RFC Ambrian

Metals & Mining

Ascot Resources

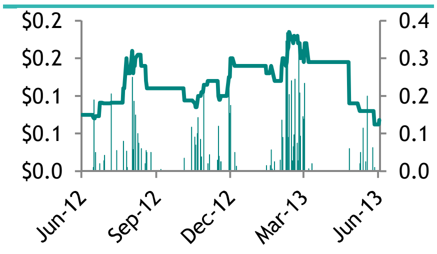
Speculative Buy

Coking Coal in Colombia

14 June 2013

Price (A$)	0.07
Target Price (A$)	N/A
Ticker	AZQ
Market cap (A$m)	3
Estimated cash (A$m)	1.5
Convertible note (A$m)	1.2
Attr resource (Mt)	N/A
EV/Resource (US$/Mt)	N/A
Shares in issue	
Basic (m)	33.3
Fully diluted (m)	110.9
52-week	
High (A$)	0.185
Low (A$)	0.062
3m-avg daily vol (000)	14
3m-avg daily val (A$000)	9
Top shareholders (%)	
Kopejtka P & K	7.7
Pheakes PL	6.4
AH Super	6.0
Romfal Sifal PL	4.1
Banks-Smith K	2.7
Total	**26.9**
Management	
Paul Kopejtka	CHR
Andrew Caruso	MD
Francis De Souza	NED
Joseph van den Elsen	NED

Share Price Performance (A$)



Source: FactSet

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Ascot Resources is an ASX-listed, Colombian-focused coking coal developer. The company's flagship asset is the Titiribi Coal Project in western Colombia.

Asset	Country	Status	Interest
Titiribi	Colombia	Exploration	90%

Source: Company data

Ascot Resources has completed a first phase drilling programme at Titiribi; this returned some encouraging coal quality data that indicates coking coal at the project. Preliminary results indicate that a semi-soft, high volatile coking coal could be mined at Titiribi. The coal is likely to be relatively high in sulphur (although this is likely to be confined to certain seams), but exceptionally low in phosphorous; the latter quality is likely to be desirable to customers.

Drilling intersected some 25 coal seams with thicknesses varying from 0.3m to 13m. Coal is reported to show good continuity across the project, with three seams (the thickest at 5m) likely to form the bulk of any future resources. The seams are steeply dipping and likely to produce a profitable 250,000-750,000tpa.

The project is located close to a sealed highway that is linked to both Atlantic and Pacific ports. The coal is likely to be in demand in Brazil and/or Peru as well as domestically.

Management has done this before. MD Andrew Caruso and Project Director John Malysa have experience in mining steeply dipping coal seams.

Titiribi looks set to be a low capital project in a region with few barriers to entry in the junior coal space. Ascot does not plan to wash the coal and this has resulted in relatively low capex. Anticipated margins are expected to provide a healthy operating profit.

Titiribi is likely just a foothold in the country, with Ascot having plans to grow through future acquisitions in Colombia. We see Colombia as a good mining investment environment. The country is the fourth largest coal producer globally, and was recently ranked the seventh most attractive country in the world for mining investment.

Recommendation – SPECULATIVE BUY

We are initiating coverage of Ascot with a SPECULATIVE BUY rating. Catalysts going forward include:

- Resource estimate – 3Q13
- Scoping study – 3Q13
- Further acquisitions – 2013
- Reserve definition – 1Q14

Contents

Investment Case

Valuation

We are initiating on Ascot Resources with a **SPECULATIVE BUY** rating

We are initiating on Ascot Resources with a **SPECULATIVE BUY** rating. Given the early-stage nature of the company's exploration projects, we do not feel comfortable assigning a target price at present. However, preliminary modelling utilising total FOB costs of US$90/t and pricing of US$120/t with low initial capital (US$25m) provides considerable scope for upside to the current fully diluted market cap.

