Breakaway Research

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Company Information

ASX Code	CCC
AIM Code	COOL
Share Price	A$0.05
Ord Shares	520.6m
Unlisted Options	44.1
Market Cap A$	**A$28.6m**
Cash (Dec 2012)	A$4.0m
Total Debt	A$61.2m
Enterprise Value	**A$85.8m**

Directors

Non-Executive Chairman	Mike Kilbride
Chief Executive Officer	Don Turvey
Finance Director	Jason Brewer
Chief Operations Officer	Johan Bloemsma

Substantial Share Holders

Socius CG II Ltd	10.1%
Oz Management	2.6%
Marmulla General	1.5%
Satori Intl. Pty Ltd	1.5%

Company Details

Address	1 Havelock Street, West Perth 6005, WA
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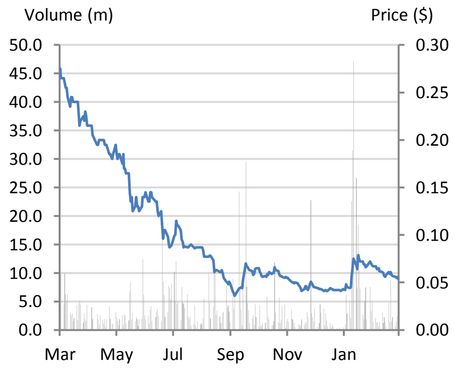
Web	www.conticoal.com

1 Year Price Chart



Source: Bloomberg

Continental Coal (CCC)

Set to almost double production of high quality thermal coal

Recommendation: Speculative BUY

Company Update

Key Points

- ***High margin Penumbra underground mine now in production and targeting 500,000tpa of export thermal coal***
- ***On track to produce 1.8Mtpa of saleable coal in FY13 with opportunity to increase production still further***
- ***De Wittekrans optimisation study indicates significant economic enhancements through utilization of existing infrastructure***
- ***BFS to be updated to reflect optimisation findings ahead of a development decision***
- ***Current operations underpin company valuation with no value attributed to a solid pipeline of growth opportunities***

Continental Coal's Penumbra mine was recently commissioned and production is set to ramp up as a second continuous miner is installed. The company is well on track to produce 2.2Mt ROM for ~1.8Mt of saleable thermal coal for FY13. The much larger De Wittekrans project has potential for +30 year mine life producing a further 2.4Mtpa of export coal.

Investment Thesis

Continental Coal (74%) and its Black Economic Empowerment (BEE) partner (26%) have exposure to a portfolio of coal assets totalling 600Mt of coal resources, located in the highly productive Witbank/Ermelo coal fields of South Africa. Continental, in its own right, also has exposure to highly prospective tenements in Botswana (2Bt JORC Inferred with further 4Bt exploration target) and an option to acquire a 50% interest in a producing coking coal asset in Colombia.

The company is on track to produce ~1.8Mtpa of saleable thermal coal from two open cut mines and the newly commissioned Penumbra underground mine. Penumbra is currently in the 'ramp up' phase with just one of the two continuous miners in operation, with the second due to be commissioned imminently. Once fully operational, Continental Coal will be targeting production of ~500,000tpa of export quality thermal coal from Penumbra (+10 year mine life), replacing and increasing on production which will be lost from the near exhausted Ferreria mine which has ~18 months remaining reserves.

Continental Coal is also making steady progress assessing the large De Wittekrans project which hosts a combined JORC Resource of 250Mt of which 43.8Mt is in reserves. Following the positive outcomes of a feasibility study, Continental recently completed an optimisation study designed to assess potential capital cost savings and production enhancing opportunities.

Investment Thesis Continued…

2.4Mtpa of export coal targeted from De Wittekrans

The potential of the De Wittekrans project should not be underestimated as it provides the scale to become the company's flagship project. Based on the outcomes of the optimisation study, Continental (and the BEE partner) now envisage producing 2.4Mtpa of a ~5,000kcal thermal coal product for sale into the export (Asian) markets over a +30 year life of mine.

Optimisation study significantly reduces CAPEX

Based on US$60/t for the 5,000kcal export coal, Continental is forecasting annual sales revenue of ~US$145M, which is a 37% increase on total annual revenue outlined in the feasibility study. The optimisation study also identified opportunities for ~US$60M of cost savings in initial CAPEX requirements from ~US$220M to US$160M through utilisation of existing infrastructure such as wash plants, rail sidings and other surrounding infrastructure.

