

# MetroCoal

## Billion tonne baby

### Spec Buy

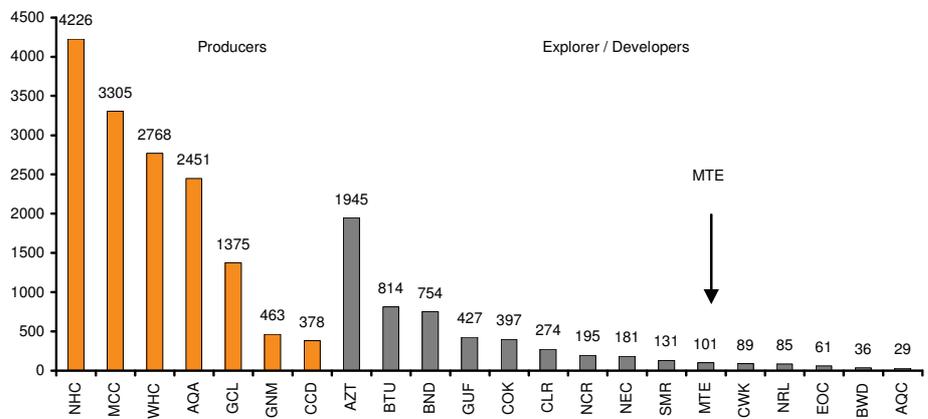
**Target price**  
A\$1.00

**Price**  
A\$0.61

**Short term (0-60 days)**  
n/a

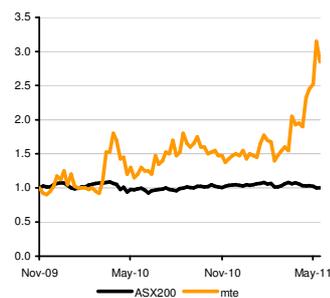
Surat basin explorer MTE is comparable to the likes of Waratah (acquired), LNC (asset sold) and BND (for sale) in the Galilee. MTE has multi-billion tonne thermal coal resource potential and a modest market cap. Near term upside looks linked to partial asset monetisation, highlighting longer term production potential, but more likely for an end user given capital, infrastructure and timing challenges.

Australian/NZ based coal producer / developers – diluted EV (A\$m)



Source: RBS Morgans

#### Price performance



**Market capitalisation (diluted)**  
A\$114m

**Average (12M) daily turnover**

#### Sitting on a multi-billion tonne coal inventory

MetroCoal (MTE) is a coal explorer with assets in the Surat Basin, QLD. Since listing in late 2009, the company has increased its coal inventory from 172Mt to 923Mt defined at its Bundi and Norwood underground projects. The company has nominated for 12Mtpa of capacity through Stage 2 at Wiggins Island to facilitate its planned transition from explorer to coal exporter. We believe the near term investment case relates most to large increases in the resource base anticipated in 2011, flagged to reach 2.5-3.5Bt by year end. This in turn is likely to attract the investment dollar of strategic coal investors similar to Waratah, Linc and Bandanna in our view.

#### Significant upside relative to peer group metrics

As an early stage play there are few concrete inputs with which to build a DCF based valuation with certainty. However, from Page 5, we highlight MTE's peer group valuation metrics showing that MTE looks too cheap. Namely; 1) MTE's absolute EV is modest relative to higher profile peers; 2) by virtue of its large resource potential MTE sits at the bottom of the peer group on an EV/t basis (current and forecast); and 3) transactions for comparable assets highlight significant upside should the assets prove attractive to a strategic investor.

#### Spec Buy for strategic attractiveness

MTE is likely to trade as a coal asset play until the resources, project inputs and Surat Basin infrastructure solutions are better defined. However we've seen very large coal properties attract very large strategic premiums (LNC, BND), hence we believe MTE's resource base will support significant shareholder returns via likely ongoing consolidation in the sector.

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Important disclosures can be found in the Disclosures Appendix.

## Company snapshot

**MTE is building value through coal resource growth via exploration**

Metrocoal (MTE) is a junior coal exploration company with extensive tenements within the Surat Basin of Queensland. Since listing Metrocoal has entered a significant drilling program through its Columboola and Wandoan West projects. The company has identified thermal coal seams that extend from shallow opencast deposits, dipping to depths of around 400m. With further exploration and analysis, the deposits will be shown to be well suited for both conventional underground mining and UCG.

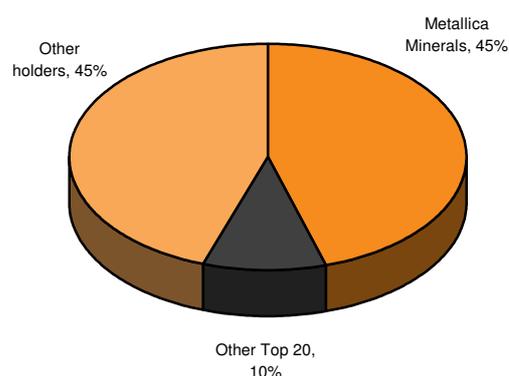
The upside for MTE lies in its resource upgrades and the de-risking over 2-3 years of infrastructure risk around the proposed Surat Basin Rail JV and its participation in WICET Stage 2 development. With these two catalysts in mind, we expect to start to see MTE re-rate in line with peers. The signing of a \$30m EPC1165 Columboola JV with Sinocoal will also allow MTE to rapidly grow its resource base in the near term.

