

Carbon Energy Limited

CNX A\$0.01

TARGET PRICE A\$0.09

SPECULATIVE BUY

Carbon Energy Limited (CNX) is a resources development company targeting the development of UCG in Australia and Asia (China). CNX has entered into a strategic JV with a Chinese partner which is likely to enable a relatively rapid rollout of its patented keyseam UCG business model throughout targeted sites. This technology has globally significant ramifications.

Chris Mears

+61 2 9226 0295

chris.mears@appsecurities.com.auAsia Pacific
Prudential Securities

This Research has been prepared and issued by APP Securities Pty Ltd and remains the property of APP Securities Pty Ltd. No material contained in this Research may be reproduced or distributed without prior written approval of APP Securities Pty Ltd, except as allowed by the Copyright Act. This Research is current at the date of publishing. For updates or further information regarding this research, please contact your advisor. APP Securities Pty Ltd does or seeks to undertake business with companies covered in its research, including being paid for research and therefore, Investors should consider this report as only a single factor in making their investment decisions. For explanations regarding ratings and other important disclosures, please refer to the disclosure section at the end of this document.

QLD Govt plays hardball on UCG....

QLD Govt Announcement

Carbon Energy Limited (ASX: CNX) is a small QLD based energy technology company focussed on the development and commercialisation of underground coal gasification (UCG) projects.

On 18/04/2016, the QLD Labor Govt announced the prohibition of UCG/USG development in QLD after Linc Energy Ltd (SGX: BRE) was forced into voluntary administration under section 436 (a) of the Commonwealth Corporations Act.

This announcement was apparently unexpected and occurred without the release of any triggering evidence.

Background

The Independent Scientific Panel (ISP) Report on UCG Pilot Trials (June 2013), commissioned by the then Liberal QLD Govt, stated that commercial UCG operations in QLD could be viable "subject to successful demonstration of project decommissioning".

In the last Quarter of 2014 CNX completed a site Decommissioning Report and a Rehabilitation plan for its Bloodwood Creek pilot demonstration site in QLD. According to CNX, the Government advisors had advised CNX that the decommissioning recommendations as required by the ISP had successfully been completed. CNX reported that key findings included that:

- Operations were safe and effective;
- The process was highly controlled; and
- No material impact on regional ground water quality was evident.

Company Data

Number of shares	1763.483
Market capitalisation	\$17.6M
Free Float (%)	61%
12 month high/low	\$0.032/\$0.008
Average Daily Turnover (\$M)	
% S&P/ASX 200	n/a
% All Ordinaries	n/a
DDM Ranking	n/a
GICS Industry Group	

Data Source: Fact set, APP Securities

Earnings Summary (AUD)

Year end June	2014A	2015A	2016F	2017F
Revenue (\$M)	6.2	4.2	3.3	29.0
EBITDA (\$M)	-4.9	-3.6	-3.8	12.4
Reported NPAT (\$M)	-9.3	-6.2	-4.8	11.8
Adjusted NPAT (\$M)	-9.3	-6.2	-4.8	11.8
Adjusted EPS (c - FD)	-0.8	-0.5	-0.3	0.7
Adjusted EPS growth (%)	n/a	n/a	n/a	n/a
Adjusted P/E (x)	n/a	n/a	n/a	1.5
Dividend (c/sh)	0.0	0.0	0.0	0.0
Gross yield (%)	0.0	0.0	0.0	0.0
Net yield (%)	0.0	0.0	0.0	0.0

Share Price Performance



Source: APP Securities, Company Reports. APP Securities contribute all company estimates to Bloomberg, Thomson Reuters, Fact Set and Capital IQ.

Valuation Impact

Original valuation and price target (\$0.23cps, \$0.14cps respectively) pre-dilution from the recent 3 for 11 renounceable rights issue, included items for:

- An approximate \$4M “adjustment” to CNX’s market capitalisation based on a comparison of EV/Pj of gas reserves (v another ASX listed company) and;
- Booked deferred exploration, development and evaluation costs of A\$90M (as per 2015 annual report) associated with pre-development of the Bloodwood Creek/Blue Gum UCG project, QLD.

As per the 2015 annual report, CNX state that recoverability of the carrying amount of this asset is “dependant on successful development and commercial exploitation of the resource”.

Whilst we had always assumed a low probability of development of the QLD gas assets, taking out the MV uplift and capitalised development costs (assuming zero probability of QLD development) reduces our valuation and price targets to **\$0.15cps, \$0.09 cps** respectively (includes dilution from recent rights issue).

There is still some uncertainty as to whether this announcement will pass through legislation.

Recommendation

Given our revised valuation and price target still significantly exceeds current share price our Speculative Buy recommendation remains.

This Research has been prepared and issued by APP Securities Pty Ltd ("APP Securities") and remains the property of APP Securities Pty Ltd. No material contained in this Research may be reproduced or distributed, except as allowed by the Copyright Act, without the prior written approval of APP Securities.

This report has been prepared and issued (in Australia) by APP Securities Pty Ltd (ABN 45 112 871 842) (AFS Licence No. 307 706) (APP Securities) and is subject to the disclosures and restrictions set out below.

Analyst Certification:

The research analyst(s) identified on the cover of this report individually certify that in respect of each security or issuer that the research analyst covers that: this report accurately reflects his or her personal views about any and all of the subject issuer(s) or securities; and no part of the research analyst's compensation was, is, or will be directly or indirectly related to the specific recommendation(s) or views expressed by the research analyst(s) in this report.

