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# Linc Energy Limited

## Linc Produces Liquids!

**LNC** **A$3.20** **BUY**

14 October 2008

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**Linc Energy Limited (LNC) has produced first liquids from its pilot Gas to Liquids (GTL) plant in Chinchilla, QLD. This is a major milestone for the company and sets the platform for the company to progress to constructing its first commercial 20,000 barrel per day plant, expected to be in production at the beginning of CY12. Whilst significant risks remain including: i) scale-up; ii) maintaining a continuous flow of liquids from the pilot plant; iii) obtaining the necessary environmental approvals; and iv) importantly in the current environment completing the A$1.5B sale of its Emerald coking coal tenement to obtain the necessary CAPEX funding, this sets the stage for LNC to become a significant player in the petroleum industry. We maintain our BUY recommendation. Our DCF valuation increases to A$14.94/sh (prev A$7.43/sh) as we now factor in multiple 20,000 barrel per day plants into our analysis. Our 12 month price target increases to A$7.50/sh (prev A$6.50/sh), a significant discount to our DCF valuation due to the key milestones the company still needs to complete in the lead up to commercial production.**

### First Liquids

- **A major milestone** – While LNC has accomplished a number of milestones since listing, first liquids from its pilot plant is the most significant to date.
- **Continuous Flow** – Over the coming weeks it will be important that LNC can demonstrate a continuous flow of liquids from its pilot plant i.e. approximately 10 barrel per day. We expect that LNC will run its pilot plant for a number of months in order to: i) improve catalytic efficiency; ii) commence trials with potential customers for the commercial 20,000 barrel per day facility; and iii) allow potential JV partners and investors to see the site.
- **Laboratory on site** – Over the past few months LNC has built a gas catalyst laboratory on site at Chinchilla. This will aid LNC to test the syngas on different types of catalysts and be able to monitor the performance of the GTL facility.
- **Capital Raise** – LNC have also raised A$17M through the issue of c.5.9M shares at A$2.90/sh for working capital.

### Our View

While it has been a longer than expected wait, we cannot downplay the significance of the announcement today. LNC can now embark on Stage 2 of its business plan, the construction of its 20,000 barrel per day plant.

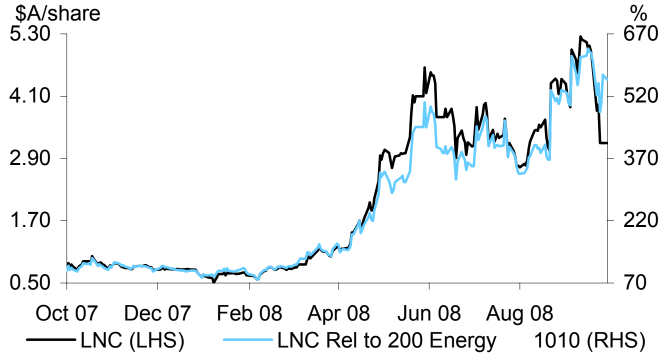
| Company Data | |
|---|---|
| Number of shares (fully diluted) | 441.1M |
| Market capitalisation | $1.41B |
| 12 month high/low | $5.39 / $0.48 |
| Average monthly turnover | $46.8M |
| All Ordinaries Index | 4392 |
| % All Ordinaries | 0.07 |

**Earnings Summary**

| Year to June | 2010F | 2011F | 2012F | 2013F |
|---|---|---|---|---|
| NPAT (A$M) | (8.0) | (15.0) | 20.0 | 347.0 |
| EBITDA | (4.5) | (10.5) | 70.0 | 545.6 |
| EPS (A$) | n/a | n/a | n/a | 0.81 |
| PE (x) | n/a | n/a | n/a | 4.1 |
| Dividend (A$) | 0 | 0 | 0 | 0 |