Colombia is largely free of junior coal miners and explorers; whilst this represents an opportunity for Ascot, it makes peer comparisons difficult, and consequently we have not completed them.

Investment Case

Titiribi has returned strong indications that an open-pittable, semi-soft, high volatility coking coal can be mined

The maiden drilling programme at Titiribi has returned strong indications that an open-pittable, semi-soft, high volatility coking coal can be mined. The coking coal looks set to have ultra-low phosphorous content, which is likely to attract interest as a favourable blending coal. Whilst the phosphorous could attract a slight premium to benchmark pricing, it seems likely that the end product will be relatively high in sulphur and lead to an overall discount to the benchmark pricing of the coal.

A relatively high strip ratio is likely

The dip of the coal seams is relatively steep and, taken in combination with the width of some seams, indicates that a relatively high strip ratio is likely. Management does not want to wash the run-of-mine (ROM) coal and looks likely to utilise relatively small machinery to mine seams selectively. This should keep mining dilution down, but will limit production to less than 750,000tpa. While the low tonnage production restricts revenue, it does have benefits as lower royalties would be applicable and a less arduous approvals process likely.

The nearby La Margarita mine has been successfully mining similar geology

Management has mined this style of coal geology before and this gives us confidence that it can do this again. The nearby La Margarita mine has been successfully mining similar geology, perhaps with even steeper dipping seams, and trucking thermal coal 300km. This provides us with further confidence that mining will be successful at Titiribi. We suspect production will likely commence in 2015 rather than the hoped for 2014.

Colombia represents a favourable, low-cost operating environment

Colombia represents a favourable, low-cost operating environment and Ascot's forecast FOB cost of US$90/t looks achievable and should provide healthy operating margins. The plan to deliver ROM coal to market has saved considerably on initial capex, which greatly reduces the barriers to entry and lifts the NPV of the project considerably.

Titiribi is well located near a sealed road with links to both Atlantic and Pacific ports

One of the key considerations when it comes to bulk mining projects is access to infrastructure. Titiribi is well located near a sealed road with links to both Atlantic and Pacific ports. This location, in conjunction with low haulage costs and reported port capacity, gives the company a high degree of flexibility when marketing the coal to customers.

In our view Colombia represents an exciting opportunity to acquire good quality exploration assets

In our view, one of the reasons Ascot Resources is undervalued is that it is listed on the ASX. Our experience is that much of the Australian investment community still believes that Colombia is controlled by drug cartels and is not a good place in which to operate and invest. This view is further enhanced by the relative lack of a junior coal mining sector in Colombia. However, in our view Colombia represents an exciting opportunity to acquire good quality exploration assets.

The country is the fourth largest coal producer globally, and was recently ranked the seventh most attractive country in the world for mining investment. We think this is understood by European and North American investors, and Ascot may want to look to players in these markets as it develops from explorer to producer.

Titiribi is likely to be a relatively small coal producer, but will act as an important foothold in the country

One of the key selling points with Ascot Resources is its 'first-mover advantage' in the junior coal space in a country with substantial coal mining opportunities. We would expect Titiribi to be just the first of many future acquisitions in the space for Ascot. The Titiribi asset is likely to be a relatively small coal producer, but will act as an important foothold in the country and should generate early cashflow and local goodwill. From this base Ascot intends to make additional acquisitions to grow its presence in coal in Colombia.

We initiate on the company as a **SPECULATIVE BUY**

Whilst the company does not as yet have a confirmed coal resource to pin value against, we believe that the likely path to near-term cashflow and the expectation of future positive newsflow from progress at Titiribi and further accretive acquisitions justify our anticipation of share price appreciation and our initiation on the company as a **SPECULATIVE BUY**.