**Table 1: Corporate snapshot**

Code	MTE
Issued equity (inc Restricted)	176.7m
Price (A\$ps)	\$0.61
Options (m)	10.38m
Diluted Equity (m)	187.1m
Diluted Market cap (A\$m)	\$114.1m
Cash on hand (A\$m)	\$13.0m
<b>Diluted EV (A\$m)</b>	<b>\$101.1m</b>

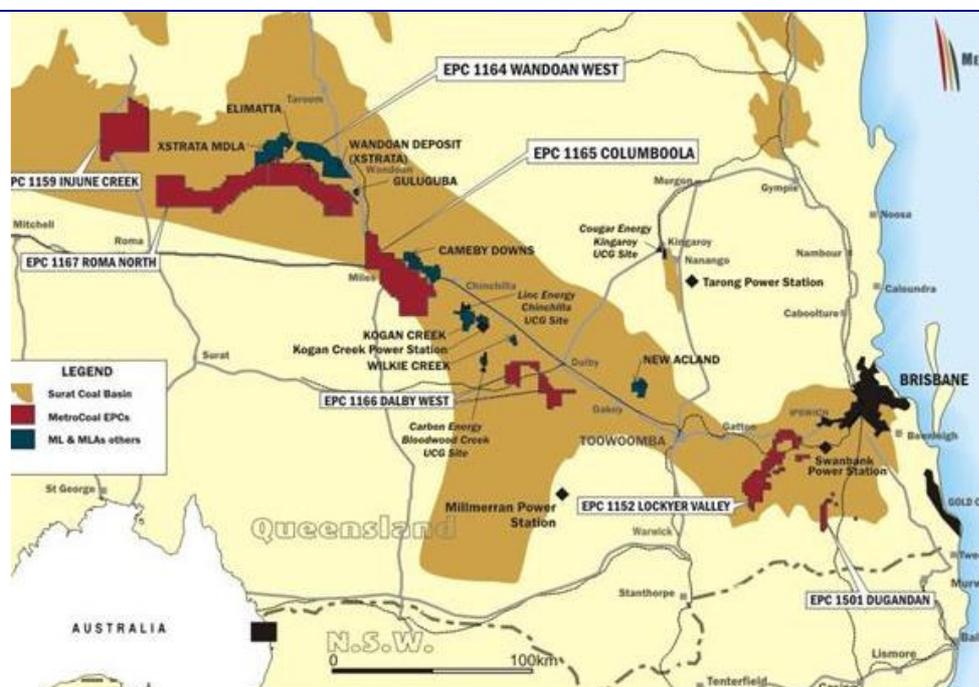
Source: MTE, IRESS

**Chart 1: MTE Ownership**



Source: MTE

**Figure 1 :MTE coal tenements**



**1) Wandoan West (100%)** - Thermal + UCG targets over 721km<sup>2</sup> of the Walloons. Close to Xstrata's Wandoan and NEC's Elimatta.

**2) Columboola (49%)** – Sinocoal JV signed 2010. Covers 902km<sup>2</sup>, 9 of 35 drillhole program complete

**3) Dalby West (100%)** – Close to established projects. Exploration target 160-220Mt. Historical drill intersections on all sides.

**4) Roma North (100%)** – MTE intersected a 10.3m seam in 2008. Covers 890km<sup>2</sup> targeting 600Mt-850Mt.

**5) Lockyer Valley (100%)**- Ipswich project along eastern end of the Moreton Basin, targeting 25-35Mt in the Walloons.

**6) Injune Creek (100%)** - North West Surat Basin 70km north of Roma.

Source: MTE, RBS Morgans

## Valuation and Investment View

We initiate informal coverage of MTE with a Speculative Buy and set our target price at A\$1.00ps. We believe that the company will re-rate through 2011 as exploration drilling enables ongoing resource upgrades. Key positives/ catalysts include;

- Anticipated resource upgrades through 2011. If the 2.5-3.5 Bt target is reached, this will form one of the largest coal resources in the Surat Basin
- MTE trades at a modest absolute EV and EV/t compared with higher profile peers
- MTE also looks discounted versus recent coal transactions. Significant upside is available if commerciality can be proven for MTE or for a third party acquirer
- There is no market understanding or value attributed to the Injune Creek, Dalby West and Lockyer Valley tenements