*Numbers are based on a long term WTI oil price of US$75/bbl*

**LNC versus 200 Energy 1010 Index**

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## Proposed Commercial Plant Financials - One 20,000 Barrel Per Day Facility

| | | | | | |
|---|---|---|---|---|---|
| **Gas Production** | | | | | |
| Plant capacity | 20,000 | bbl/day | | | |
| Availability Factor | 90.4 | % | Plant Availability Time | 7,920 | hours / year |
| Gas Production | 1,397,023 | Nm3 / hour | Total Gas Production | 11,064,424,587 | Nm3 / year |
| Gas Calorific Value | 5.23 | MJ / Nm3 | Total Energy Output | 57,866,941 | GJ / year |
| **By-Product Production - Hydrocarbons** | | | | | |
| Hydrocarbon Production | 15.27 | g / Nm3 | 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 / Nm3 | 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 * 75 US$ / bbl | 93.75 | $ / barrel | Total Diesel Revenue (Year 3+): | 587,812,767 | $ |
| Federal Tax Exemption | no | | Federal Tax Rate | 0.36 | $/litre |
| **Economic Factors** | | | **Discount Rate:** | 12.0 | % |
| Exchange Rate $/US$ | 0.8 | | | | |
| **Capital Expenditure Details** | | | | | |
| Gas Process Plant | 70,000,000 | $ | | | |
| Clean Up Plant | 180,000,000 | $ | Total Capital Required | 900,000,000 | A$ |
| GTL Plant | 650,000,000 | $ | | | |
| **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+) | 649,678,117 | $ / year | DCF @ 12 % | 6,589,837,664 | $ |
| 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 | | | |
| **EBITDA** | 545,578,117 | $ / year | | | |

*Source: BBY, Company Reports*

## Growth Options

With LNC producing first liquids from its pilot GTL plant, we expect that this will open up a number of further opportunities and will also help consolidate those MOU's/LOI's that the company has signed with parties both domestically and internationally.

LNC currently has MOU's/LOI's in China (Huadian and Xinwen), Vietnam (Marubeni and VINACOMIN) and India (Shiv-Vani). LNC also recently obtained shareholder and option holder approval for the merger with Sapex Limited (SXP) based in South Australia. The company has also expressed an interest to partner with companies in the US.

Whilst BBY expects the company's first commercial plant to be constructed adjacent to the pilot GTL plant in Chinchilla, QLD, we cannot rule out the possibility of LNC's first plant being in China or South Australia, if, for some reason, the approval process slows in QLD.

LNC's business model and methodology is not to license its technology, i.e. to always have a sizable stake in any JV company. If LNC were to do a JV in an overseas country, i.e. China, we believe that the Chinese group would fund the entire CAPEX requirements, effectively giving LNC an interest (e.g. 49%) in the project without having to inject any funds. However, we have not factored this into our valuation at present.

### Further Milestones to be Completed

The announcement marks the completion of Stage 1 of LNC's business plan. LNC however still has a number of milestones to complete to commercialise its first 20,000 barrel per day plant. These include:

- **Sale of Emerald coal deposit for A$1.5B** – due diligence has been successfully completed by Xinwen and LNC. Both Chinese and Australian state/government approvals now need to be given. Once completed, this will provide the necessary funds to finance the commercial facility.
- **Conducting a Bankable Feasibility Study** – scheduled to commence at the end of CY08/beginning of CY09.
- **Environmental Impact Study (EIS) approvals** – expected to be given by mid CY09.
- **Ground breaking for the commercial 20,000 barrel per day** – expected in 2HCY09 following EIS approvals. LNC anticipate that construction of the plant will take 20 months and that it will be in production during CY11 (BBY conservatively estimates commencement of production at the beginning of CY12).

### BBY Valuation

BBY has increased its DCF valuation significantly primarily due to factoring in **four 20,000 barrel per day plants (previous one plant) into our analysis by 2017.** We believe that this number is a conservative measure due to the company's already established agreements in place internationally.