SWOT Analysis

Strengths

Coking coal likely

Access to sealed road & ports

Low-cost operating environment

Management has done this before

Very low phosphorous coal

Low capex and low barriers to entry

Nearby mining operation

Weaknesses

Relatively high strip and dip

Limited to low tonnage

ASX-listed Colombian asset

Relatively high sulphur and fairly high volatility

Perception of political instability

Low liquidity on market

Threats

Coal prices

Possible permitting delays

Opportunities

Further acquisitions in-country

Expansion of project through acquisition of adjacent properties

Company Overview

Background

Ascot Resources started life as a listed entity in September 2010 when it listed on the ASX as the junior explorer Epic Resources. Epic was originally focused on the Quartz Hill Uranium and REE Project in Australia.

Project Location

Source: Ascot Resources

In August 2012 Epic acquired 90% of the Titiribi coal concessions for an initial consideration of 4.5m shares and A$500,000 in cash. At this time the vendor, Paul Kopejtka, joined the board as Executive Chairman and Epic changed its name to Ascot Resources Limited.

Corporate Overview

Ascot currently has cash of around A$1.5m and a fully-drawn, two-year unsecured convertible note for A$1.2m issued by Resource Capital Funds (RCF). The note is convertible at RCF's election into shares at a conversion price of A$0.18/share and pays a coupon of 14% pa.

The company's share register is largely made up of small retail holdings and high net worth individuals. Ascot has issued 4.3m options with a strike of A$0.20 and expiry between January 2014 and February 2016.

Further consideration for the 90% ownership in the Titiribi Coal Project is to be staged in the form of vendor performance shares. These look set to dilute the shares in issue considerably. They are summarised below.

Vendor Performance Shares

Hurdle	Detail	Consideration (shares)
Stage 1 - 12 months	10Mt Inferred Resource*	11.00m
Stage 2 - 18 months	20Mt Inferred Resource*	11.50m
Stage 3 - 24 months	20-day VWAP >A¢35c	12.00m
Stage 4 - 24 months	20Mt Measured Resource*	38.76m
Total		**73.26m**

*Coal quality >5,500Kcal/kg, <15% ash and <1% sulphur; Source: Ascot Resources

Furthermore, a small royalty payment is owed to the 10% minority JV partner on production based on the size of the coal reserve delineated.

Corporate Strategy

The company intends to commission the Titiribi mine by the end of 2014

The company intends to commission the Titiribi mine by the end of 2014. The Titiribi asset is likely to be a relatively small coal producer, but will act as an important foothold in the country and should generate early cashflow and local goodwill. From this base Ascot intends to make additional acquisitions to grow its presence in coal in Colombia.

Titiribi Project, Colombia (90%)

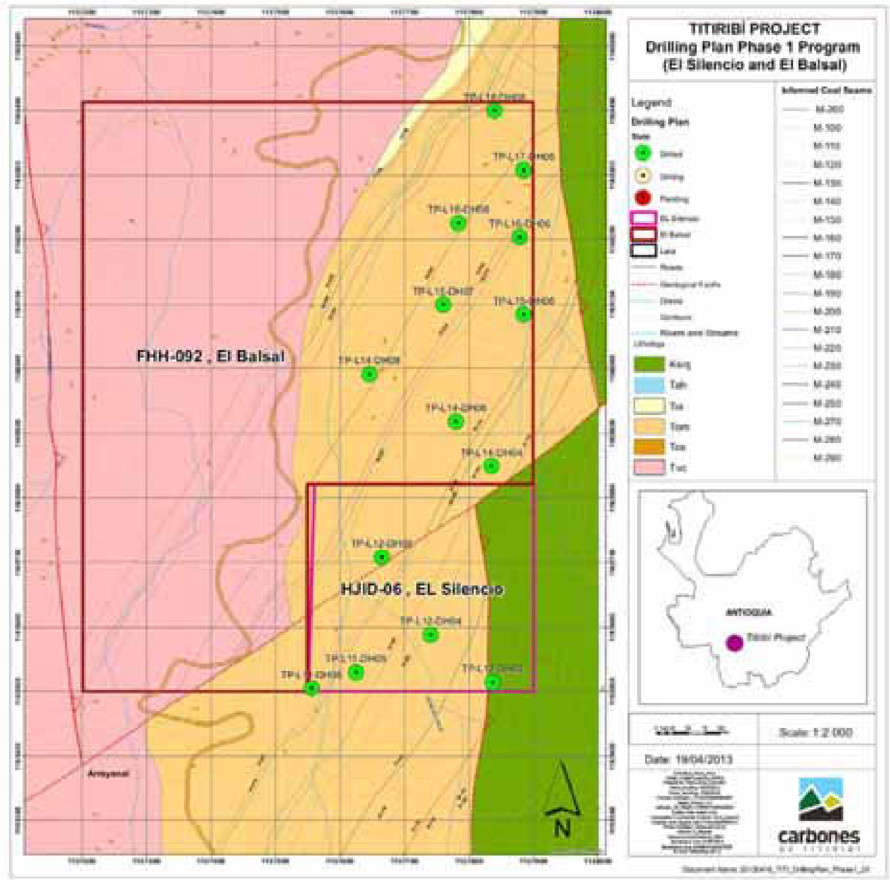
The project sits in the valley of Rio Cauca, which lies between the Cordillera Occidental and the Cordillera Central of the Andes mountains. Access to the project is via sealed road to the town of Titiribi and then via semi-improved gravel roads.

