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Leigh Creek Energy Limited

SA's electricity price crisis offers opportunities

12 August 2016

LCK A$0.15 **(TP A$0.66)**

Recommendation
Speculative Buy

Risk Assessment
Higher

Resources – Oil & Gas

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Lack of baseload power, heavy reliance (40%) on renewables - particularly intermittent wind power, high demand, and a failure of the Heywood interconnector with Victoria, saw wholesale electricity spot prices in South Australia (SA) skyrocket in July to A$14,000/MWh - more than 180x typical levels of ~A$75/MWh. As a measure of the crisis, SA Treasurer Tom Koutsantonis had to request Engie (a French-owned company) to restart their mothballed gas-fired Pelican Point power station.

Not surprisingly, companies see opportunities here. NSW's newly privatised electricity transmission monopoly, Transgrid, and SA transmission company Electranet, have proposed building and operating a new A$500m NSW-SA high-voltage interconnector (SA is currently only connected with Victoria via two interconnects). AGL Energy (ASX:AGL) has proposed that the state should pay its gas generators to provide spare capacity as a backup to unreliable wind and solar power. DP Energy - a private Irish energy group – which recently secured development approval for the Port Augusta Renewable Energy Park, proposes "doubling down" on renewables, and is looking to develop a A$680m combined solar and wind power project.

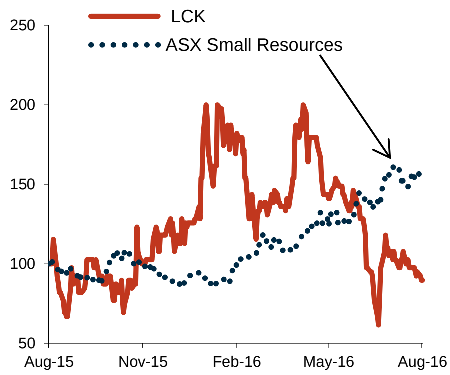
Federal Government Energy Minister Josh Frydenberg is scheduled to meet with state energy ministers next week (19 August 2016) at a key Council of Australia Government's (COAG) energy council. At this meeting, the overhaul of the National Electricity Market (NEM), including the development of a national (versus state-led) approach to integrating renewables into the energy mix, will be an important area of discussion. We believe that the ministers will also be aware of a controversial recent report by the Melbourne Energy Institute, which indicates that the spikes in SA electricity prices have been due to energy companies "gaming" the system and exploiting their market power.

We believe that in this environment, LCK can play a role in diversifying SA's gas and electricity supply. LCK is targeting to produce up to 100PJpa of saleable gas via In-Situ Gasification (ISG) at its Leigh Creek coalmine (550km north of Adelaide) with up to 20% of production feeding a proposed 350MW syngas-fired power station. Management is actively engaging with potential gas and electricity buyers for long-term contracts, while Heads of Agreements (HOAs) have already been signed with the APA Group (ASX:APA) and with Shanghai Electric Power Generation Group.

LCK's share price has fallen by ~50% over the past quarter. **We suggest this has largely been due to a lack of news flow on key developments** specifically, 1) the planned Stage 1 gas production demonstration targeted for end 2016/beginning 2017 and, 2) progress with customer offtake or farm-in agreements. Progress here, could act as significant share price catalysts. We calculate LCK's total NPV_{10} (pre-debt) at A$1.95bn (A$1.77bn gas sales, A$180m electricity JV). Adjusted for A$1.2bn in forecast project debt finance, we calculate LCK's equity value at A$747m or A$2.66 per share (on a fully diluted basis). Attaching a 75% discount for Leigh Creek Energy Project risk (execution, funding), we calculate a risk-adjusted NPV-derived target price of A$0.66ps. **We believe that LCK offers exciting capital upside for speculative investors as the LCEP is progressively de-risked.**

Leigh Creek Energy Ltd	
ASX Code	LCK
52 week range	A$0.11-A$0.42
Market Cap (ASm)	40
Shares Outstanding (m)	266.4
Av Daily Turnover (shares)	163k
ASX All Ordinaries	5,616
FY16E BV per share (A$)	0.05
EPS FY16E (A$)	-0.01
Net Debt/(Cash) FY16E (A$m)	-12

