the difficulties in FY21 of South African domestic coals sales and the deliberate scale-back of Blair Athol production as TER assumed owner-operatorship, we see FY22 as modestly higher coal sales. More growth in FY23 is in prospect once the Eloff mine secures domestic coal sales contract and ramps up. Domestic sales volumes may expand from 48% to as much as 54% by FY23.

Unit revenues and unit NPAT on the rise

In FY21 average revenue was A$58.9/t and on our base case forecasts these are set to rise 46% and 21% to A$86/t and $70/t in FY22 and FY23. The unit revenue rise arises even with higher proportions of coal placed into lower priced domestic markets, given stronger export pricing.

Despite rising revenues in FY22 & FY23, *unit costs are flat to declining* as fixed costs are offset by rising volumes and a greater proportion of lower cost Domestic sales. The result is a huge rise in unit EBITDA from A$2.70/t to ~A$30/t in FY22.

Unit net interest costs are expected to fall as TER pays back the Euroclear loan progressively through to Dec 2022. An earlier refinancing of the Eurobond loan may reduce this cost element than our estimate. Overall, unit NPAT switches from losses to potentially around A$10/tonne.

Production, Sales and Unit Earnings per tonne analysis

Y/E 30 June	**'000t.**	**FY'21a**	**DecH'21**	**JunH'22**	**FY'22**	**DecH'22**	**JunH'23**
Group ROM -Managed		13,233	7,299	7,990	15,290	8,858	8,953
Group Coal Sales -Managed		9,320	4,881	5,381	10,262	5,973	6,039
Equity ROM '000t.		8,030	4,273	4,641	8,914	5,037	5,082
Equity Exports - Australia		2,247	1,073	1,168	2,241	1,095	1,105
Equity Exports - Sth Africa		814	340	525	865	529	529
Equity Domestic - Sth Africa		2,792	1,525	1,538	3,063	1,861	1,888
Equity Coal Sales	**'000t**	**5,841**	**2,938**	**3,232**	**6,170**	**3,484**	**3,522**
Domestic % of Equity sales		48%	52%	48%	50%	53%	54%
Y/E 30 June	P&L/sales tonne	**FY'21a**	**DecH'21**	**JunH'22**	**FY'22**	**DecH'22**	**JunH'23**
Av. Price Received A$/t		58.9	90.7	81.6	85.9	71.1	67.9
Cost of Goods Sold A$/t		-50.9	-52.1	-49.9	-50.9	-45.9	-45.3
Gross Profit A$/t		8.0	38.6	31.7	35.0	25.3	22.6
Operating & Admin		-5.3	-5.2	-5.0	-5.1	-4.7	-4.7
Other Income & associates		0.0	0.0	0.0	0.0	0.1	0.1
EBITDA A$/t		2.7	33.4	26.7	29.9	20.6	18.0
Deprecn & Explorn w/off		-7.8	-3.8	-3.7	-3.8	-3.5	-3.6
EBIT - operations A$/t		-5.1	29.5	23.0	26.1	17.0	14.4
Net Interest & FX A$/t		-5.5	-4.1	-3.2	-3.6	-1.4	-1.3
Pre-Tax Profit A$/t		-10.6	25.5	19.8	22.5	15.6	13.1
Tax & other items		0.9	-12.6	-10.7	-11.6	-8.8	-7.5
NPAT A$/t		-9.7	12.9	9.0	10.9	6.8	5.6

Source: CorporateConnect estimates

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Valuation $0.37/share, and 1-year price target - $0.31/share