2011 feasibility study to be updated to include optimisation outcomes

Given the opportunity for significant enhancements to the De Wittekrans project economics, Continental are now set to update the 2011 feasibility study. A final development decision will then be made soon after.

Base case valuation of 13c/share

Breakaway has updated its model based on production from just the three current operating mines (Vlakvarkfontein, Ferreria and Penumbra) and has attributed no value to the other significant assets within the project portfolio. Based on these three projects alone, **Breakaway estimate a base case NPV_{10} of $90m which equates to A$ 0.13/share** after accounting for Continentals economic interest in the projects.

Continental 'Operational' Valuation Summary

Discount Rate	**%**	5.0	10.0	15.0
Total NPV	A$m	110	90	80
NPV per share (undiluted)	A$m	$0.21	$0.17	$0.15
NPV per CCC 74% interest	A$m	$0.16	$0.13	$0.11

Source: Breakaway Estimates

An internal valuation of De Wittekrans values the project @ 21c/share

An internal valuation of the De Wittekrans project, carried out by Continental Coal, has assessed the project NPV_{10} to be in excess of US$110m (A$0.21/share, assuming a AUD:USD of 1.00). When combined with Breakaway's estimate valuation for the current producing mines, equates to A$0.34/share.

CAPEX funding negotiations ongoing

Discussions with several parties relating to strategic joint ventures and/or long term off take agreements to help fund the ~US$160M CAPEX requirement are ongoing.

Numerous valuable projects in the portfolio overlooked by market

Significant exploration opportunities also exist at the Vlakplaats Coal project, located just 25km from Continental's operating Vlakvarkfontein mine. Continental has entered into a 'Joint Development Agreement' with Korea Resources Corporation (KORES), a minerals and exploration company wholly owned by the Korean Government, to create a 'Special Purpose Vehicle' (owned 50% by Continental, 37% by KORES and 13% by Continental's BEE) to advance the Vlakplaats project through to completion of a bankable feasibility study.

Elsewhere, Continental has a 83% interest in three exploration licences in Botswana, which cover an area thought to be a continuation of the Waterberg coal field. The company has completed the first round of drilling and identified multiple coal seams. A maiden **JORC Inferred Resource of 2.2Bt** has been estimated at Kweneng (1 of the 3 prospects), with a further 5Bt exploration target. At Serowe (the northern two licences), independent geological consultants have estimated a 4Bt exploration target.

Operational Update

The table below shows a summary of Continental Coal's operational performance based on the three operating mines within the portfolio for the 1H FY13 and Breakaway's estimates for the 2H FY 13.

1H 2013 performance was solid

Operational Performance

	1H 2013 Actual	2H 2013 Estimates	FY 13 Total Estimates
ROM production			
Vlakvarkfontein	735,748	700,000	1,435,748
Ferreira	258,037	300,000	558,037
Penumbra	2,964	210,000	212,964
Total ROM Production	996,479	1,210,000	2,206,749
Feed to plant			
Vlakvarkfontein	-	-	-
Ferreira	323,253	300,000	623,253
Penumbra	3,260	210,000	213,260
Total Plant Feed	326,513	510,000	836,513
Avg Export Yields			
Ferreira	68%	68%	68%
Penumbra	26%	50% (rising to 67% by June)	50%
Domestic Sales	647,659	650,000	1,297,659
Export Sales	209,750	329,000	518,750
Total Coal Sales	**857,409**	**959,500**	**1,816,409**

Source: Continental Coal and Breakaway estimates

Breakaway estimate 1.8Mtpa of saleable coal for FY 2013

Performance from the Vlakvarkfontein and the Ferreira coal mines have been tracking on or above annual targeted production rates for the most part. A repetition of the 1H results should see the company outperform expectations.

Penumbra mine now producing and in the ramp up phase

Targeting 500,000tpa of saleable export coal

Breakaway is particularly encouraged by the Penumbra mine which recently commenced mining operations. ROM production is set to dramatically ramp up during 2H 2013 as the two continuous miners target a combined 63,000t per month (750,000tpa ROM) with an average target yield of 67% to produce ~500,000t annually of export quality thermal coal.