Relative price performance



Source: IRESS

Financial Statements

Leigh Creek Energy Limited

Year ending June

Profit & Loss Statement (A$M)	FY15A	FY16E	FY17E	FY18E	FY19E
Revenue	0.0	0.0	0	0	330
Production/Pipeline	0.0	0.0	0	0	(149)
Corporate	0.0	(2.5)	(2.5)	(2.5)	(5.0)
PRRT	(17.6)	0.0	0	0	(36)
EBITDA	**(18)**	**(3)**	**(3)**	**(3)**	**140**
Depreciation & Amortisation	0.0	0.0	0	0	(24)
Operating profit	**(17.6)**	**(2.5)**	**(3)**	**(3)**	**116**
NOI	0.0	0.0	5	0	0
EBIT	**(17.6)**	**(2.5)**	**3**	**(3)**	**116**
Interest income	0.0	0.0	0	0	0
Interest expense	0.0	0.0	0	0	(42)
Tax expense	0.0	0.0	0	0	0
Reported NPAT	(17.6)	(2.5)	3	(2)	75
Normalised NPAT	**(18)**	**(2)**	**(2)**	**(2)**	**75**
EBITDA Margin (%)	na	na	na	na	42%
Operating profit margin (%)	na	na	na	na	35%
EPS Reported (A$)	(0.08)	(0.01)	0.01	(0.01)	0.27
EPS Normalised (A$)	(0.08)	(0.01)	(0.01)	(0.01)	0.27
EPS growth (%)	nm	nm	nm	nm	nm
DPS - Declared (A$)	0.00	0.00	0.00	0.00	0.00
Avg. no. of fully-diluted shares (m)	138	263	281	281	281
YE no. of fuly-diluted shares (m)	231	281	281	281	281

Cash Flow Statement (A$M)	FY15A	FY16E	FY17E	FY18E	FY19E
EBITDA	0	(2.5)	(2.5)	(2.5)	140
Investment in working capital	0	0.0	0.0	0.0	(25)
Tax expense	0	0.0	0.0	0.0	0
Operating Cash Flow	**0**	**(2.5)**	**(2.5)**	**(2.5)**	**115**
Capex	0	0	(300)	(600)	(302)
Other investments	0	0	0	0	0
Investing Cash Flow	**0**	**0**	**(300)**	**(600)**	**(302)**
Net interest received / (paid)	0	0	0	0	(42)
Debt drawdown / (repayment)	0	0	300	600	300
Dividends paid	0	0	0	0	0
Equity raised / (repaid)	0	13	0	0	0
Financing Cash Flow	**0**	**13**	**300**	**600**	**258**
Non-operating & Other	0	0	5	0	0
Inc/(Dec) in Cash	**0**	**10.8**	**2.7**	**(2.2)**	**71**

Balance Sheet (A$M)	FY15A	FY16E	FY17E	FY18E	FY19E
Cash & Equivalents	1.5	12	15	13	84
Receivables	0.1	0	0	0	33
Inventories	0.0	0	0	0	25
Other Current Assets	0.0	0	0	0	0
PPE and Exploration & Development	0.8	1	301	901	1,179
Deferred tax asset	0.0	0	0	0	0
Other Non Current Assets	0.0	0	0	0	0
Total Assets	**2.4**	**13**	**316**	**914**	**1,321**
Payables and other current Liabilities	0.4	0	0	0	33
Short Term Debt	0.1	0	0	0	0
Long Term Debt	0.0	0	300	900	1,200
Other Non Current Liabilities	0.0	0	0	0	0
Total Liabilities	**0.5**	**1**	**301**	**901**	**1,233**
Total Equity	**1.9**	**13**	**15**	**13**	**88**
Net Debt (Cash)	(1.4)	(12)	285	887	1,116

