

## CHURCHILL MINING

## CORPORATE

### FEASIBILITY STUDY CONFIRMS EKCP ECONOMICS

113p<sup>#</sup>

| Year-end June             | 2009A  | 2010A | 2011E | 2012E |
|---------------------------|--------|-------|-------|-------|
| EBITDA (\$m)              | (9.2)  | (5.7) | (4.2) | (4.3) |
| Adj. Pre-tax Profit (\$m) | (3.6)  | (4.6) | (3.9) | (4.3) |
| Adj. EPS (c)              | (10.5) | (5.7) | (4.1) | (4.4) |
| Net Cash/(Debt) (\$m)     | 10.9   | 22.9  | 2.3   | (4.4) |

| Key Data           |             |
|--------------------|-------------|
| Ticker             | CHLL        |
| Shares in issue    | 96.7m       |
| Market cap         | £109.3m     |
| 12-mth price range | 83.75p-147p |
| Next event         | AGM - Dec   |

SOURCE: Northland Capital Partners Ltd estimates

<sup>#</sup>Priced at market close November 3<sup>rd</sup>, 2010

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Churchill Mining has made significant progress in taking East Kutai Coal Project (EKCP), its world class Indonesian coal licence, to feasibility study (FS). The project comprises high quality sub-bituminous coal and is well located to satisfy demand from Indian, Chinese and domestic markets. Results of the recent FS suggest a project NPV of c.\$1.8bn with a seven year payback. We test the sensitivities and find reducing expected price/tonne to a very conservative \$39 (from \$47/t in the FS) whilst raising the discount rate to 12% (10%) produces a project NPV of c.£270m (\$430m). Progress is somewhat reliant on third-party financing which entails significant risk, but there could yet be scope for considerable upside in the shares.

- **High quality coal:** EKCP offers a world class resource of high quality sub-bituminous, low ash and low sulphur thermal coal. There is a JORC Probable In-Situ reserve of 961m tonnes from a total JORC resource of 2.7bn tonnes from only two of four licences.
- **The recently completed feasibility study** established an NPV of \$1.8bn at a 10% discount rate and projected coal price of \$47/t. Anticipated capex is \$1.6bn which includes \$265m for contingency while opex is estimated at c.\$25 per tonne.
- **Third-party financing:** Requisite infrastructure investment is likely to rely on third-party financing. Credit Suisse has been charged with sourcing investment (JV partners/potential acquirers), the process is well underway.
- **Delivering value:** Ultimate shareholder value is of course dependent on the value JV partner/acquirer attributes to EKCP and we would anticipate a discount to NPV irrespective of its sensitivities.
- **Results present few surprises:** The key event in the period was the recent feasibility study which is the central focus for this note.
- **Valuation:** The project NPV of \$1.8bn equates to £12.6 per share (pre-tax). We test the sensitivities and find a more aggressive 12% discount would suggest around 223p per share (post tax) for only 25% of the project, against the prevailing 113p for 75%

#### COMPANY DESCRIPTION

The principal activity of the group is the 75% owned world-class East Kutai (sub-bituminous) Coal Project (EKCP) in the Regency of Kalimantan, Indonesia. Churchill has advanced the EKCP to a 961m tonne JORC reserve (2.7bn tonne resource), through a recent feasibility study and is currently evaluating financing options.

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## INVESTMENT APPRAISAL

Using very conservative assumptions our analysis suggests the current share price is more than underpinned by East Kutai. The key caveat and inherent risk is the funding requirement for the project. However, early indications of interest offer some encouragement on this front. Churchill is currently trading at around 11% of the company's post tax NAV for East Kutai, which discounts a considerable amount of risk that either that valuation is overblown or that the project will fail to attract financing. If funding is secured we can envisage significant upside to the valuation. Ahead of that, while much depends upon potential deal terms (a major uncertainty at this stage), upside of between 15-20% (142p-190p) does not seem too demanding.

## RESULTS

Recent results were unsurprising. As is common with development stage mining companies, the key news flow relates to on-going operating activities and this was foreshadowed by the feasibility study completed in September which has been our focus here. Full year results reflected a clean pre-tax loss of \$4.6m against \$7.15m last year and adjusted EPS of (5.7c) compared to (10.5c). Reported LBT of \$6.7m (\$14.1m) and loss per share of 8.25c (20.8c) reflect the impairment of non-core assets. The company ended the period with a strong cash position of \$23m to continue pre-development work with around \$21m of expenditures earmarked for the next twelve months.

**Strong cash position of \$23m**

## VALUATION

The ultimate value is dependent on both the extent of discount and the sensitivities applied to NPVs. We outline various scenarios in this note. We have conducted a high level review of the NPV suggested by the post feasibility valuation and subjected this to our own sensitivities (see valuation matrix following). We find that on the basis of our 12% discount factor the project valuation ranges from \$173m at \$37/t to \$1.8bn at \$51/t (the company's long range price forecast suggests \$47/tonne), with breakeven just shy of \$35/t.