Corporate Update

Sale of 'VanMag' brings in A$10M in cash

Funds to be used to purchase minority interests in Mashala Resources for A$8.6M

Continental Coal recently announced the sale of its shareholding in the Vanadium and Magnetite Exploration and Development Co Pty Ltd ("VanMag") for total consideration of US$10M. As per the terms of the transaction, US$4M has already been received, with settlement of the remaining US$6M scheduled imminently. The proceeds of the sale of 'VanMag' will be used to fund all the remaining amounts due for outstanding minority interests in Mashala Resources (~A$8.6M) which are not already held by Continental Coal.

Continental has also recently established a A$15M standby facility with Baycrest Capital over a period of 3 years. Continental is under no obligation to use this facility.

Project Update

Penumbra Coal Project (83% economic interest)

Now in production - ramping up to 500ktpa of export quality coal

5.44Mt in Reserves

Reserve upgrades likely

The Penumbra Coal Project hosts a 68.3Mt JORC Resource with 5.44Mt Reserves and is located 2km from the 1.8Mtpa Delta Processing Plant and 1.2Mtpa rail siding. On the 17th December 2012, Continental Coal reached a significant milestone and commenced underground mining operations from the 'C-Lower' seam which has an average thickness of 1.8m at a depth of 50m-115m.

Targeting a yield of 67%

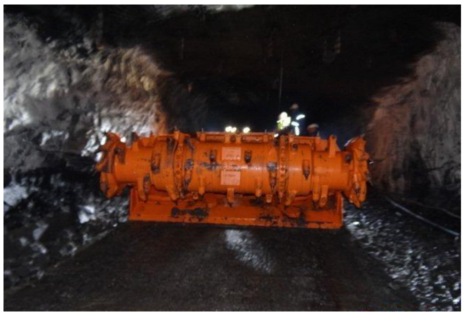
During the month of January, 14,031t ROM was mined and transported to the Delta Processing Plant where it was washed and upgraded to produce 5,212t of saleable export quality thermal coal, representing a yield of 37.2%. This yield is expected to significantly increase to ~67% once operating at steady state production

First continuous miner in operation with second to follow imminently

The coal is mined using a '14HM15 Joy Continuous Miner' which is capable of mining in excess of 30,000t per month (1,000tpd). Following the successful commissioning of the first continuous miner, Continental is now in the final stages of commissioning a second continuous miner which should be operational by March 2013 and is expected to lift total production to 35,000 – 40,000t (for March) and then ~63,000t per month once in steady state production.

Continuous Miner – Underground at Penumbra

Targeting ROM production 750,000tpa



Source: Continental Coal

+ 10 year mine life

Continental Coal is targeting 750Ktpa ROM for ~500ktpa (at a 67% yield) saleable coal with total costs per tonne (ROM) estimated at ZAR490/t (~A$60/t) FOB.

CAPEX requirements are fully funded

The total development costs are estimated at US$40m with over 90% of the planned project capital already committed. Some remaining underground development and surface infrastructure, including the main ventilation fans and shaft fans are the only key outstanding developments, which are forecast to be completed by April 2013. The development CAPEX has been fully funded from existing cash and the debt facility provided by ABSA Capital (part of Barclays Bank).

Continental has also established a coal hedging program with ABSA capital of 664kt at an average price of ZAR 1,057 (A$117) against forecast total FOB costs ~ZAR490/t (~A$54/t) as per SRK's Competent Persons Report, which provides a profit margin of ~A$63/t. This hedge has been fortuitous for the company as the current Richards Bay export price is ~US$86/t (A$86/t). With 665kt hedged, Continental can guarantee healthy returns for at least the next 15 months.

The estimated mine life is 10 years, however with a further +60Mt in resources, there is clear potential for reserve upgrades and mine life extensions.

Ferreira Mine (83% economic interest)

Mine life extended through acquisition of adjacent farms

The Ferreira open cut is located ~3km from the Delta Processing Plant and is adjacent to the Anthra railway siding. Targeted ROM production from Ferreira is ~54,000t per month (~650,000tpa) with an average yield of 60% to produce ~32,500t per month of a high quality export thermal coal.