The company holds 90% of three concessions located in southern Antioquia near the town of Titiribi, some 70km from the city of Medellin. The project is located 350km from the Atlantic port of Turbo and 450km from the Pacific port of Buenaventura.

To date Ascot has completed drilling, mapping of outcropping seams and resistivity surveys, largely focused on the southern two concessions.

The coal seams are hosted within a thin package of sediments that are surrounded by volcanics. It is the proximity of these large igneous bodies that is believed to have cooked up the coal seams to form a semi-soft coking coal in a region known for its thermal coal.

Titiribi Geology and Drilling



Source: Ascot Resources

Drilling to date has indicated 25 seams of varying thickness (from less than 1m to 13m)

Drilling to date has indicated 25 seams of varying thickness (from less than 1m to 13m), and mining is likely to be focused around three primary seams, the main one of which averages around 5m thickness. The seams dip at approximately 55° and are truncated by a number of cross-cutting faults. Management does not believe these faults disrupt the stratigraphy significantly, and reports good continuity of seams. The current drilling programme will lead to an initial inferred coal resource in July that will assist in a scoping study and coal quality analysis (that is running concurrently).

Drilling at the Titiribi Project

Source: Ascot Resources

Preliminary coal quality analysis is reasonably encouraging

Preliminary coal quality analysis is reasonably encouraging (as shown in the table below). In our view the moisture, ash, free swelling index (FSI) and calorific value (CV) are all favourable for a semi-soft coking coal. Sulphur is relatively high in some seams; even the company's targeted <1% sulphur is on the high side, and this will likely require blending by customers and may attract a discount. However, much of this high sulphur may occur as discrete bands of pyrite that could be stockpiled and sold at cost locally, allowing for a lower sulphur export product. The volatiles in this coal are quite high, but within the scope of acceptability.

A real positive is the unusually low phosphorous in the raw coal

A real positive is the unusually low phosphorous in the raw coal. This is likely to attract a premium and will, at least partly, offset possible discounts for sulphur, etc. Further test-work is required; this is currently underway.

Coal Quality Analysis

Raw Coal Quality	Seam Mining Range	AZQ Blended Target
Total Moisture (%)	<10	<10
Ash (%)	5.5-9.5	7-8
FSI (%)	5-9	>5
Phosphorous (%)	0.003-0.004	0.003-0.004
Volatile Matter	37-41.5	<39
Total Sulphur	0.71-1.56	<1
Calorific Value (Kcal/kg)	7,390-7,790	>6,500

Source: Ascot Resources

The company does not expect to wash the coal. This will keep initial capital costs low, perhaps in the region of just US$25m.