**Our valuation ranges from \$260m at \$37/t to \$1.8bn at \$51/t**

If we employ the 10% threshold, breakeven falls to below \$35/t. As this is an NPV and not a DCF at the corporate level we have stopped short of calculating WACC. This is only a benchmark against which potential returns can be measured. For shareholders, the achievable value is of course dependent on the extent of NAV an interested party is prepared to pay.

## RESULTS OF NET PRESENT VALUE CALCULATION

|  |      |       |
|--|------|-------|
| Sum of present values in defined forecast period | \$m  | 1,386 |
| Exchange rate                                    | \$/£ | 1.5   |
| Value  | £m   | 924   |
| Shares (m)                                       | m    | 96.7  |
| Per share  | \$   | 14.3  |
| Per share  | £    | 9.53  |

Source: Northland Capital Partners Ltd



## POTENTIAL JV AGREEMENT

An outright sale is not the only show in town, however, and there is the potential for a JV. Thus another way to look valuation is to consider, in the event of a JV, how much of the asset the company is likely to retain. Again this is an unknown quantity, but if we estimate that a deal was to preserve at least 50% of the project then we can attribute a 50% discount, 25%/75% etc. The company would look to establish a 50/50 JV relationship. In the case of a 50% share, the company would anticipate 25% of that equity coming from Ridlatama, the Indonesian partner (see later), leaving Churchill with 50% of the prospect. However, if we assume a more punitive 75% divestment, leaving Churchill with 25%, our model implies a value of \$462m (£308m) pre-tax and \$323m (£205m) post tax which reflects 319p and 223p respectively.

Looks to establish a 50/50 JV relationship

## KEY ASSUMPTIONS

| Variable                     | Company | Astaire (most likely case) | Astaire (base case) |
|------------------------------|---------|----------------------------|---------------------|
| Capex                        | \$1.6bn | \$1.6bn                    | \$1.6bn             |
| Price per tonne              | \$47    | \$47                       | \$41                |
| Opex per tonne               | \$25.1  | \$25.1                     | \$25.1              |
| Discount Rate                | 10%     | 12%                        | 12%                 |
| Time frame production years  | 25      | 25                         | 25                  |
| Percentage of value achieved | 50%     | 25%-50%                    | 25%-50%             |
| Valuation range pretax       | £6.30   | £3.20 - £6.40              | £1.60 - £3.30       |
| Valuation range post-tax     | £4.46   | £2.23 - £4.46              | £1.06 - £2.13       |

Source: Northland Capital Partners Ltd

## KEY CONSIDERATIONS

At this stage our model is necessarily high level. In our sensitised case we have assumed a flat rate of \$47/t (the projected rate for long term pricing), though we consider the impact of lower pricing in our sensitivity analysis which follows. We have also maintained costs identified by the feasibility study, as we view these as likely to be at least fairly conservative and perhaps overstated (the company believes that it may be possible to save significant sums from capex, for example. Similarly we have stuck with the FS expectation for operating costs of \$25.1/t. Whilst it's not unusual for the industry (to look at NPVs on a 10% discount rate, we have stress tested this against the higher rates generally expected by the small cap investment market.

Assumed a flat rate of \$47/t

## PRICING

The price assumption used in the post feasibility NPV may be fairly aggressive but this seems well grounded in expectations of increasing demand from energy hungry India and China. The long-term coal price of US\$46.6/t factored in by the company is based on a 3-year historical average of Platts Weekly 90-Day Forward Benchmarks for Pacific coal freight on board (FOB). This comprises Kalimantan 5,900 kcal/kg, Kalimantan 5,000 kcal/kg, Newcastle and Gladstone mines. A best fit line was plotted against the trend and on the basis of calorific values with prices cross referenced against nearby production.

Long-term coal price of US\$46.6/t



## OTHER CONSIDERATIONS

An area of conservatism is that the current feasibility incorporates only two of the four licence blocks. Given a 25 year forecast production period, it is unnecessary to calculate value to perpetuity though it seems likely that a mine will be economic outside of the initial 25 year timescale incorporated into the NPV. Value attributable to shareholders is of course dependent on the valuation attributed by a JV partner or potential acquirer and we look to a range of scenarios.

**FS incorporates only two of the four licence blocks**

## VALUATION SUMMARY

Ultimately, the NPV provides only a benchmark against which we test both positive and negative variances. Generally resource companies tend to trade at a discount to NPV of anywhere between 20%-50% which seems a reasonable barometer for now when considering the upside potential (netting off the JV share as we have disused previously). The current share price is discounting that around 11% of the official project NPV (around 17% of our sensitised post tax valuation case), which sensibly encapsulates a fair degree of risk but also suggests potential for upside.