Terracom Ltd	$0.170	ROM P+P	Confidence	Risked	Risked	Reserves	Unrisked	Unrisked
Diluted No. sh.	Ownership	Reserves	Factor	Valuation	Valuation	Valuation	Valuation	Valuation
754.6	%	Net mil.t.	%	A$m.	A$/sh	A$/t.	Valn A$m.	A$/sh
Blair Athol	100.0%	23	90%	256.7	0.34	12.23	285.2	0.38
Kangala/Eloff	49.0%	26	83%	89.5	0.12	3.15	108.5	0.14
New Clydesdale Co	49.0%	20	90%	18.0	0.02	0.97	20.0	0.03
North Block Compl	49.0%	21	90%	126.6	0.17	6.19	140.6	0.19
Ubuntu Colliery	48.9%	5	90%	3.2	0.00	0.59	3.5	0.00
Manage't Fees	100.0%		87%	9.0	0.01		10.3	0.01
Projects Valuation		95	89%	503.0	0.67	5.56	568.2	0.75
Net Debt est. @	DecH'21		100%	-199.3	-0.26	-3.24	-199.3	-0.26
Net ST Liabilities			100%	-22.4	-0.03	-0.11	-22.4	-0.03
Other incl. Corporate Cost			100%	-49.2	-0.07	-0.52	-49.2	-0.07
Total Projects & Financials		Net Resources		232.1	0.31		297.3	0.39
Australia Mine Extension		57	20%	33.4	0.04	0.58	167.0	0.22
Sth Afric. Mine Extension		436	20%	9.3	0.01	0.02	46.7	0.06
Australian Explorn		1,850	3%	0.3	0.00	0.00	12.7	0.02
Sth African Explorn		675	20%	1.9	0.00	0.00	9.4	0.01
Guinean Bauxite, Iron Ore				0.0	0.00		0.0	0.00
Total Valuation		3,018	52%	**277.0**	**0.37**	**0.07**	533.1	0.71

Source: CorporateConnect Estimates

Our valuation methodology is to calculate each mine's NPV at an appropriate country related discount rate. To this we apply various risks including weather or industrial disputation which can impact mine efficiencies. We apply an added risk for Eloff as it has yet to finalise a domestic sales contract with Eskom.

We slightly increased our discount rate for Blair Athol at 10.2%pa as we see accumulating evidence of rising local inflation trends and higher sector cost of equity. We make no change to our assumed South African assets discount rate of 15.9%.

Our valuation for all operating assets and development projects plus corporate costs and balance sheet items amounts to A$0.37/share. Our one-year target price of A$0.31/share is set to capture all these elements except exploration and development projects. *Recent market trends appear to heavily discount future coal operations, due in part to policies seeking to accelerate phase out of coal fired stations. However, as TER firms up mining developments and marketing plans, our target price will rise*.

The proposed bauxite and iron ore projects in Guinea, are excluded from our target price as TER have yet to commit to these investments. However, these *Guinean development assets present further target price upside* upon great definition or commitment to develop.

NPV valuation changes

Our post-risk NPV-based valuation of $0.37/share has increased from our $0.24/share set in early June. Key changes reflect higher near-term export pricing and a later start-up of Eloff and a higher short-term cost of debt. Domestic disruption means that an expected lift in South African exports will be delayed until DecQ21.

Most of the higher valuation of TER a higher Blair Athol valuation and lower net debt as at 31 Dec 2021, due to higher export pricing and added received net cashflow.

We see upside in this valuation should coal pricing and mine production remain firmer than our expectations and greater efficiency results from South African operations are secured.

Changes in Corporate Connect's assessed NPV

DCF after project risking	**Disc Rate %**	**A$M**	**$/share**
Blair Athol	0.1%	71.9	$0.10
Kangala/Eloff	0.0%	-5.5	-$0.01
New Clydesdale Colliery	0.0%	-0.1	$0.00
North Block Complex	0.0%	26.4	$0.03
Ubuntu Colliery	0.0%	-9.8	-$0.01
Other items & Fees	0.0%	-10.7	-$0.01
Net Debt est. @		7.7	$0.01
Net ST Liabilities		9.3	$0.01
Total Projects & Financials		**89.2**	**$0.12**
Mine Extension & Exploration		4.2	$0.01
Projects, Financial & Exploration		**93.3**	**$0.12**

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Some investment catalysts in coming quarters