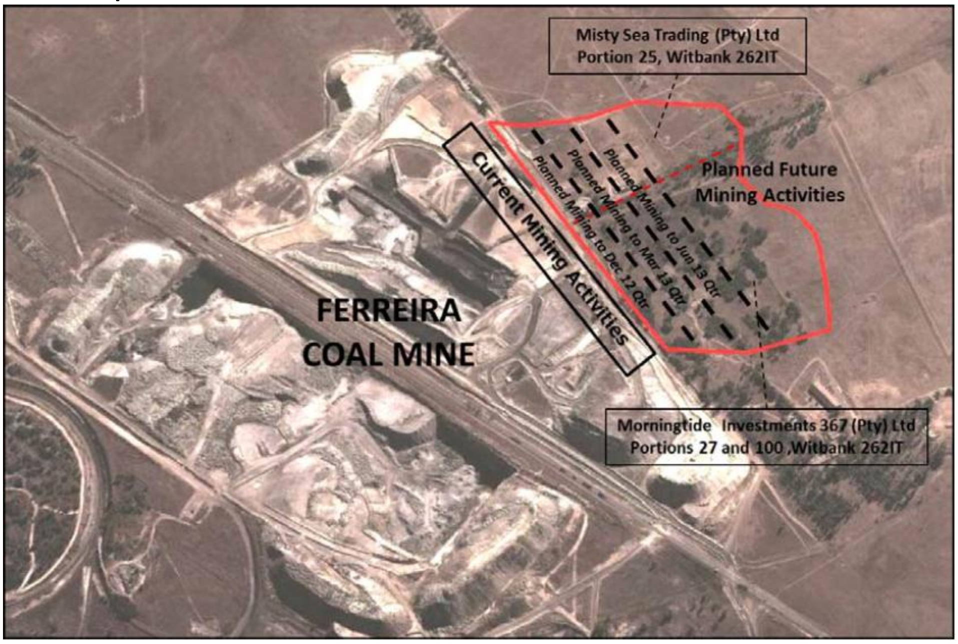
Purchase of adjacent farms provides additional 750,000t ROM

The current operations are nearing the end of their mine life (~6 months left) however, Continental Coal entered into a purchase agreement with two neighbouring operators for the right to develop the 'Portion 25, 27 and 100' of the farm 'Witbank 262 IT', all located immediately adjacent to the Ferreira coal mine, for an undisclosed market related monthly royalty payment based on each tonne of run-of-mine coal mined from the properties. The acquisition provides up to 750,000 tonnes of ROM production, extending the mine life by a further 15 to 18 months.

Ferreira mine extended by further 18 months

Export quality coal

Ferreira Open Cut Coal Mine



Source: Continental Coal

All approvals in place allowing seamless continuation of mining

All the necessary approvals and mine planning work has now been completed allowing seamless continuation of mining operations. This is an excellent outcome for Continental Coal as it provides additional feed for the Delta Processing Plant during the Penumbra ramp up phase (creating operational efficiencies) as well as providing a further ~450,000 of high quality thermal coal which can be sold into the export market.

Additional operational and utilisation efficiencies exist via the regular purchase of export quality thermal coal from neighbouring mines (that lacking processing facilities) which is then blended with Ferrerira coal and exported via the RBCT.

Vlakvarkfontein (45% economic interest)

~1.2Mtpa of domestic quality thermal coal for local power stations and industry

Large domestic coal operation

The Vlakvarkfontein mine is situated on an 850 hectare property and is located 13km from the Kendal power station, owned and operated by Eskom, South Africa's principle power generation company. Vlakvarkfontein has a Measured Resource of 17.4Mt of which 13.7Mt is in Proven Reserves (without taking into account mining decline).

+10 year mine life

Continental Coal began open cut mining in May 2010 targeting production from two 5m thick coal seams. The mine currently produces ~100,000t of domestic coal per month for ~1.2Mtpa ROM, with a low strip ratio of ~2:1. The coal is crushed and screened to produce a 50mm product which is then sold to the local power stations (a three year agreement was recently signed with Eskom to supply 720ktpa) and local industry at the mine gate. Assuming no further increase to mining reserves and steady state production at current levels, Vlakvarkfontein has a mine life of +10 years.

Crushing and screening operation and open pit mining at Vlakvarkfontein

Source: Continental Coal

Recently, the Vlakfarkfontein mine has been exceeding targeted production levels with 103,751t of domestic coal produced in January 2013. The average mining and processing costs are ZAR126/t while the average sales price received (year to date) is ZAR181/t, providing a modest margin of ~ZAR55/t (~A$5/t).