**Table 2: Valuation summary**

Project	MTE	Type	Resources (Inf + Ind) (Mt)	Additional Target (Mt)	Attrib. Resources (Mt)	EV/t Multiple (A\$/t)	Value (A\$m)	Value (A\$ps)	Methodology
Wandoan West	100%	Thermal	595	290-600	590	0.22	129.8	0.735	Pre-feas multiple
Columboola	49%	Thermal	172	658-993	84	0.20	16.84	0.095	Exploration stage EV/t
Roma North	100%	Thermal	156	449-694	156	0.20	31.2	0.177	Exploration stage EV/t
Injune Creek	100%	Thermal	0	30-40	0				Nil value
Dalby West	100%	Thermal	0	160-220	0				Nil value
Locker Valley	100%	Thermal	0	25-35	0				Nil value
Total exploration			923	1612-2582	830		177.84	1.006	
Corporate							-15	-0.085	
Net cash							13.0	0.075	
<b>Total valuation</b>							<b>176.14</b>	<b>\$1.00</b>	<b>= Target Price</b>

Source: RBS Morgans forecasts

## Upcoming Milestones 2011

- Bundi/Norwood resource upgrades
- Columboola JV first JORC resource and further resource upgrades
- JV partner announcement for EPC1164/1251 (Bundi project)
- Scoping study for Bundi Underground Mine
- Commencement of Pre-feasibility study of the WICET Stage 2
- Final investment decision on Surat Basin Rail

## Recent activity in Surat Basin

The rate of progress of the opening up of the Surat Basin for coal exports has been long seen as both an opportunity and a risk for coal juniors leveraged to the timely development of basin infrastructure. Strategic milestones reached by both MTE, and predominantly larger plays in the basin (i.e. Xstrata) will in part dictate the rate at which investors take interest in Surat juniors.

- Xstrata lodges extensive MLAs and MDLAs near Wandoan
- Xstrata proceeding with final stage of the Wandoan Mining Lease application
- Cockatoo Coal acquires Anglo Coal Surat Basin assets
- New Hope takes majority share of Northern Energy

- Cameby Downs commences production

### **Infrastructure progress**

MTE is not a member of the “WICET” consortium of coal producer/developers that will develop and own the Wiggins Island Coal Terminal to be built at Gladstone. However the company has lodged bank guarantees in support of applications for 12Mtpa of export capacity through Stage 2 of the proposed terminal in support of its growth ambitions. The guarantees will be used to underwrite a detailed feasibility study for the port expansion with WICET Stage 2 targeting commissioning in 2015.

WICET stage 1 is targeting Financial Close early Sep-Q allowing construction of Stage 1 to commence, which helps the timeline of Stage 2 to further develop. Commissioning of Stage 2 towards port operations for 2015 has been flagged although this looks too aggressive given delays already experienced to Stage 1. Risk to the proposed timetable given the uncertainties created by inter-action with required rail upgrades, equity contributions from producers and uncertainty over some greenfields projects required to underwrite Stage 2, will be de-risked over the next 2-3 years. A possible delay to MTE’s greenfields developments due to infrastructure capacity limitations is a key risk to the investment case.

### **Strategic Cropping not a show-stopper**

On first pass, MTE Surat Basin projects should not be adversely impacted by new “Strategic Cropping Land” legislation. MTE’s two principal project areas, Bundi/Norwood (EPC 1164) and Columboola (EPC 1165 in Joint Venture with SinoCoal) are not within the proposed “Protected Zones” except for a relatively insignificant section of EPC 1165. The Company’s Dalby West Project (EPC 1166), appears to be partially within the proposed “Protected Zone”, but at this stage, MTE believes the most likely area of interest is outside the proposed “Protected Zone”.

## Valuation + Compco's

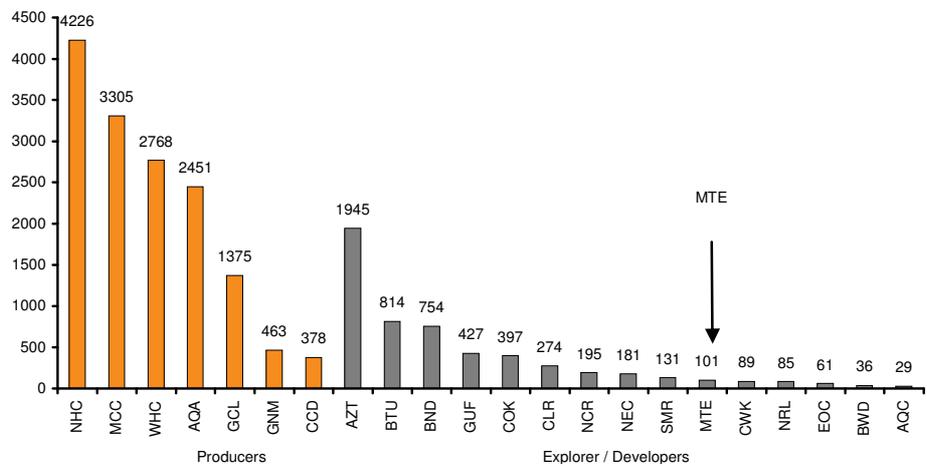
As an early stage explorer there are relatively few inputs with which to build a robust valuation. We instead highlight;

1. MTE's absolute market value relative to its peers
2. Market value relative to the current and potential resource base also relative to peers
3. Market value relative to recent coal transactions