- While TER has succeeded in securing an *Alternative Refinance Package* for its Euroclear Bond, evidence of rapid repayment or the securing of a cheaper priced replacement funding would likely see more investment interest in TER.
- The results for Jun Year 2021 report provides a strong platform for margin growth in FY22. Further indications of this improving performance in the upcoming SepQ21 report can boost investor sentiment.
- Announcement of a start date for the new Eloff mine. Eloff is a low-cost extension of the depleted Kangala mine. Eloff has strong resource position and may also secure an expanded Eskom coal contract in later periods.
- The ~A$50m upgrade of wash facilities and loading capacity at NBC and NCC operations may produce higher volumes of export coals than our conservative forecasts and boost our assessment of profits.
- An acquisition of Anglo-African Minerals PLC, with prospect that a bauxite project may proceed in 13-months, can convert TER into a more diversified bulk commodity producer with potential positive cost of capital and share market rating benefits.
- Over coming months – TER's due diligence may lead to acquisition of the large Kalia magnetite iron resource in Guinea.
- If during FY22 TER can capture strong cashflow growth and balance sheet strengthening, TER may clarify when it will be able to resume dividend payment. This could be possibly during FY23 or FY24.

Sensitivity to Coal Price and Currencies

We believe that some pull-back in coal pricing is likely as supply restrictions abate but note that TER is highly leveraged to export coal prices to the extent of a US$10/t rise for the remaining FY22, equating to ~13.7% rise on our base expectation of EPS in FY22 of A$0.148/share.

On the table on right, we review our longer-term changes to coal price and currency assumptions over remaining life of assets. The most impact from our base case valuation is the coal price with a 1% change leading to a 5% change in our risked valuation. The Australian dollar has a 4% change in NPV for 1% change. The South African Rand to US dollar rate changes values modestly due to a sizable proportion of in-country domestic sales.

Inputs to Base Case		Newcastle coal US$/t	AUDUSD	ZARUSD
Real FY'2024 Inputs		$73.50	0.765	16.6
Sensitivity of Base Cas	Real $ Input	Valn $/sh	% change	change/1%
Base Case Valn		**$0.37**		
+10% Export Coal Price	$80.9	$0.55	51%	5%
-10% Export Coal Price	$66.2	$0.17	-55%	-5%
+$0.01 AUD/USD	$0.775	$0.35	-5%	-4%
-$0.01 AUD/USD	$0.755	$0.39	6%	4%
ZAR/US$0.25 Apprec.	$16.38	$0.37	2%	1%
ZAR/US$0.25 Deprec	$16.88	$0.36	-2%	-1%

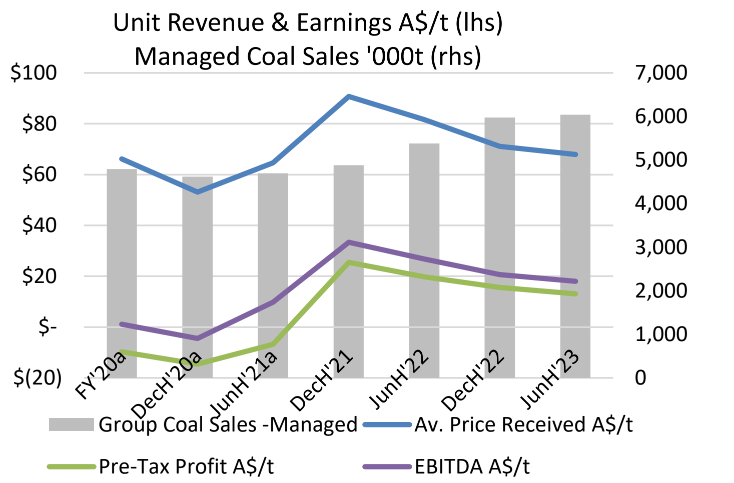
Source: Corporate Connect estimates

Base Case unit revenue and earnings

The base case valuation from which the sensitivity table is derived is based upon the key metrics in the chart on right. Rising group coal sales is accompanied by higher unit prices received in the current FY22.

EBITDA per unit of sales rises as prices rise much more than unit costs.

Interestingly the unit pre-tax profit converges toward the EBITDA per tonne, due to falling debt servicing costs.