**Trading at around 17% of potential past tax valuation (12% discount)**

## NET PRESENT VALUE MODEL

| NPV model  |            | 2011         | 2012         | 2013         | 2014         | 2015         | 2016         | 2017         | 2018         | 2019         | 2020         | Yrs 11-28       |
|--|------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|-----------------|
| Group sales tonnes   | m          | -            | -            | -            | 10           | 22           | 30           | 30           | 30           | 30           | 30           | 540             |
| Group sales price per tonne                                      | \$         | -            | -            | -            | 47           | 47           | 47           | 47           | 47           | 47           | 47           | 846             |
| Group sales revenues   | \$m        | -            | -            | -            | 470          | 1,034        | 1,410        | 1,410        | 1,410        | 1,410        | 1,410        | 25,380          |
| Mining & ore P/T   | \$         | -            | -            | -            | (15)         | (15)         | (15)         | (15)         | (15)         | (15)         | (15)         | (266)           |
| Transport & port P/T   | \$         | -            | -            | -            | (7)          | (7)          | (7)          | (7)          | (7)          | (7)          | (7)          | (119)           |
| Admin & contingency P/T  | \$         | -            | -            | -            | (4)          | (4)          | (4)          | (4)          | (4)          | (4)          | (4)          | (68)            |
| Production cost P/T  | \$         | -            | -            | -            | (25)         | (25)         | (25)         | (25)         | (25)         | (25)         | (25)         | (452)           |
| <b>Production cost</b>   | <b>\$m</b> | <b>0</b>     | <b>0</b>     | <b>0</b>     | <b>(251)</b> | <b>(552)</b> | <b>(753)</b> | <b>(753)</b> | <b>(753)</b> | <b>(753)</b> | <b>(753)</b> | <b>(13,554)</b> |
| Mine Site, Utilities and ROM Facilities                          |            | (33)         | (33)         | (33)         |              |              |              |              |              |              |              |                 |
| Overland Conveyor civil, structure & install.                    |            | (130)        | (130)        | (130)        |              |              |              |              |              |              |              |                 |
| Power station  |            | (80)         | (80)         | (80)         |              |              |              |              |              |              |              |                 |
| Power Transmission System  |            | (31)         | (31)         | (31)         |              |              |              |              |              |              |              |                 |
| Port - Civil, Stacker/Reclaimer, Conveyors                       |            | (25)         | (25)         | (25)         |              |              |              |              |              |              |              |                 |
| Marine & Ship Loader   |            | (24)         | 0            | 0            |              |              |              |              |              |              |              |                 |
| Mobilisation/Demobilisation                                      |            | (23)         | 0            | (23)         |              |              |              |              |              |              |              |                 |
| Pre-development  |            | (61)         | 0            | 0            |              |              |              |              |              |              |              |                 |
| Insurance/other  |            | (20)         | (20)         | (20)         |              |              |              |              |              |              |              |                 |
| Mine infrastructure  |            | (23)         | 0            | 0            |              |              |              |              |              |              |              |                 |
| Indirect costs   |            | (167)        | 0            | 0            |              |              |              |              |              |              |              |                 |
| Contingency/Maintenance capex (from 2014)                        |            | (133)        | (133)        | 0            | (30)         | (30)         | (30)         | (30)         | (30)         | (30)         | (30)         | (540)           |
| <b>Total cost</b>  |            | <b>(750)</b> | <b>(452)</b> | <b>(342)</b> | <b>(281)</b> | <b>(582)</b> | <b>(783)</b> | <b>(783)</b> | <b>(783)</b> | <b>(783)</b> | <b>(783)</b> | <b>(14,094)</b> |
| <b>Pre-tax free cash flow</b>                                    | <b>\$m</b> | <b>(750)</b> | <b>(452)</b> | <b>(342)</b> | <b>189</b>   | <b>452</b>   | <b>627</b>   | <b>627</b>   | <b>627</b>   | <b>627</b>   | <b>627</b>   | <b>11,286</b>   |
| Tax (25%)  | \$m        | 113          | 80           | 86           | (47)         | (113)        | (157)        | (157)        | (157)        | (157)        | (157)        | (2,822)         |
| <b>Post-tax cash free flow</b>                                   |            | <b>(638)</b> | <b>(372)</b> | <b>(257)</b> | <b>142</b>   | <b>339</b>   | <b>470</b>   | <b>470</b>   | <b>470</b>   | <b>470</b>   | <b>470</b>   | <b>8,465</b>    |
| <b>Plc (75%) share (Pre-tax)</b>                                 |            | <b>(563)</b> | <b>(339)</b> | <b>(257)</b> | <b>142</b>   | <b>339</b>   | <b>470</b>   | <b>470</b>   | <b>470</b>   | <b>470</b>   | <b>470</b>   | <b>8,465</b>    |
| <b>Plc (75%) share (Post-tax)</b>                                |            | <b>(478)</b> | <b>(279)</b> | <b>(192)</b> | <b>106</b>   | <b>254</b>   | <b>353</b>   | <b>353</b>   | <b>353</b>   | <b>353</b>   | <b>353</b>   | <b>6,348</b>    |
| Discount rate  | %          | 12%          | 12%          | 12%          | 12%          | 12%          | 12%          | 12%          | 12%          | 12%          | 12%          | -               |
| Discount factor timing   | -          | 1.0          | 2.0          | 3.0          | 4.0          | 5.0          | 6.0          | 7.0          | 8.0          | 9.0          | 10.0         | -               |
| Discount factor  | %          | 0.89         | 0.80         | 0.71         | 0.64         | 0.57         | 0.51         | 0.45         | 0.40         | 0.36         | 0.32         | -               |
| <b>Discounted cash flow (pre-tax)</b>                            | <b>\$m</b> | <b>(502)</b> | <b>(270)</b> | <b>(183)</b> | <b>90</b>    | <b>192</b>   | <b>238</b>   | <b>213</b>   | <b>190</b>   | <b>170</b>   | <b>151</b>   | <b>1,098</b>    |
| <b>Discounted cash flow (post-tax)</b>                           | <b>\$m</b> | <b>(427)</b> | <b>(223)</b> | <b>(137)</b> | <b>68</b>    | <b>144</b>   | <b>179</b>   | <b>160</b>   | <b>142</b>   | <b>127</b>   | <b>114</b>   | <b>823</b>      |
| <b>Sum of present values in defined forecast period pre-tax</b>  |            |              |              |              |              |              |              |              |              |              | <b>\$m</b>   | <b>1,386</b>    |
| <b>Sum of present values in defined forecast period post-tax</b> |            |              |              |              |              |              |              |              |              |              | <b>\$m</b>   | <b>970</b>      |