Upcoming Projects

De Wittekrans Coal Project (83% interest)

Large resource for +30 year LOM targeting 3.6Mtpa ROM production rate

Large project with +30 years mine life

The De Wittekrans Coal Project lies within the greater De Wittekrans Complex which also hosts the nearby Vaalbank, Knapdaar and Project X coal projects. The combined resources over these four projects is 250Mt of which 43.8Mt is currently in reserves.

In September 2011, TWP Projects completed a draft Bankable Feasibility Study on the De Wittekrans coal project which concluded that the project was technically sound and viable with a potential mine life of +30 years.

Outcomes of feasibility study have been superseded by optimisation study

Continental Coal envisages an initial open cut operation, targeting production of ~1.2Mtpa ROM over a period of approximately 5 years. In year 2 of operations, underground development would commence, targeting a further 2.4Mtpa ROM (totalling ~3.6Mpta). The coal would then be processed through a 600 tonne per hour plant to produce 1.7Mtpa of domestic coal and 0.8Mt of export quality coal.

Utilisation of existing infrastructure reduces CAPEX

The feasibility study originally estimated a CAPEX requirement of ~US$230M to advance the De Wittekrans Coal Project into production. A recently completed optimisation study assessed (amongst other things) the potential of using existing coal wash plant and rail siding (in close vicinity) to reduce upfront capital costs and accelerate first coal production. The outcomes of the study are outlined in the table below:

Optimisation Results compared to initial feasibility study results

	Initial Feasibility Study Results1	Optimisation Results	% Change
Reserves and Mine Life			
Mine Life	33 years	33 years	-
Saleable Reserves	43.8Mt	43.8Mt	-
Gross In Situ Resources	167.0Mt	167.0Mt	-
Run of Mine (ROM) Production			
Annual ROM Production	3.6Mt	3.6Mt	-
Total Open Cast ROM Production	6.1Mt	6.1Mt	-
Total Underground ROM Production	110.0Mt	110.0Mt	-
Primary Wash Plant Yields (%)			
Open Cast Primary Yield	29.16%	78.00%	167%
Underground Primary Yield	26.26%	75.00%	186%
Coal Sales			
Annual Domestic Coal Sales	1.7Mt (Eskom)	-	-
Annual Export Coal Sales	0.8Mt (6,000 kcal Export)	2.4Mt (5,000kcal Export)	200%
Forecast Sales Revenue			
Annual Domestic Coal Sales	ZAR 306m	-	-
Annual Export Coal Sales	ZAR 645m	ZAR 1,292m	100%
Total Annual Sales Revenue	ZAR 951m	ZAR 1,292m	37%
Estimated Operating Expenses			
Average Unit Operating Expenses	ZAR 140/t ROM	ZAR 251/t ROM	76%
Average Operating Expenses	ZAR 614/t Export	ZAR 367/t Export	-30%
Estimated Capital Costs			
Total Capital Costs to First Production	ZAR 342m	ZAR 161m	-53%
Surface Infrastructure and Siding	ZAR 554m	ZAR 444m	-20%
Coal Wash Plant	ZAR 308m	-	-
Underground Development	ZAR 838m	ZAR 838m	0%
Forecast Cashflow			
Annual Free Cashflow After Tax	ZAR 215m	ZAR 276m	28%

Source: Continental Coal

De Wittekrans envisaged to now produce 2.4Mtpa of export coal

Significant economic enhancements

Potential to become flagship project

The results of the optimisation study indicate a substantial boost to the project economics and also a significant reduction in the CAPEX requirement from ~US$230M to ~US$160M (assuming a ZAR:USD exchange rate of 0.11).

Funding solutions under investigation

Of particular importance, the study has identified the opportunity for the De Witterkrans Project to become an exporter of 2.4Mtpa of **export** thermal coal (5,000kcal) suitable for the Asian market over an initial 30 year mine life. As a result, the forecasted annual sales revenue has increased by 37% with the after tax forecast free cashflow also increasing by ~30%.

De Wittekrans has the potential to become the company's flagship project.

Analyst Verification

We, Grant Craighead and Andrew McLeod, as the Research Analysts, hereby certify that the views expressed in this research accurately reflect our personal views about the subject securities or issuers and no part of analyst compensation is directly or indirectly related to the inclusion of specific recommendations or views in this research.

Disclosure

Breakaway Investment Group (AFSL 290093) may receive corporate advisory fees, consultancy fees and commissions on sale and purchase of the shares of Continental Coal and may hold direct and indirect shares in the company. It has also received a commission on the preparation of this research note.

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