### 1) Absolute market value vs peers

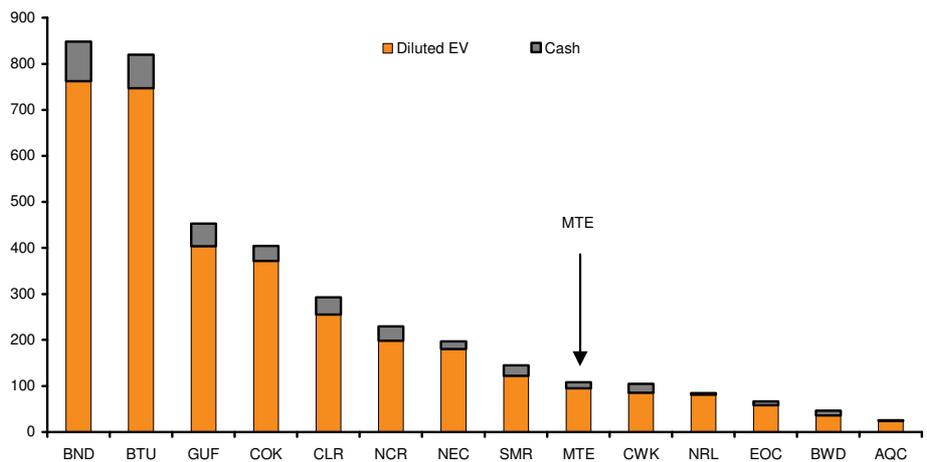
MTE is still trading at a relatively modest market valuation of A\$94m (diluted EV) relative to its peer group. With plans to develop into a 12Mtpa coal exporter at the commissioning of WICET Stage 2, MTE holds potential for significant upside relative to coal producer valuations.

**Chart 2: Australian/NZ based coal producer / developers – diluted EV (A\$m)**



Source: IRESS, RBS Morgans

**Chart 3: Junior coals – Diluted EV + cash (A\$m)**



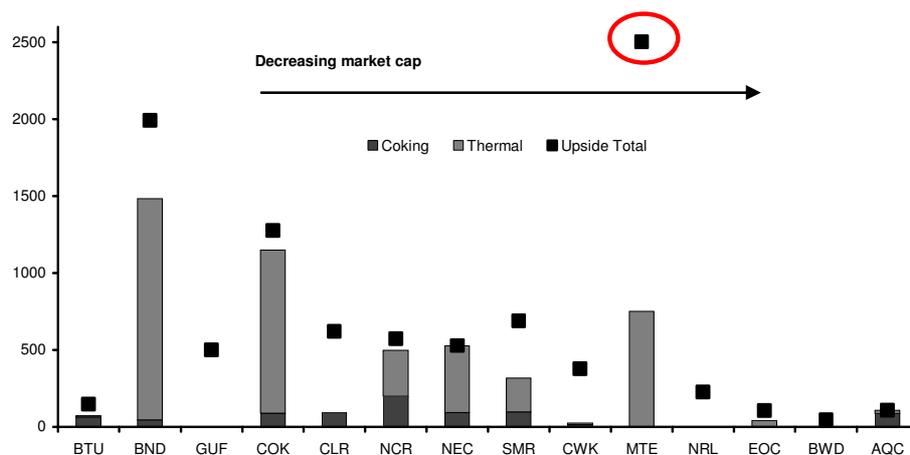
Source: IRESS, RBS Morgans

## 2) Valuations vs resources and resource upside

Chart 4 shows the current defined JORC resource positions of the comparable junior coal collective with assets in Australasia split by product type. We also show the sizes to which we believe these companies can grow their resources over the course of 2011. Chart 5 then evaluates the current and “End-CY11” Resource multiples on which these companies are trading.

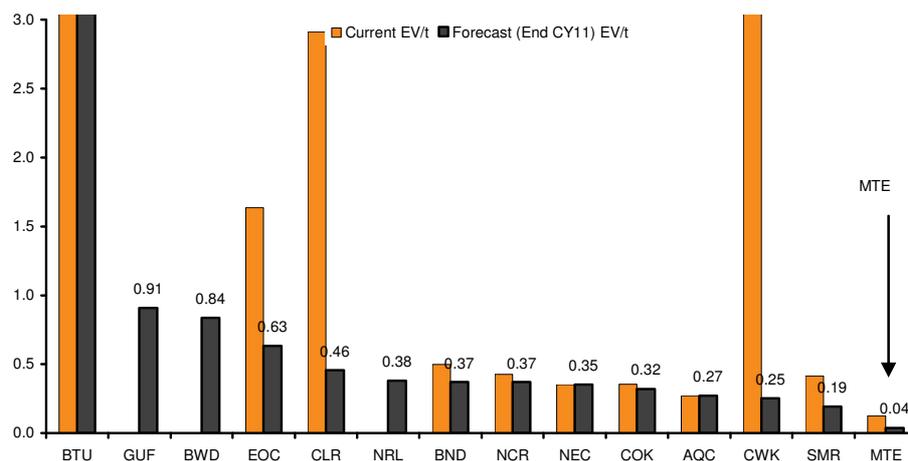
Chart 5 illustrates the conservatism of the valuation multipliers used to derive our \$1.00 price target. We have attributed a \$0.20/t valuation to the Columboola and Roma West tenements and a slightly higher \$0.22/t valuation to the Wandoan West project. The Bundi project within the West Wandoan tenements holds all 595Mt indicated and inferred and is currently under a scoping study for feasibility of underground mining.