Source: Corporate Connect estimates

Peer Group Valuation Comparisons

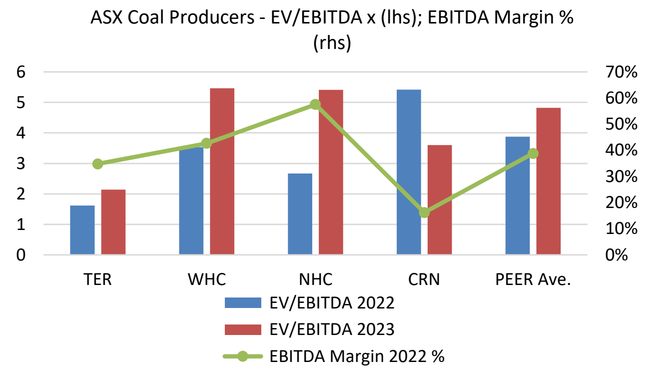
TER has a cheap EV/EBITDA and good earnings margins

We have compared our own estimates of TER's financial performance to a peer group of Australian listed coal producers. This peer group comprises Whitehaven Coal (WHC); New Hope Corporation (NHC) and Coronado Global Resources (CRN). The data on the peer group is compiled from FactSet consensus average forecast earnings and completed period to date balance sheet items.

Enterprise value (EV) is made up of market capitalisation plus net debt. EV divided by EBITDA (earnings before interest tax & depreciation) provides a market related valuation.

TER at current market price of $0.17/share has a highly attractive EV/EBITDA of under 2.0x over FY22 and FY23. This is less than half the peer group average of $4.0x.

TER's EBITDA margins are strong and appear higher than CRN. Sector leaders NHC and WHC have higher margins.



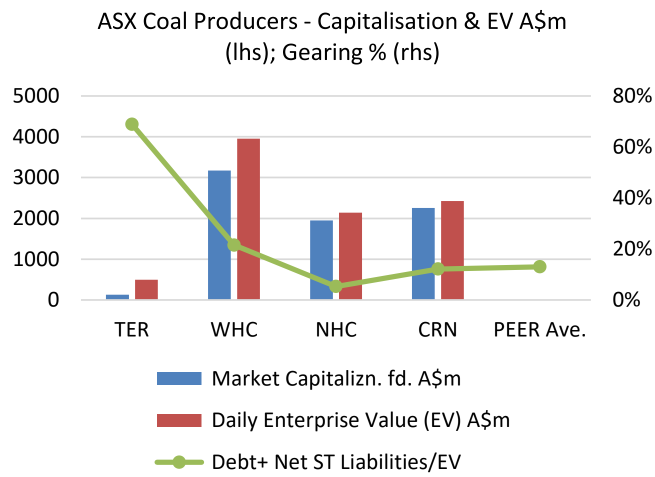
Source:FactSet, CorporateConnect estimates

Size and gearing – TER is likely to improve a lot

Size of company in terms of market capitalisation is often desired by investors and this results in a lower cost of capital and higher valuation. Size often brings added trading liquidity.

Clearly TER is a small-capitalised company compared to the peer group. However, there is strong potential for TER to improve its market capitalisation relative to its EV, as it deploys free cashflow to debt reduction.

The key disadvantage of TER is its starting point of debt plus net short-term liabilities to EV. As TER reduces it financial gearing, we believe its capitalisation will rise relative to the less geared peer group.



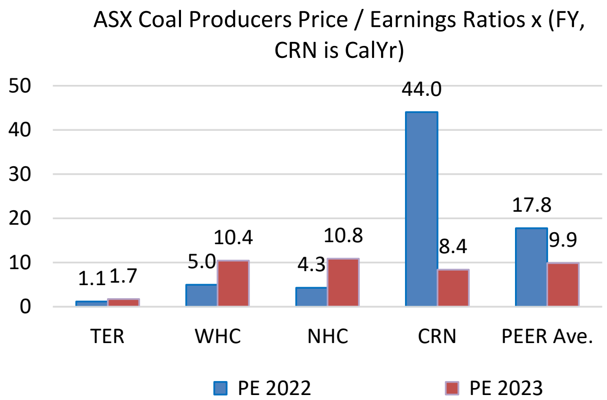
Source:FactSet, CorporateConnect estimates

PE Ratio – TER is highly attractive

On our estimates of TER's booming earnings in FY22 and FY23, its price to earnings ratio is at an exceptionally cheap multiple of 1.1x and 1.7x. We expect highly geared companies to trade at lower PE ratios compared to less financially geared peers. This is due to the volatility of earnings and the likelihood that free cashflow will not flow immediately into dividends.