Mining will need to be relatively selective and utilise quite small machinery

Mining of the coal will be through an open pit. Given the relatively narrow nature of some seams and the desire not to wash the coal, mining will need to be relatively selective and utilise quite small machinery. The dip of the ore and width of the seams make for a fairly high strip ratio (in the order of 10:1). However, the company believes that it will be profitable with small-scale mining despite the amount of waste that will be mined.

Ascot expects to operate at mining cash costs of US$45/t to mine gate

Managing Director Andy Caruso has mined this type of geology before at Collie in Western Australia, and ASX-listed Cockatoo Coal is also working high strip ratios and steeply dipping seams in Queensland. Given the low operating costs in Colombia, Ascot expects to operate at mining cash costs of US$45/t to mine gate despite its relatively high strip ratio.

Relatively low production, commencing at 250,000tpa and possibly ramping up to 750,000tpa

The operation will be restricted to relatively low production, commencing at 250,000tpa and possibly ramping up to 750,000tpa. This could have its advantages though as it will attract low government royalties and thus require a far less arduous approvals process.

Approximately 15km from the project is the locally-owned La Margarita mine that has been in operation since 2006. This operation has been mining seams of thermal coal that have a very similar geometry to Titiribi (often steeper dipping seams). The La Margarita operation trucks coal over 300km to market.

The Path to Production

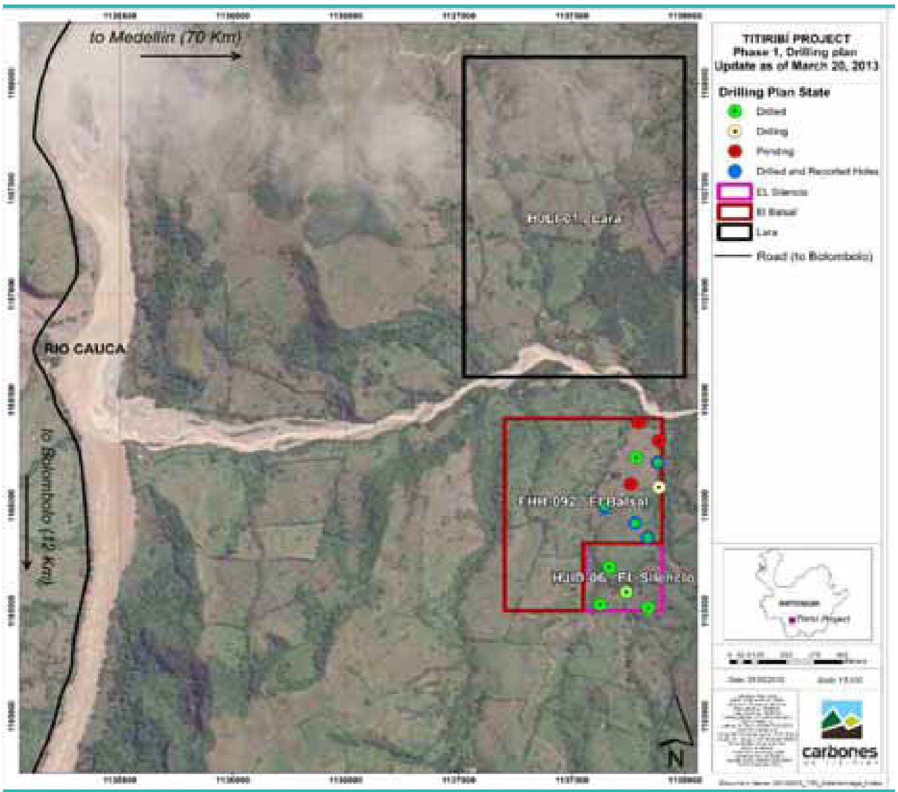
On completion of a scoping study Ascot intends to complete an infill drilling programme and reserve estimate and then commence mining and environmental approvals. In 2H14 Ascot aims to complete both the permitting process and trial mining. The company (optimistically) hopes to be in production by late 2014.