Source: Company/Northland Capital Partners Ltd



**VALUATION MATRIX (PRE-TAX NPV PER SHARE)**

|                 |    | Price per tonne (\$) |         |         |         |         |         |         |         |         |         |         |         |         |
|-----------------|----|----------------------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|
|                 |    | 31                   | 33      | 35      | 37      | 39      | 41      | 43      | 45      | 47      | 49      | 51      | 53      | 55      |
| Discount rate % | 8  | -\$ 1.8              | \$ 1.9  | \$ 5.5  | \$ 9.1  | \$ 12.8 | \$ 16.4 | \$ 20.0 | \$ 23.7 | \$ 27.3 | \$ 30.9 | \$ 34.6 | \$ 38.2 | \$ 41.8 |
|                 | 9  | -\$ 2.6              | \$ 0.7  | \$ 3.9  | \$ 7.1  | \$ 10.3 | \$ 13.6 | \$ 16.8 | \$ 20.0 | \$ 23.3 | \$ 26.5 | \$ 29.7 | \$ 32.9 | \$ 36.2 |
|                 | 10 | -\$ 3.3              | -\$ 0.4 | \$ 2.5  | \$ 5.4  | \$ 8.3  | \$ 11.2 | \$ 14.1 | \$ 16.9 | \$ 19.8 | \$ 22.7 | \$ 25.6 | \$ 28.5 | \$ 31.4 |
|                 | 11 | -\$ 3.8              | -\$ 1.2 | \$ 1.4  | \$ 3.9  | \$ 6.5  | \$ 9.1  | \$ 11.7 | \$ 14.3 | \$ 16.9 | \$ 19.5 | \$ 22.1 | \$ 24.6 | \$ 27.2 |
|                 | 12 | -\$ 4.3              | -\$ 2.0 | \$ 0.4  | \$ 2.7  | \$ 5.0  | \$ 7.4  | \$ 9.7  | \$ 12.0 | \$ 14.3 | \$ 16.7 | \$ 19.0 | \$ 21.3 | \$ 23.7 |
|                 | 13 | -\$ 4.7              | -\$ 2.6 | -\$ 0.5 | \$ 1.6  | \$ 3.7  | \$ 5.8  | \$ 7.9  | \$ 10.0 | \$ 12.2 | \$ 14.3 | \$ 16.4 | \$ 18.5 | \$ 20.6 |
|                 | 14 | -\$ 5.0              | -\$ 3.1 | -\$ 1.2 | \$ 0.7  | \$ 2.6  | \$ 4.5  | \$ 6.4  | \$ 8.3  | \$ 10.3 | \$ 12.2 | \$ 14.1 | \$ 16.0 | \$ 17.9 |
|                 | 15 | -\$ 5.3              | -\$ 3.6 | -\$ 1.8 | -\$ 0.1 | \$ 1.6  | \$ 3.4  | \$ 5.1  | \$ 6.9  | \$ 8.6  | \$ 10.3 | \$ 12.1 | \$ 13.8 | \$ 15.6 |