**Chart 4: Current and forecast (2011) JORC Resources (Mt)**



Source: IRESS, RBS Morgans

**Chart 5: Current and forecast end CY11 EV / t**



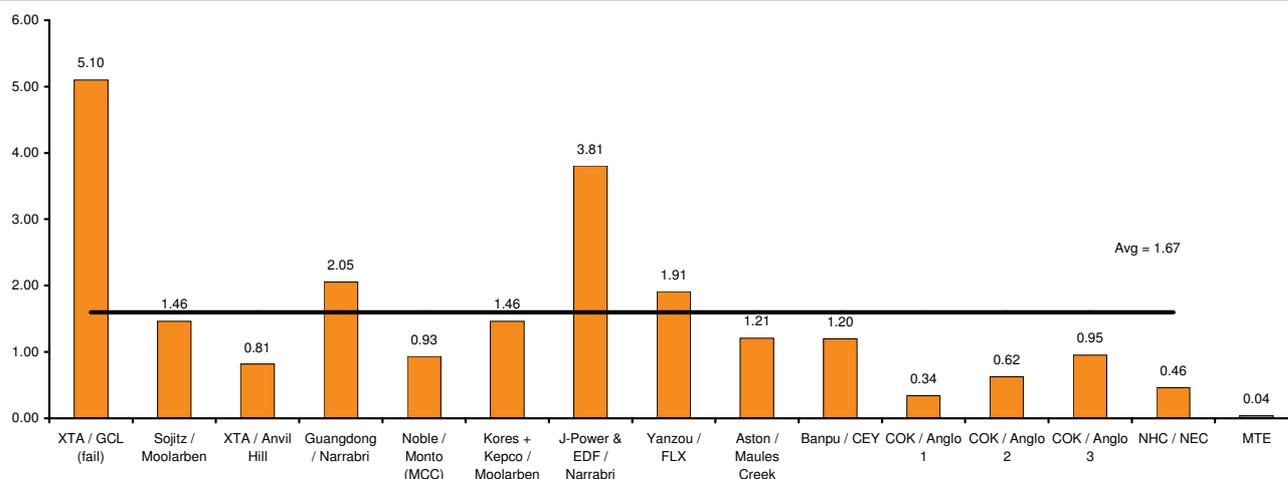
Source: IRESS, RBS Morgans

## 3) Value relative to recent coal transactions

We believe that in time, MTE will attract strategic interest at both the asset and corporate level. Independent QLD and NSW coal explorers, developers and producers have been the subject of intensifying corporate and strategic interest driven by consumers striving to secure their long term offtake requirements, support alternate supply or grow via acquisition.

MTE is trading at a nominal \$0.04 EV per Resource tonne on its forecast CY11 exploration target. However we believe an EV/t comparison is less relevant in MTE's case due to the size of tonnages under consideration. We believe a better measure is to compare MTE's current capitalisation (EV = A\$101m) against recent comparable transactions including the A\$500m + royalties achieved for LNC's sale of its Galilee tenements, and the possibility that BND will attract investments exceeding its current EV of cA\$750m. We also note that the former Waratah tenements (acquired for cC\$160m in 2008) are likely to eventually return to the listed market with a +US\$1bn valuation. We acknowledge that coal exploration assets are far from like for like based on varying locations, access, geology, coal quality and unique infrastructure challenges. However the variance between MTE's EV and these achieved (or likely) asset sales suggests significant upside for MTE from current levels.

**Chart 6: MTE versus recent coal market transactions (A\$EV/t)**



Source: IRESS, RBS Morgans

#### Recent corporate in the East Coast coal market

- Jul-07 – Felix JV's with Sojitz, Kores and Kepco implying A\$900m Moolarben valuation
- May-09 – Waratah announces MOU with China Metallurgical Group re development of its 30Mtpa, A\$6b Galilee Basin project
- Aug-08 – WHC JV's with J-Power, EDF and Guandong implying A\$1.6bn Narrabri valuation
- Aug-09 – Whitehaven sells 7.5% of Narrabri to a Korean consortium for A\$125m
- Aug-09 – Chinese steelmaker Baosteel invests A\$285.6m for 15% of Aquila
- Sep-09 – Korean coal miner SAMTAN invests A\$22.5m in Bandanna Energy for 10%
- Apr 10 – China Coal to earn 51% of MetroCoal's Columboola for A\$30m in exploration
- Apr-10 – Chinese steelmaker Xinyang invests A\$23m in Northern Energy for 12.7%
- Aug -10 – Indian conglomerate Adani purchases Linc Energy's Galilee project for +A\$500m
- Jan-11 – Bandanna announces it has commenced a formal sale process
- Feb-11 – Bathurst Resources appoints a corporate adviser in lieu of takeover speculation
- Feb-11 – New Hope acquires NEC for A\$242m
- Apr-11 – Court proceedings over MCG's sale of MDL162 to MCC (for +A\$400m) commence in lieu of further (higher priced) demand for the asset