However, **TER's exceptionally low PE ratios warrant investors' attention.** As TER reports strong results though FY22, we believe there is a likely re-rating and resultant increase in share price toward our target price.

Note: data as of 24th Sep 2021



Wednesday, 29 September 2021

COMPANY REVIEW

CORPORATE CONNECT

TerraCom Limited

ASX Code: TER

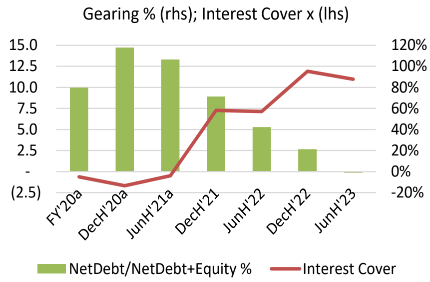
Accelerating free cashflow secures funding; & boosts re-rating potential

TerraCom – CorporateConnect's Revised Forecasts

PROFIT & LOSS (A$m)							
Y/E 30 June	**FY'21a**	**DecH'21**	**JunH'22**	**FY'22**	**DecH'22**	**JunH'23**	**FY'23**
Sales Revenue	**549.0**	**442.6**	**439.2**	**881.7**	**424.8**	**410.3**	**835.1**
Cost of Goods Sold	-474.6	-254.1	-268.7	-522.8	-274.0	-273.7	-547.7
Gross Operating Profit	**74.4**	**188.5**	**170.5**	**359.0**	**150.9**	**136.6**	**287.4**
Operating & Admin	-49.4	-25.6	-26.7	-52.2	-28.3	-28.4	-56.7
Other Income & associates	0.0	0.0	0.0	0.0	0.4	0.4	0.8
EBITDA	25.0	162.9	143.8	306.7	123.0	108.5	231.5
Exploration w/off	-33.6	0.0	-0.1	-0.1	0.0	-0.1	-0.1
Deprecn & Amortn	-39.0	-18.7	-19.9	-38.7	-21.1	-21.7	-42.8
EBIT - operations	**-47.6**	**144.2**	**123.8**	**267.9**	**101.8**	**86.7**	**188.6**
Net Interest Expense	-44.9	-19.8	-17.4	-37.2	-8.6	-7.9	-16.5
FX & Other W/offs	-6.7	0.0	0.0	0.0	0.0	0.0	0.0
Pre-Tax Profits	**-99.2**	**124.3**	**106.4**	**230.7**	**93.3**	**78.8**	**172.1**
Tax	-1.7	-36.1	-30.7	-66.8	-26.7	-22.6	-49.3
Minorities	-10.5	25.2	27.1	52.2	25.9	22.5	48.4
Discontinued & other	0.0	0.0	0.0	0.0	0.0	0.0	0.0
NPAT TER s/holders pre-Compreh	**-90.3**	**63.1**	**48.7**	**111.7**	**40.6**	**33.8**	**74.4**
Net Comprehensives	28.2	-0.7	2.5	1.7	0.0	0.0	0.0
Reported Profit TER sh/holders	-65.5	62.7	49.9	112.6	40.6	33.8	74.4
Group Profit	-72.6	**87.5**	78.2	165.7	**66.6**	56.3	122.9
Minorities share Profit	9.8%	28.3%	36.2%	32.1%	39.0%	40.0%	39.4%
Tax Rate (%)	-1.7%	29.1%	28.8%	28.9%	28.6%	28.6%	28.6%
BALANCE SHEET (A$m)							
Y/E 30 June	**FY'21a**	**DecH'21**	**JunH'22**	**FY'22**	**DecH'22**	**JunH'23**	**FY'23**