Source: Northland Capital Partners Ltd

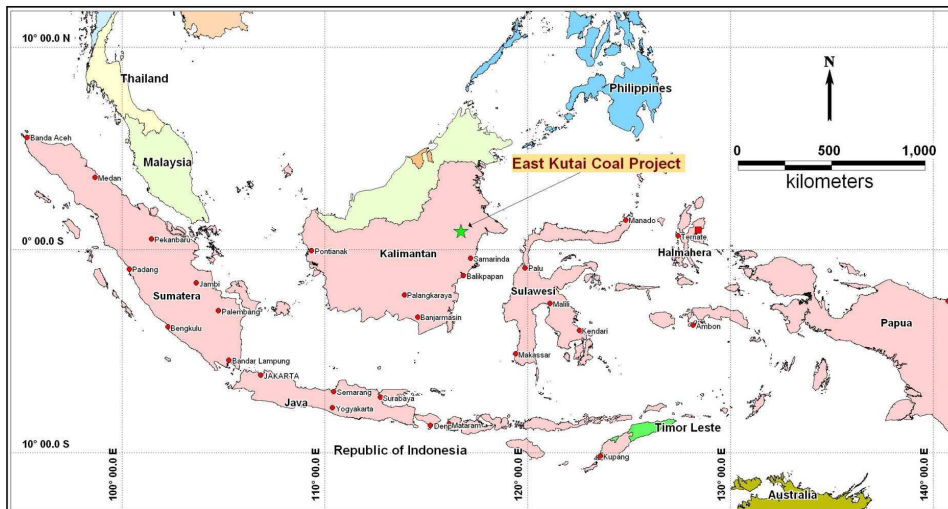
**VALUATION MATRIX (POST-TAX NPV PER SHARE)**

|                 |    | Price per tonne (\$) |         |         |         |        |         |         |         |         |         |         |         |         |
|-----------------|----|----------------------|---------|---------|---------|--------|---------|---------|---------|---------|---------|---------|---------|---------|
|                 |    | 31                   | 33      | 35      | 37      | 39     | 41      | 43      | 45      | 47      | 49      | 51      | 53      | 55      |
| Discount rate % | 8  | -\$ 2.1              | \$ 0.6  | \$ 3.4  | \$ 6.1  | \$ 8.8 | \$ 11.5 | \$ 14.3 | \$ 17.0 | \$ 19.7 | \$ 22.4 | \$ 25.2 | \$ 27.9 | \$ 30.6 |
|                 | 9  | -\$ 2.7              | -\$ 0.3 | \$ 2.2  | \$ 4.6  | \$ 7.0 | \$ 9.4  | \$ 11.9 | \$ 14.3 | \$ 16.7 | \$ 19.1 | \$ 21.5 | \$ 24.0 | \$ 26.4 |
|                 | 10 | -\$ 3.2              | -\$ 1.0 | \$ 1.1  | \$ 3.3  | \$ 5.5 | \$ 7.6  | \$ 9.8  | \$ 12.0 | \$ 14.1 | \$ 16.3 | \$ 18.5 | \$ 20.6 | \$ 22.8 |
|                 | 11 | -\$ 3.6              | -\$ 1.7 | \$ 0.3  | \$ 2.2  | \$ 4.2 | \$ 6.1  | \$ 8.0  | \$ 10.0 | \$ 11.9 | \$ 13.9 | \$ 15.8 | \$ 17.7 | \$ 19.7 |
|                 | 12 | -\$ 4.0              | -\$ 2.2 | -\$ 0.5 | \$ 1.3  | \$ 3.0 | \$ 4.8  | \$ 6.5  | \$ 8.3  | \$ 10.0 | \$ 11.8 | \$ 13.5 | \$ 15.3 | \$ 17.0 |
|                 | 13 | -\$ 4.2              | -\$ 2.7 | -\$ 1.1 | \$ 0.5  | \$ 2.1 | \$ 3.7  | \$ 5.2  | \$ 6.8  | \$ 8.4  | \$ 10.0 | \$ 11.6 | \$ 13.1 | \$ 14.7 |
|                 | 14 | -\$ 4.5              | -\$ 3.1 | -\$ 1.6 | -\$ 0.2 | \$ 1.2 | \$ 2.7  | \$ 4.1  | \$ 5.5  | \$ 7.0  | \$ 8.4  | \$ 9.8  | \$ 11.3 | \$ 12.7 |
|                 | 15 | -\$ 4.7              | -\$ 3.4 | -\$ 2.1 | -\$ 0.8 | \$ 0.5 | \$ 1.8  | \$ 3.1  | \$ 4.4  | \$ 5.7  | \$ 7.1  | \$ 8.4  | \$ 9.7  | \$ 11.0 |

Source: Northland Capital Partners Ltd



## BACKGROUND



## EAST KUTAI

Churchill has a 75% controlling interest in the EKCP coal concession of East Kutai in the Kalimantan region of Indonesia. The remaining 25% is owned by the company's Indonesian partner Ridlatama Group, a diversified Energy and Resources company. East Kutai includes four contiguous coal concessions over an area of 350km<sup>2</sup>. The current defined resources and subsequent feasibility study relate to only two of these. The Ridlatama Tambang licence area is the larger of the two licences comprise the East Kutai Coal Project with a resource of 2.5 billion tonnes (93% of the 2.7 billion outlined resource).