## Risks to the investment view

- Execution risk inherently linked to exploration and evaluation
- Resource size, geology and coal quality risks associated with MTE's prospects
- Feasibility and execution risk of UCG targets
- Susceptibility to delays in the mining and environmental approvals process, labour and skills constraints and to changes in government regulation, royalties and/or policy
- Funding risk, although we believe this is low in the current joint venture at Columboola and proposed JV for West Wandoan
- Possibility of further delays in the development of port and rail capacity (Wiggins Island, Surat Basin Rail) both of which are required to get MTE's product to market

## Company background

### Ambitions to become a major coal owner

**MTE is pursuing an aggressive development strategy to support applications for 12Mtpa of export capacity from 2015**

MetroCoal is planning to be a coal exporter by utilising the proposed Wiggins Island Coal Export Terminal (WICET) stage 2 in Gladstone. Metrocoal has lodged a \$2million bank guarantee for the expansion of WICET stage 2, joining a conglomerate of coal industry companies who are underwriting the cost of a full feasibility study. WICET Stage 2 expects to be commissioned by 2015, of which Metrocoal has requested a 12Mtpa allocation. The 12Mtpa will be made up of its key Surat Basin projects, 5Mtpa from its Bundi project in the Wandoan West tenement and 7Mtpa from the Columboola JV (49%).

MetroCoal has signed \$30 million joint venture with Sinocoal, Australian subsidiary of China Coal Import & Export Company (CCIEC), a wholly owned subsidiary of China National Coal Group Corp (China Coal). The joint venture agreements have a capital expenditure commitment of \$4m over the next two years on its Columboola tenement, which will de-risk some funding issues for the company. MetroCoal has assigned Caldrex Capital to co-ordinate the marketing and management of a second JV of its Wandoan West project.

Typical of MTE and its peer group, there are still many infrastructure and regulatory approval risks which will take 2-3 years to de-risk. Significant upside for Metrocoal will be achieved as milestones from WICET stage 2 and the SBR JV are crossed off, MTE's coal resource value will be unlocked at each of these milestones.

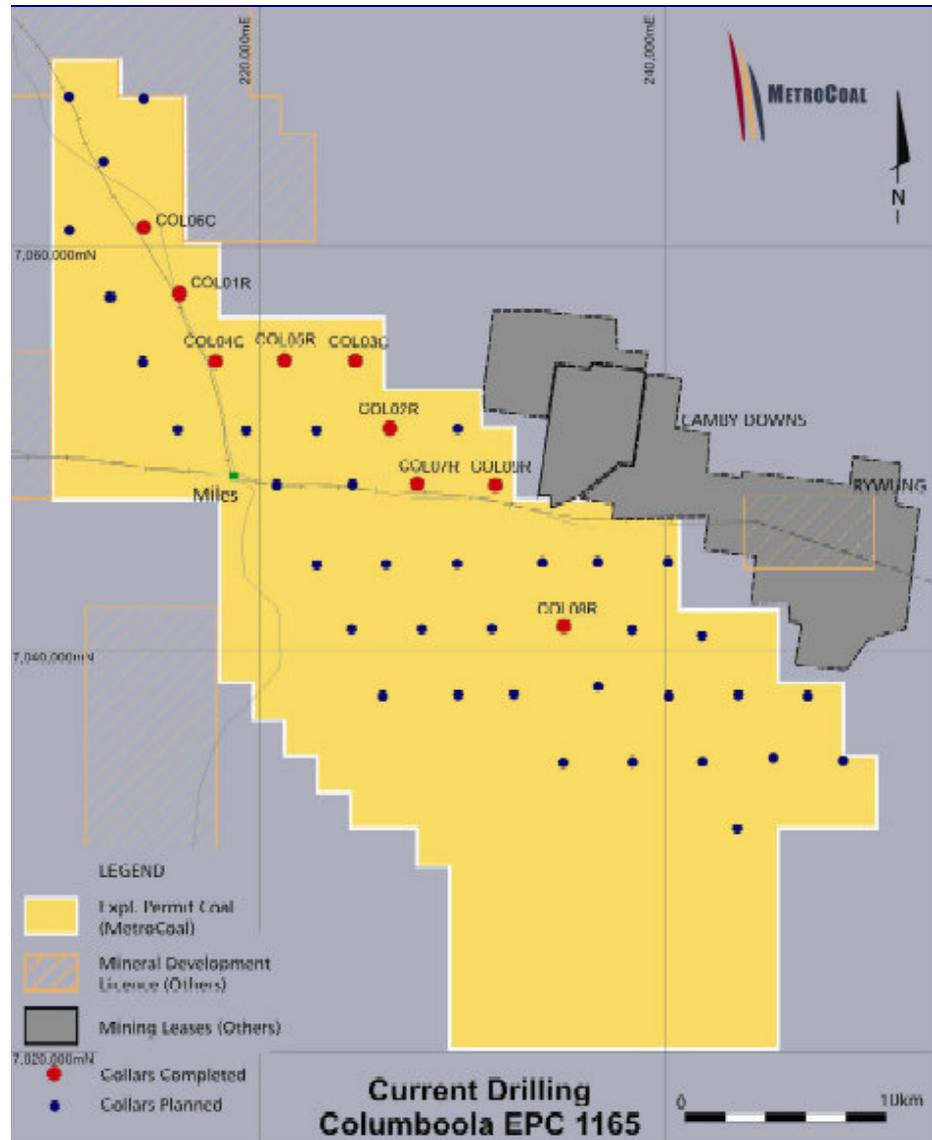
Nonetheless, both coal consumers and the equities market continues to demonstrate strong support for junior coal companies through strategic support and investment at both the asset and corporate levels. We also believe the risks to our short and long term coal price deck remains to the upside as both China and India continue to surprise on the rate of import growth from the seaborne market. Our latest analysis of the macro coal environment is detailed in our Quarterly Commodities Compendium, *'Pump up the Volume, 16/3/11'*.