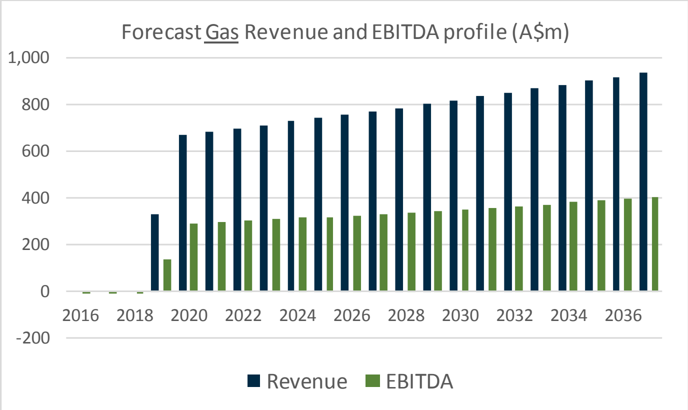
Top 3 Shareholders	%	Date
Allied Resource Partners Pty Ltd	45.5	
Former ARP TriEnergy shareholders	14.6	Mar-16
CITIC	7.5	

Source: Company, IRESS, State One Stockbroking forecasts

Assumptions	FY15A	FY16E	FY17E	FY18E	FY19E
Production (PJ)	-	0.0	0.0	0.0	50.0
Market gas price (A$/GJ)	-	7.00	7.14	7.28	7.43
Extraction/processing costs (A$/G	-	*na*	*na*	*na*	*2.33*
Pipeline tariff costs (A$/GJ)	-	*na*	*na*	*na*	*0.80*
Corporate/Admin costs (A$/GJ)	-	*na*	*na*	*na*	*0.10*
Royalties (A$/GJ)	-	*na*	*na*	*na*	*0.73*
Total costs (A$/GJ)	-	na	na	na	3.57
EBITDA (A$/GJ)	-	na	na	na	3.86
EBITDA margin (%)	-	na	na	na	52%

Resources (PRMS)	*Category*	*Est. Recoverable Energy (PJ)*
PEL 650:LCEP	1P Reserves	0.0
	2P Reserves	0.0
	3P Reserves	0.0
	1C Contingent Resource	2,748
	2C Contingent Resource	**2,964**
	3C Contingent Resource	3,303

Note: PRMS = Petroleum Resources Management System



Leverage	FY15A	FY16E	FY17E	FY18E	FY19E
Net Debt/Equity	cash	cash	1847%	6705%	1272%
Gearing (ND/ND+E)	cash	cash	95%	99%	93%
Interest Cover (x)	na	na	na	na	2.8

Valuation Ratios (x)	FY15A	FY16E	FY17E	FY18E	FY19E
Normalised P/E	na	na	na	na	1.4
Price/OP Cash Flow	na	na	na	na	0.4
Book value per share (A$)	0.01	0.05	0.05	0.05	0.31
EV/EBITDA	na	na	na	na	8
ROE (%)	na	na	na	na	85%

$NPV_{10\%}$ Valuation	(A$m)	(A$/share)	A$/ Resource PJ
NPV	1,947	6.94	0.66
…less Project Debt	(1,200)	(4.28)	(0.40)
Equity value - unrisked	747	2.66	0.25
Risk weighting	*75%*		
Equity value - risked	**187**	**0.66**	**0.06**

Note: Per share valuation based on fully diluted number of shares

Company Overview:
Leigh Creek Energy (LCK) is an emerging unconventional gas producer. The company's key asset is 2,964PJ of 2C recoverable gas Resources associated with 377Mt of coal (Inferred Resource, 2012 JORC compliant) at its flagship Leigh Creek Energy Project located at the shuttered Leigh Creek coal mine in Central South Australia (550km north of Adelaide). LCK has an oil and gas exploration licence (PEL 650) -which overlays the Leigh Creek coal mining licence, and is targeting to produce ~ 100PJ per annum of gas from underground coal gasification (UCG) from early 2019. Near term objectives include successfully completing gas flaring in late 2016 to prove up the commercial potential of the project.

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State One Stockbroking Ltd was Lead Manager (Australia) for LCK's April 2016 capital raise.

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