**75% stake in Ridlatama Tambang licence area**

In addition, Churchill has converted a 75% direct ownership in PT Ridlatama Trade Powerindo which has a prospective 53km<sup>2</sup> license area adjacent to the Ridlatama Tambang license area. As yet, no drilling has taken place of this section. Feasibility and development work has identified that mine facilities at the Northern Pit have the potential to support a production rate of 40-45mtpa for a nominal 20 to 25 year. The feasibility study included an uplift in expected output from 20mtpa to 30mtpa.

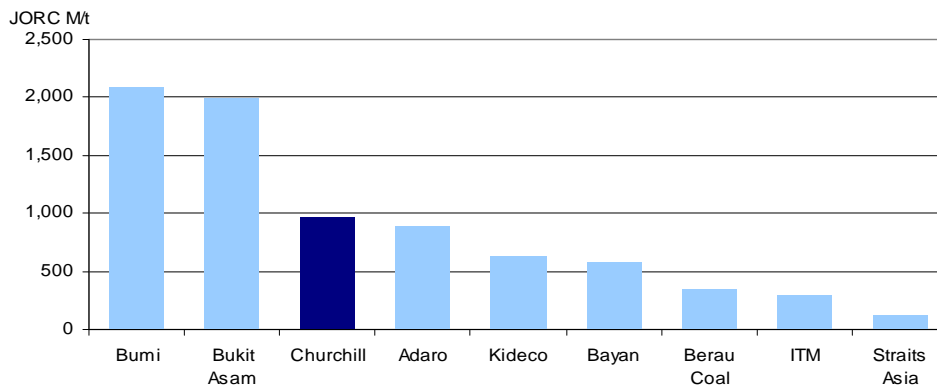
## WORLD CLASS RESOURCE

East Kutai offers a world class resource of high quality sub-bituminous (higher moisture content than bituminous coal), low ash/low sulphur thermal coal. Seams extend to over 20m thick and the stripping ratio of 3.7:1. Impurities are negligible whilst there is also a very high vitrinite content of around 90%. There is a JORC Probable In-situ Reserve of 961m tonnes in situ with a total inclusive resource of a 2.7bn tonnes. The latest resource update was derived from 287 drill holes aggregating 40,900 metres, including 14,200 metres of open hole and 26,700 metres coring. At 961m tonnes the company has one of the largest JORC certified coal reserves in Indonesia (which is one of the world's largest producers) and a world class pre-development coal project with a total 2.7bn tonnes resource. Seam thicknesses of up to 33 metres are very encouraging whilst the deposit is still open at width with 40% of the EKCP area unexplored.

**High quality sub-bituminous steaming coal**



## EKCP COMPARISON TO INDONESAIN COAL PROJECTS



Source: Ministry of Energy and Mineral Resources (Indonesia), Companies

## KEY MARKETS

The project is well situated to serve domestic markets but the key markets are likely to be the export markets of China, India, South Korea and Thailand. A recent feasibility study helped establish an NPV of \$1.8bn for the project with a capital cost of \$1.6bn. Given the substantive capital requirement the company commissioned Credit Suisse Asia as strategic adviser to review development options for the project. This includes the active marketing of the project to interested investors (mostly likely emanating from India and China). Credit Suisse is in due diligence with expressions of interest expected to follow in subsequent months. In the meantime discussions regarding potential JV agreements have been cited by the company, though no formal offer or agreements have been entered into.

**China, India, S. Korea and Thailand**

## DEMAND CHARACTERISTICS

The past few years have seen rapid growth in demand for thermal coal. Growth has been driven by the increase in electricity consumption, particularly in growing markets such as China, India and Indonesia. Whilst the key markets are likely to be China, India and South Korea, the domestic market is by no means insignificant. For example under the guise of the 10,000MW "crash program", the government has signalled its intention to develop coal-fired power generation plants across 40 locations within the country.