### Columboola JV (49%)-EPC 1165

EPC 1165 Columboola is centrally located in the Surat Basin. MTE is targeting the Juandah and Taroom coal measures within the Jurassic Walloon Sub-group. Columboola EPC 1165 consists of 294 sub blocks (902 km<sup>2</sup>) located west of Chinchilla and surrounds the town of Miles. The tenement strategically covers the Juandah Coal Measures from 100m to 400m depth. Columboola was considered attractive for exploration as it covers the down dip extensions of the identified Juandah Coal Measures currently forming the coal resource seams of the Cameby Down, Rywung and Sefton Park deposits. The project area is directly over the existing railway proximal to the future proposed Surat Basin Rail, a Joint Venture by Queensland Rail, Xstrata and ATEC, and associated infrastructure which would enhance the economic viability of coal resources within the permit area.

The joint venture with SinoCoal, which acquired 51% through signing a \$30 million expenditure commitment program, was signed in late 2010. The first nine holes have been completed over a 25km strike distance and there are currently 3 drill rigs onsite. Of the total 12Mtpa MTE has requested for the WICET stage 2, Columboola accounts for 7Mtpa.

**Figure 2: Columboola Project (JV 49%)**



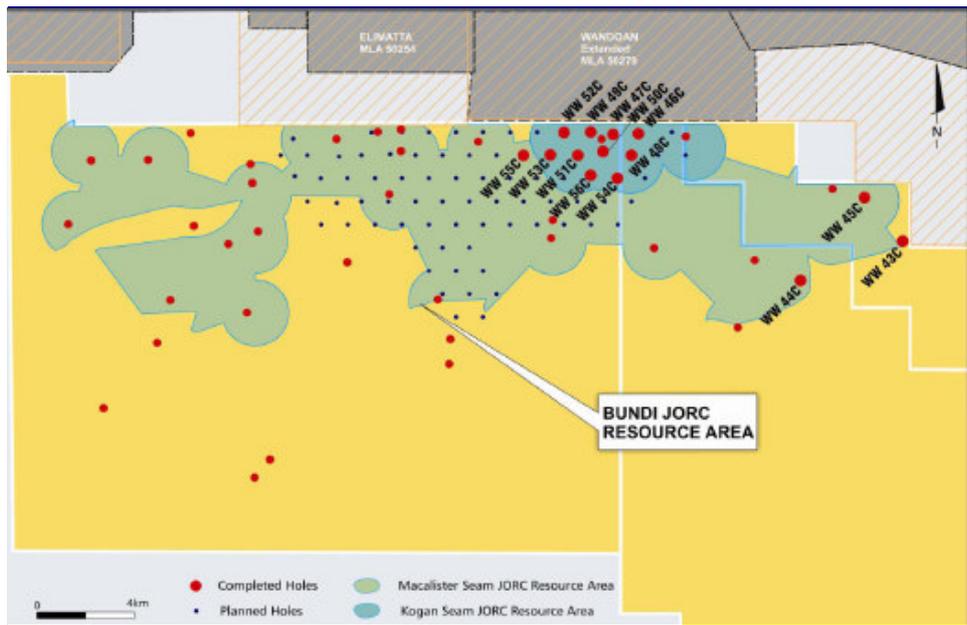
Source: MTE

### **Bundi Project – Wandoan West (100%)**

The Bundi Project area lies within the Company’s EPCs 1164 & 1251 in the Surat Basin and is essentially the down dip extension of Xstrata’s Wandoan project. Further drilling and geological modelling has confirmed the correlation and continuity of the Macalister Upper (MU) Seam and extended the resource area. Furthermore, the addition of the Kogan Seam (KO) as a workable mining section has seen a substantial addition of tonnages to the resource.

The drilling program has also confirmed a resource in the overlying Kogan Seam. Currently a 595Mt indicated and inferred resource has been identified. MTE has started a 70 hole drilling program and is currently seeking a JV partner that is being managed and marketed by Caldrex Capital.