Infrastructure

Located just a few kilometres from a sealed highway that could be used to truck the coal to the ports of Buenaventura on the Pacific coast (450km) or to Turbo on the Atlantic coast (350km)

The project is located just a few kilometres from a sealed highway that could be used to truck the coal to the ports of Buenaventura on the Pacific coast (450km) or to Turbo on the Atlantic coast (350km). The company would likely build a 2.2km long conveyor belt along the river valley from the project and across the Rio Cauca to the highway.

Titiribi Project Location and Infrastructure



Source: Ascot Resources

The company estimates a tolling cost in the region of US$35/t

The cost of trucking the ore to either port is relatively low and the company estimates a tolling cost in the region of US$35/t. Also, a backhaul discount is reportedly achievable and could result in cheaper haulage costs. Ascot has commenced preliminary discussions with the port of Buenaventura to secure access to available stockpiling, loading facilities and services. Ascot estimates a cost in the region of US$10/t for port handling and ship loading.

Off-take Options

Ascot's most likely off-takers are within South America. Brazil has a significant requirement for coking coal and Peru is also reportedly in need of this. The larger Brazilian market is likely to suit exports from the Atlantic port of Turbo, although Buenaventura remains an option for both. As a Pacific port it is also well placed to export to Asia.

We have assumed what we feel is a conservative price of US$120/t FOB for Ascot's coal

We assume that the company will produce a semi-soft, high volatile coking coal that will have quite high sulphur and ultra-low phosphorous. Overall we would expect a slight discount to benchmark pricing and view this as a useful blending product. We have assumed what we feel is a conservative price of US$120/t FOB for Ascot's coal. If Ascot can get the coal on a ship for US$90/t, with US$25m initial capital then Titiribi looks a viable project.

The company will likely be able to produce a quantity of high-quality thermal coal for export. This is reportedly being bought for as much as US$115/t on Peru's Pacific coast. Ascot is well placed to produce excellent quality thermal coal with easy export options out of Buenaventura to Peru.

Future Acquisitions

The coal seams look to open up in width to the south of Titiribi into concessions under application by a gold explorer. It seems likely that once these concessions are granted Ascot could gain an option to explore and exploit coal along-strike from Titiribi. This could substantially grow the Titiribi operational capacity.

Titiribi represents just a foothold in Colombia and an opportunity to gain credibility in-country

Ascot has stated that Titiribi represents just a foothold in Colombia and an opportunity to gain credibility in-country and grow the business through acquisitions in the Colombian coal space. Ascot is one of just a small number of junior coal companies in a country that is awash with coal majors, including BHP, Anglo American, Xstrata, Glencore and Drummond.

Colombia

The Republic of Colombia is the fourth largest country in South America, with over 46m people, and is the fourth largest economy in Latin America, known for the production and export of coffee, flowers, emeralds, coal and oil.

Colombia was recently awarded an investment grade rating by Standard & Poor's, Moody's and Fitches, with the ratings agencies noting its improved macroeconomic credibility and security conditions. Similarly, the World Bank ranks Colombia fifth (out of 183 countries) in its 'protecting investors' index.

BHP, Anglo American, Xstrata, Glencore and Drummond are all operating in the growing Colombian coal market

Colombia is in the enviable position of being the only South American country bordering both the Atlantic and Pacific oceans. BHP, Anglo American, Xstrata, Glencore and Drummond are all operating in the growing Colombian coal market; Colombia is the world's fourth largest exporter of coal and has the largest identified coal resource base in South America. Colombia's overall coal production was 85.8 Mt in 2011 and 89.2Mt in 2012. On average, Colombian coal ranks second in energy values globally. The country is strategically situated to export to Europe, with the EU being the largest importer of Colombian coal in 2011. Demand is also increasing from Asia. With the Brazilian steel industry expected to grow in the coming decade, the 'local' market for coking coal is likely to increase. Recent reports suggest that Colombia expects to increase coal exports to approximately 150Mt by 2020.