**Rapid growth in demand for sub-bituminous coal**

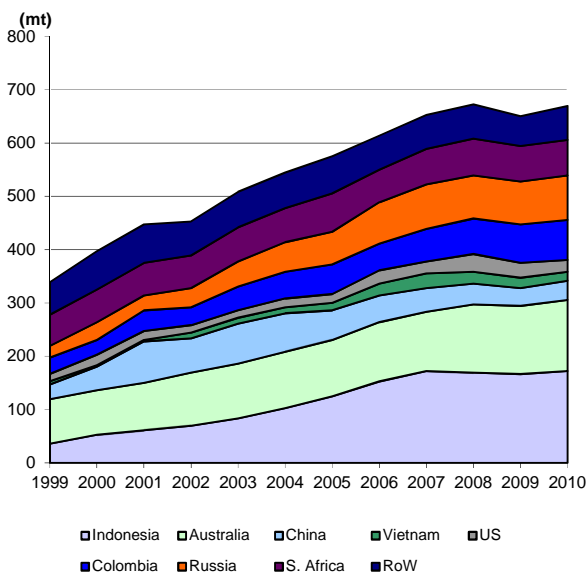
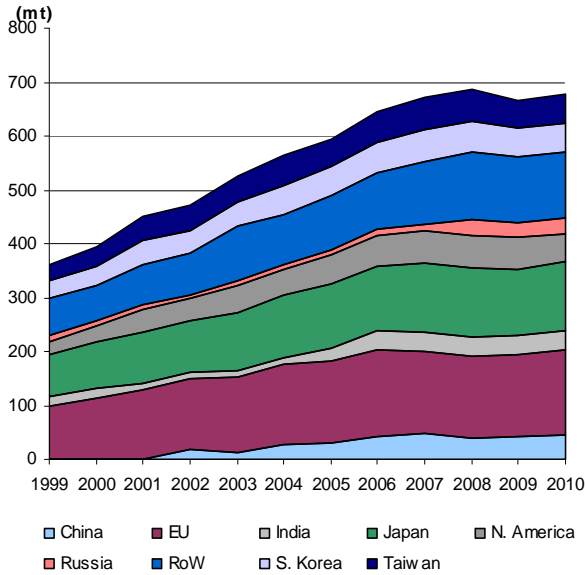
The charts below highlights Indonesia's emergence as a significant producer of thermal coal. In terms of consumption it is notable that India and China are relatively small importers. Indeed China import demand only emerges in 2001 and it was not until last year that the country became a net importer. Given the relatively recent nature of net demand it is easy to see the why the country is expected to be a key market along with India moving forward as the consumer economy continues to drive demand for electricity usage. In addition, whilst India's exports seem to be growing, China's has visibly shrunk, indicative of the growing internal requirement.



## GLOBALLY TRADED THERMAL COAL MARKET TO 2010

*Thermal Coal import demand*

*Thermal Coal export supply*

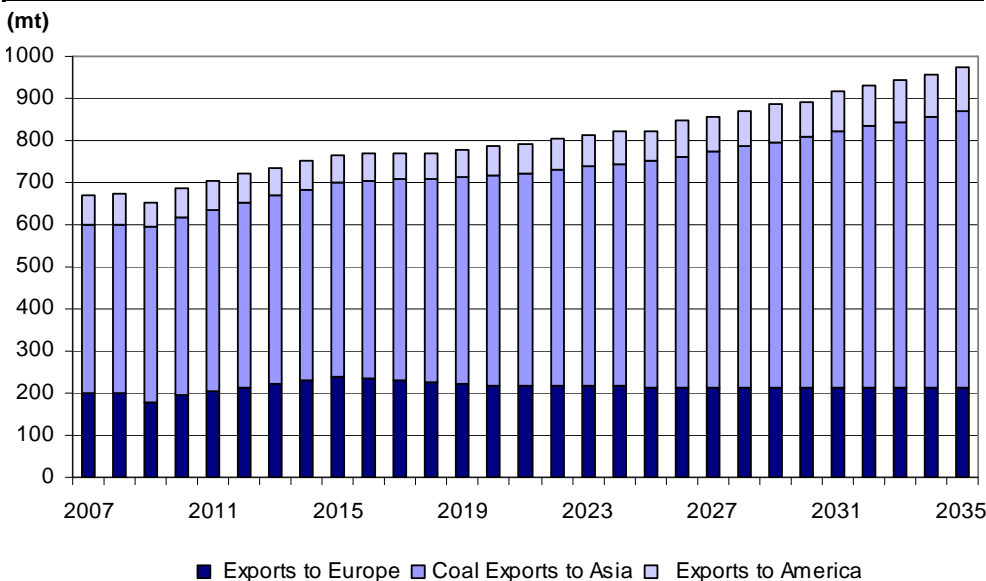


Source: EIA, AMI

### ASIA GROWTH

China is widely predicted to overtake Japan as the world's largest importer of thermal coal by 2015. However, it is also worth noting that growth in China and India are not the only economic drivers for the coal market. As the estimates below show the Asian continent as a whole is expected to underpin strong demand going forward.