Current Assets	**104.5**	**138.1**	**141.6**	**141.6**	**174.8**	**225.3**	**225.3**
Cash and Liquids	11.2	41.7	43.9	43.9	77.7	130.1	130.1
Other	93.3	96.4	97.6	97.6	97.2	95.3	95.3
Non-Current Assets	**531.5**	**523.1**	**514.3**	**514.3**	**510.2**	**496.4**	**496.4**
Receivables & Restricted Cash	47.1	45.6	44.0	44.0	42.4	40.8	40.8
Propert, Plant & Exploration	436.0	429.2	421.9	421.9	419.3	407.2	407.2
Finanacial & Intangibles	48.4	48.4	48.4	48.4	48.4	48.4	48.4
Current Liabilities	**366.9**	**173.1**	**132.8**	**132.8**	**117.0**	**108.8**	**108.8**
Borrowings	245.2	36.8	3.7	3.7	3.7	3.7	3.7
Creditors, Leases & Finan Liab.	128.0	120.1	115.7	115.7	102.2	93.9	93.9
Provisions & Other	-6.3	16.3	13.4	13.4	11.2	11.2	11.2
Non-Current Liabilities	**277.7**	**409.5**	**364.9**	**364.9**	**343.2**	**331.9**	**331.9**
Borrowings	69.4	201.2	156.6	156.6	134.9	123.6	123.6
Creditors, Leases & Finan Liab.	6.8	6.8	6.8	6.8	6.8	6.8	6.8
Provisions & Other	201.6	201.6	201.6	201.6	201.6	201.6	201.6
GROUP EQUITY	**-18.3**	**78.6**	**158.2**	**158.2**	**224.8**	**281.1**	**281.1**
Minority Interest	61.0	85.8	114.2	114.2	140.1	162.6	162.6
SHAREHOLDERS EQUITY	-79.4	-7.2	44.1	44.1	84.7	118.5	118.5
CASHFLOW STATEMENT (A$m)	9.7	0.0	0.0	0.0	0.0	0.0	0.0
Y/E 30 June	**FY'21a**	**DecH'21**	**JunH'22**	**FY'22**	**DecH'22**	**JunH'23**	**FY'23**
Cash Flows From Operating Activitie	**2.4**	**120.9**	**89.3**	**210.2**	**74.2**	**73.4**	**147.7**
Working Cap ∆ & other chge	0.0	-8.6	-3.6	-12.2	-10.8	-4.2	-15.1
Cash Flows From Investing Activities	**-43.9**	**-11.9**	**-12.8**	**-24.7**	**-18.6**	**-9.7**	**-28.2**
Cash Flows From Financing Activitie	**42.6**	**-78.5**	**-74.3**	**-152.8**	**-21.9**	**-11.4**	**-33.3**
Net Change in Borrowings	46.2	-77.6	-73.9	-151.4	-21.7	-11.3	-33.0
Other Financing & FX Adjust.	-3.7	-0.9	-0.5	-1.4	-0.2	-0.1	-0.3
Net Increase In Cash	**1.1**	**30.5**	**2.2**	**32.7**	**33.7**	**52.4**	**86.1**
Cash At End of Period	11.2	41.7	43.9	43.9	77.7	130.1	130.1
Free Cash flow	*-41.5*	*109.0*	*76.5*	*185.5*	*55.7*	*63.8*	*119.4*