General Disclosure

APP Securities and its associates (as defined in Chapter 1 of the Corporations Act 2001), officers, directors, employees and agents, from time to time, may own or have positions in securities of the company(ies) covered in this report and may trade in the securities mentioned either as principal or agent or may be materially interested in such securities.

APP Securities does and seeks to do business with companies covered in its research reports. As a result, investors should be aware that the firm may have a conflict of interest that could affect the objectivity of this report. Investors should consider this report as only a single factor in making their investment decision.

APP Securities Pty Limited has received during the past 12 months compensation for financial and advisory services from the company, its parent or its wholly owned or majority owned subsidiary.

Contact with **Carbon Energy Limited** has been made during the preparation of this report for assistance with the verification of facts.

Disclaimer & Warning

This report may contain general advice or recommendations which, while believed to be accurate at the time of publication, are not appropriate for all persons or accounts. This report does not purport to contain all the information that a prospective investor may require. Before making an investment or trading decision, the recipient must consider market developments subsequent to the date of this document, and whether the advice is appropriate in light of his or her financial circumstances or seek further advice on its appropriateness or should form his/her own independent view given the person's investment objectives, financial situation and particular needs regarding any securities or Financial Products mentioned herein. Information in this document has been obtained from sources believed to be true but neither APP Securities nor its associates make any recommendation or warranty concerning the Financial Products or the accuracy, or reliability or completeness of the information or the performance of the companies referred to in this document. Past performance is not indicative of future performance. This document is not an offer, invitation, solicitation or recommendation with respect to the subscription for, purchase or sale of any Financial Product, and neither this document or anything in it shall form the basis of any contract or commitment. Although every attempt has been made to verify the accuracy of the information contained in the document, liability for any errors or omissions (except any statutory liability which cannot be excluded) is specifically excluded by APP Securities, its associates, officers, directors, employees and agents. The securities of such company (ies) may not be eligible for sale in all jurisdictions or to all categories of investors.

Analysts' Compensation: The research analysts responsible for the preparation of this report receive compensation based upon various factors, including the quality and accuracy of the analyst(s) research, client evaluation feedback, independent survey rankings and overall firm revenues, which include revenues from, among other business units and corporate finance.

Other International Investors: International investors outside the US, UK, UAE or Canada are encouraged to contact their local regulatory authorities to determine whether any restrictions apply to their ability to purchase this investment and should seek their own advice

Recipient Representations/Warranties: By accepting this report, the recipient represents and warrants that he or she is entitled to receive such report in accordance with the restrictions set out in this document and agrees to be bound by the limitations contained herein. Any failure to comply with these limitations may constitute a violation of law.

Meanings of APP Securities Stock Ratings

Buy – Describes stocks that we expect to provide a total return (price appreciation plus gross yield) of 10% or more within a 12-month period.

Underperform – Describes stocks that we expect to provide a total return (price appreciation plus gross yield) of less than 10% within a 12-month period.

NR – The investment rating and price target have been temporarily suspended. Such suspensions are in compliance with applicable regulations and/or APP Securities policies.

CS – Coverage Suspended. APP Securities has suspended coverage of this company.

Speculative Buy – Describes stocks we research with a positive bias, whose company fundamentals and/or financials are being covered, but for which there is insufficient information for APP Securities to assign a Buy or Underperform rating.

Speculative Underperform – Describes stocks we research with a negative bias, whose company fundamentals and/or financials are being covered, but for which there is insufficient information for APP Securities to assign a Buy or Underperform rating.

Secondary recommendation - Market weight relative to the S&P/ASX 300 under a weighting range of 0-3, with intervals of 0.5 (7 point scale). 1.0 indicates a market weight position in the stock while a weight over 1.0 indicates an overweight position and the current level of analyst conviction.

Monitor – Describes stocks whose company fundamentals and/or financials are being monitored, or for which no financial projections or opinions on the investment merits of the company are provided.

It is permitted for the total expected returns to be temporarily outside the prescribed ranges due to extreme market volatility or other justifiable company or industry-specific reasons.

Free Float (float / current shares outstanding) *100 – This float figure is the number of shares that are available to the public and is calculated by subtracting the shares held by insiders and those deemed to be stagnant shareholders. Stagnant holders include ESOP's, ESOT's, QUEST's, employee benefit trusts, founding shareholder equity stake plus senior management equity stake, corporations not actively managing money, venture capital companies and shares held by Governments.

Terminal Value methodology - APP Securities' Discounted Cash Flow (DCF) valuation applies a terminal growth rate to the last forecast year's cash flow and discounts the amount using Weighted Average Cost of Capital (WACC). The Terminal Value is tested using ASX-listed company multiples. For resource companies there is no terminal value because cash flows are forecast to the end of mine life.

Meanings of APP Securities Credit Ratings

Buy – If the last traded price of the hybrid security is more than 3% below our valuation

Underperform – If the last traded price of the hybrid security is more than 3% above our valuation

Valuation Methodology

APP Securities' methodology for assigning stock and credit ratings may include the following: market capitalisation, maturity, growth/value, volatility and expected total return over the next 12 months. The price targets are based on several methodologies, which may include, but are not restricted to, analyses of market risk, growth rate, revenue stream, discounted cash flow (DCF), EBITDA, EPS, cash flow (CF), free cash flow (FCF), EV/EBITDA, P/E, PE/growth, P/CF, P/FCF, premium (discount)/average group EV/EBITDA, premium (discount)/average group P/E, sum of parts, net asset value, discounted dividend model (DDM), franking credits and return on equity (ROE) over the next 12 months. Listed credit securities analysis uses appropriate discount rates that reflect credit risk of both issuer and the underlying instrument.