**Figure 3: Bundi Project**



Source: MTE

### MTE's other projects

- **Dalby West** EPC 1166 is located at the south eastern end of the Surat Basin adjacent to the Kumberilla Ridge which forms the boundary with the Moreton Basin. It consists of 97 sub-blocks (296km<sup>2</sup>) located west of Dalby. The tenements cover the Walloon sub-group immediately down dip of Peabody's large open cut thermal coal deposit Wilkie Creek. MetroCoal has confirmed the Walloon sub-group is continuous along and down dip from this deposit into EPC 1166 following a review of historical exploration data. The Norwood project lies on the western border of the tenement, adjacent the Bundi project in the West Wandoan tenement. Currently Norwood holds a 156Mt inferred resource.
- **Roma North** EPC 1167 Roma North covers the western limb of Mimosa Syncline of the prospective Walloon sub group where the Macalister Seam is between 100m and 400m in depth. It consists of 289 sub-blocks (890km<sup>2</sup>) located west of Wandoan and north of Roma. The tenements cover the Walloon sub-group immediately down dip of Xstrata's open cut thermal coal deposits of Glen Arden and Pony Plains. MTE has confirmed the Walloon sub-group is continuous along strike and down dip from this deposit into EPC 1167 following a review of historical exploration data.
- **Injune Creek** EPC1159 comprises 237 sub-blocks (732km<sup>2</sup>) and is situated at the north western end of the Surat Basin in South East Queensland and is approximately 70km north of the regional centre of Roma. Injune Creek was considered attractive for exploration as it covers the sub-crop of the highly prospective Juandah and Taroom Coal Measures of the Walloon sub-group of the Surat Basin.
- **Lockyer Valley** The Ipswich Project consists of 150 sub-blocks (456km<sup>2</sup>) located at the eastern end of the Moreton Basin in South East Queensland south west of the city of Ipswich. MetroCoal is targeting the Walloon Sub Group, historically and locally known as the Walloon Coal Measures within this area. EPC 1152 encircles the known coal deposits referred to as the West Moreton Coal District which contains the Ebenezer, New Oakleigh and Jeebropilly Collieries. The project area is located proximal to existing railway infrastructure with established links to the Port of Brisbane.

**Table 9: Board and management (update)**

Chairman/MD	David K Barwick	An accountant by profession, David has more than 37 years experience in the management and administration of publicly listed companies in both Australia and North America. David has played a significant role in successfully funding and bringing into production, four mining projects throughout his career. As a Director, he has managed over twenty seven public companies, using his strong skills in strategic planning to successfully restructure these and give them a solid financial base from which to operate.
Chief Executive Officer	Michael O'Brien	<b>Mr Mike O'Brien has 35 years working in the mining and minerals industry including over 25 years extensive management experience with multinational companies Shell Coal and Anglo Coal (subsidiary of Anglo American). His experience includes operational roles as General Manager of a large underground longwall mine and as General Manager of a very large opencast mine that included a coal seam gas (CSG) operation.</b>
Chief Operating Officer	Theo Psaros	<b>Mr Theo Psaros is a Chartered Accountant with considerable experience in financial management and administration. . His career in management includes working with some of Australia's biggest financial and sporting names. In his role as a Chartered Accountant, he worked for Coopers &amp; Lybrand and for PricewaterhouseCoopers.</b>
Non- Executive Director	Andrew L Gillies	Mr Andrew Gillies has been Executive Director and Managing Director of ASX-listed Metallica Minerals Limited and its subsidiaries since 1997. He has been instrumental in the selection and acquisition of all the mineral assets now held by the Metallica group, Cape Alumina Limited (ASX-CBX) and MetroCoal Limited.
Non- Executive Director & Company Secretary	John K Haley	Mr John Haley brings more than 25 years of senior corporate experience from positions in Canada and Australia to the board of MetroCoal. He is currently Company Secretary, Chief Financial Officer and Executive Director of Metallica Minerals Limited and has been employed by Metallica since late 2003.
Non- Executive Director	Michael Hansel	Mr Michael Hansel is a partner of the large Queensland law firm, HopgoodGanim Lawyers. Michael joined HopgoodGanim in 1998 and practices almost exclusively in the corporate area, with an emphasis on capital raising, mergers and acquisitions, joint ventures, due diligence, takeovers and corporate restructuring.
Columboola JV General Manager	Neil Mackenzie-Forbes	Mr Neil Mackenzie- Forbes is a geologist with 15 years of varied experience in coal, oil shale, gold and base metals. He has worked for Metallica Minerals Limited, Suncor Energy Inc, Southern Pacific Petroleum, Australian Resources, Gympie Eldorado Mining and Queensland Metals Corporation. Neil has wide and varied exploration and mining experience including resource and mine development.
Exploration Manager Nicholas Villa		Mr Nicholas Villa is a geologist with 5 years' experience in coal, manganese and coal seam gas projects. He has worked on two longwall underground mine projects in the Hunter Valley. He has an Honours Degree in Geology. from the University of Newcastle

Source: MTE

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