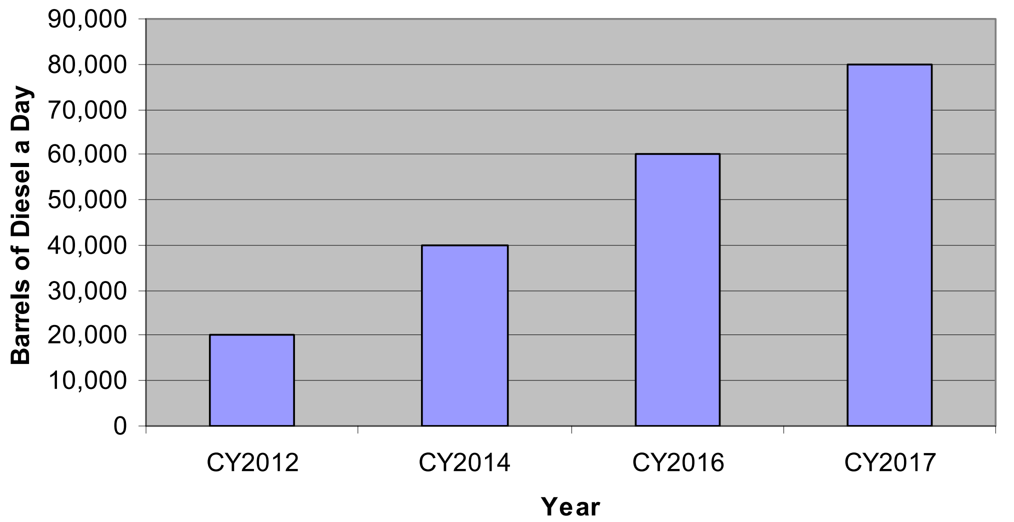
Key assumptions include:

- Decrease in the discount rate to 12% (prev 13%).
- First 20,000 barrel per day plant (expected to be comprised of 3 lots of 6,667 barrel modules) due to be in production in early CY12 – CAPEX for the plant (c.A$900M-A$1B) to be funded through the funds from the sale of the Emerald coking coal deposit.
- Selling price of US$75/bbl (while LNC's product trades at a premium (historically US$10-20/bbl) to the WTI Oil Price, BBY has not included any premium in its assumptions).

- Expected plant roll-out as follows:
  - First 20,000 barrel per day plant – in production at the beginning of CY12 (financed through sale of Emerald coal deposit).
  - Second 20,000 barrel per day plant – in production in March/April CY14 (financing through debt/equity).
  - Third 20,000 barrel per day plant – in production in March CY16 (financed through cash-flow from existing two plants).
  - Fourth 20,000 barrel per day plant – in production in January CY17 (financed through cash-flow from existing two plants).

While LNC could conceivably start construction on a number of commercial facilities from CY09 at the same time, funding each plant with part cash from the Xinwen sale and debt, we prefer to model LNC conservatively, considering current market conditions, allowing for one complete plant to be built (cash only) before construction has commenced on the second plant. However, we cannot rule out the possibility of LNC pursuing this path.

**CHART 1: BBY FORECAST RAMP-UP OF DIESEL PRODUCTION**




*Source : BBY estimates*

## Sensitivity Analysis

BBY's DCF valuation on LNC is based on a long term WTI oil price of US$75/bbl. However, we have provided sensitivity analysis based on a number of different long term oil price assumptions.

**TABLE 1: SENSITIVITY ANALYSIS – DCF VALUATION (A$/SH)**

| US$60 | US$70 | US$75 | US$80 | US$90 | US$100 | US110 | US$120 |
|---|---|---|---|---|---|---|---|
| 11.01 | 13.63 | 14.94 | 16.25 | 18.87 | 21.49 | 24.11 | 26.73 |

*Source: BBY estimates*

## Our View

We cannot downplay the significance of the announcement today. LNC can now embark on construction of its first 20,000 barrel per day plant. Maintain BUY.

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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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