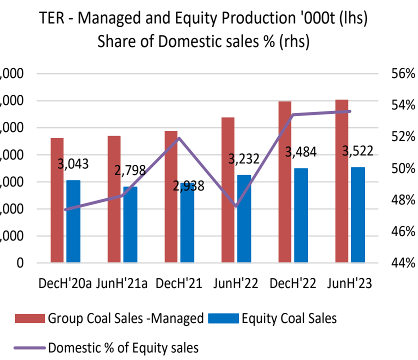
TER's strengthening balnce sheet

Falling Net Debt to Equity and rising EBITDA to interest payments cover ratio



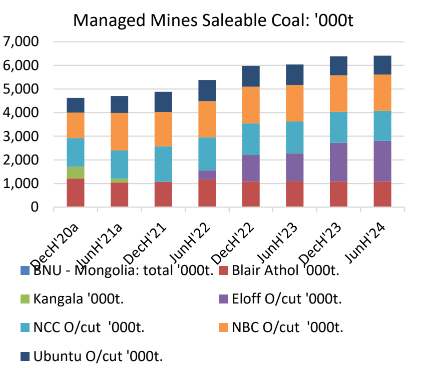
TER's Production and Sale Forecasts

Organic growth from 5.8mt in FY21 to ~6.7mt net by FY23



TER's Managed Mines Sales

Eloff mine a source of growth



Sources: CorporateConnect estimates, TER announcements, FactSet and RBA

TerraCom Limited ASX Code: TER

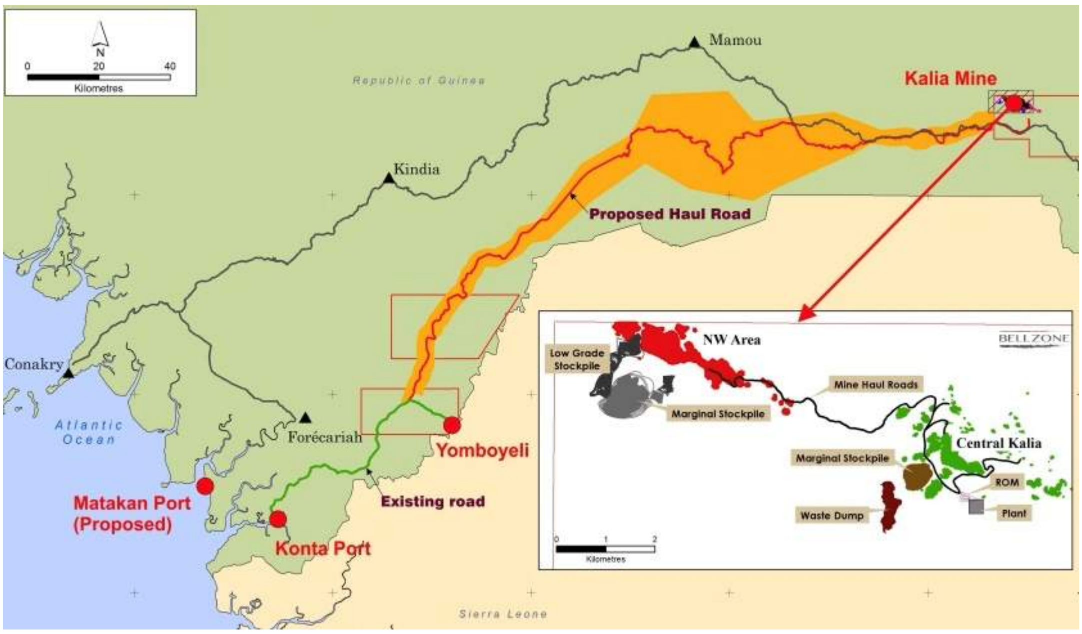
Accelerating free cashflow secures funding; & boosts re-rating potential

Appendix-1 - Operations Locations

Guinea – Kalia Magnetite Deposit and Project

On 13th August 2021 – TER announced its wholly owned subsidiary has executed an exclusive Non-Binding Memorandum of Understanding (MOU) for the acquisition of the Kalia Mine Project in the Republic of Guinea, 300km for the Port of Konta. TER will undertake due diligence to provide enough information whether to proceed to acquire the asset from Bellzone Holdings SA, with the ultimate parent company being Bellzone Mining plc, a public listed company under liquidation in the United Kingdom.

Kalia is located in the Faranah Prefecture, Republic of Guinea, which host world-class undeveloped iron ore and bauxite resources. Kalia has an indicated 4.7 billion tonnes of magnetite banded iron formation plus 900 million tonnes oxide and supergene banded iron formation targeting ferronickel; The large resource tonnage requires formal analysis and are currently best classed as an exploration target.



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