In April 2011, Colombia, in collaboration with Peru, Chile and Mexico, formed the Pacific Alliance (AP), which integrates the respective economies based on geographic location, allowing free trade and liberalised labour movement. Moreover, Chile, Peru and Colombia have formed a unique stock exchange, with Mexico in the process of being incorporated. The resulting platform, in addition to offering greater liquidity and increased access to capital funding, will have a combined market cap of US$1.2tn, slightly larger than the ASX.

Colombia was ranked seventh in Behre Dolbear's 2012 country mining investment attractiveness

Colombia was ranked seventh in Behre Dolbear's 2012 country mining investment attractiveness and ranked 42nd in the World Bank's 'Doing Business' survey in 2012. Royalties for coal are just 5% for production below 3Mtpa.

Over the last eight months government officials and FARC leaders have been in extensive peace negotiations

Since the election of incumbent President Santos, Colombia has seen a period of relative political stability and enjoyed a transition to higher socio-economic status, with income levels to upper middle status. One of the hallmarks of the current government has been acknowledgement of the internal armed conflict with FARC guerrillas, together with the accompanying proposed economic reparation for the victims and restitution of their lands. Indeed, over the last eight months government officials and FARC leaders have been in extensive peace negotiations in Havana, which are reportedly progressing well. It is thought that a signed peace deal between the two parties could add up to 1.5% to annual economic growth, which is already among the highest in South America.

Board and Management

Executive Chairman — Paul Kopejtka has a Bachelor's Degree in Chemical Engineering and is a member of the Australian Institute of Company Directors. Mr Kopejtka has been associated with a number of listed Australian companies, notably Murchison Metals Ltd, Extract Resources Ltd and Indo Mines Ltd. Under Paul's leadership Murchison successfully developed the Jack Hills Iron Ore Stage 1 mine, producing 2Mtpa of high-grade iron ore.

Managing Director — Andrew Caruso has over 20 years' experience in the mining industry, including operations, management and executive roles within Australia and overseas. He spent over five years working in significant Australian coal operations, including two years at BHP Coal in Queensland. For the past two-and-a-half years he was CEO of Crosslands Resources Ltd, which is developing the Jack Hills Iron Ore Expansion Project in Western Australia. Prior to that he was the Managing Director of Australasian Resources Ltd (ASX: ARH), which is developing the Balmoral South Iron Ore Project in Western Australia. Mr Caruso has a Bachelor's Degree in Mining Engineering and is a member of the Australian Institute of Company Directors.

Non-executive Director — Joseph van den Elsen is currently an Executive Director and the Country Manager – Colombia for the Hampshire Mining Group, a privately-owned coal project development company, as well as being a Director of (and a shareholder in) Ascot Equities Pty Ltd. Prior to joining the Hampshire Mining Group, Mr van den Elsen was an Associate Director with UBS, having previously held a comparable position with Goldman Sachs JBWere. A permanent Colombian resident, fluent in Spanish, Mr van den Elsen provides Ascot Resources with invaluable in-country experience, as well as being integral to the company's ambitions to grow by acquisition.

Non-executive Director — Francis De Souza has many years' experience in financial services, specialising in corporate advisory and equity markets, with a specific focus on the resources sector. Mr De Souza is the co-founder of Otsana Capital Pty Ltd, a boutique advisory firm specialising in M&A, capital raisings and IPOs. Mr De Souza has facilitated a number of resource transactions, ranging from reverse takeovers, project evaluations through to IPOs and capital raisings.

Project Director — John Malysa has over five years' management experience in mining steeply dipping seams in both Colombia (La Francia) and Venezuela (Mina Norte). At both projects John encountered and successfully navigated around minor faulting and multiple dipping angles – recovery rates ranged from 85% to 90% at both mines.

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