### WORLD STEAM COAL FLOWS BY IMPORTING REGIONS

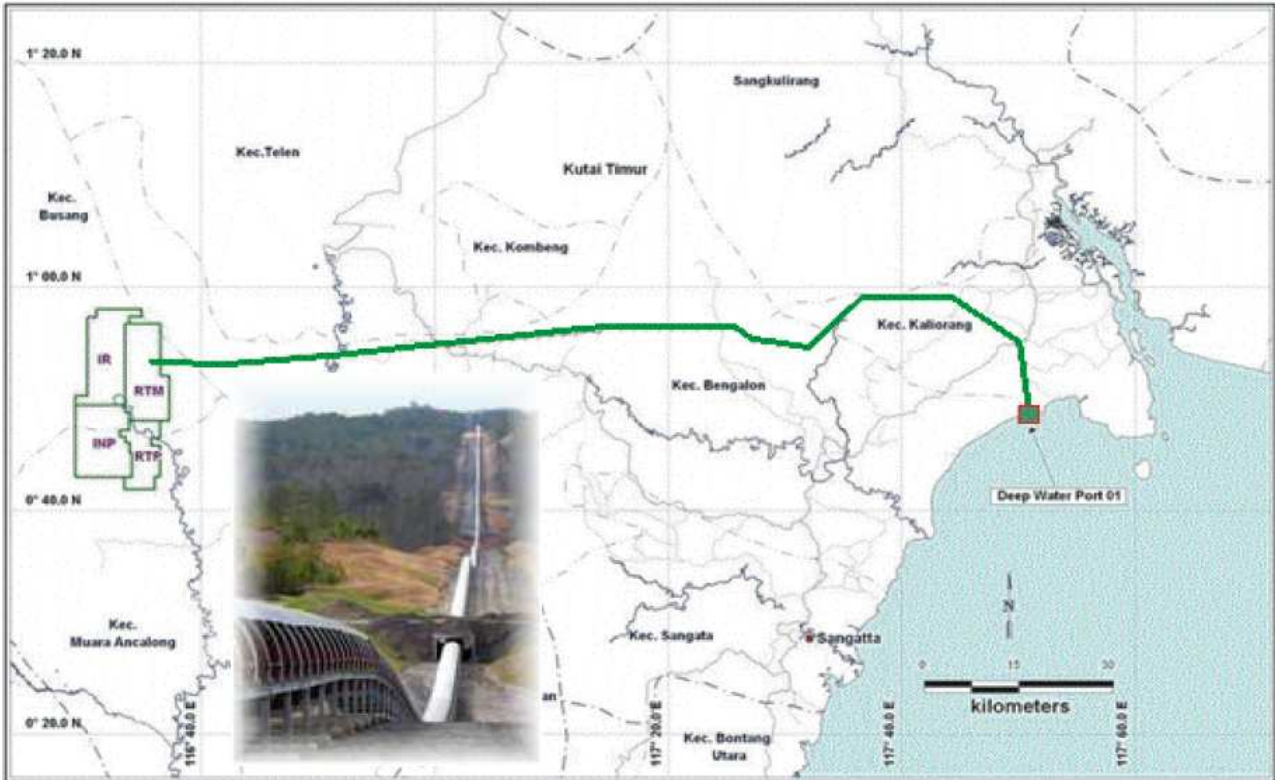


Source: EIA





### LOGISTICS BECOMING CLEARER



Source: Company

### LONG-TERM FINANCING

Expressions of interest in relation to a JV arrangement or outright purchase are expected to follow the completion of due-diligence by Credit Suisse. Any expressions must comprise a (non-binding) indicative bid and the intention is to have filtered down to a short list. With due diligence to commence shortly after, there is potential for a deal to be signed as early as Q1 2011. Early interest is emanating predominantly from India, China, South Korea and the Middle East.

Potential for short term financing partner



## KEY PARAMETERS OF THE FEASIBILITY STUDY

The key logistical parameters defined by the feasibility study can be outlined as;

- **Truck and shovel open pit mine**
- **Coal to be transferred between mine to port using Overland conveyor – 8 x 20km flights**
- **Bucket wheelstacker/reclaimer, used for stockpiling at the mine stockyard and port stockyard**
- **Export facility – conventional Jetty, Wharf and Ship Loaders, catering for vessels from Handymax to Panamax class**
- **100 MW Coal fired power station at mine area**

The mining operation is a conventional truck and shovel surface open pit mine. However, transportation and power present the key challenges and account for more than \$1bn of capital cost. The feasibility study addresses several routes to market, but the company has conducted project optimisation studies which promote a 160km overland conveyor to the coast as the most likely transportation solution.

**Relatively simple with a truck and shovel surface mine**

Large mining haul trucks will be used for the initial five years to transfer the coal from the Northern mining area to the ROM stockpile and crushing area. The potential exists for a study to investigate the use of in-pit crushing and conveying technology when either the haul distance becomes uneconomical and or, the over-burden ratio increases to more than a 4:1. The Southern pit is likely to be used to serve the domestic market and transported by truck.

Having identified all of the land owners on route, the company has commenced negotiations over land acquisition. Whilst a 160km conveyor sounds onerous such systems should be regarded as 8 x 20km sections, referred to as flights. The conveyor will be built to meet Australian standards and shall be fully covered for protection of persons, flora and fauna. Construction is likely to take up to 24 months to complete.

## KEEPING OPTIONS ALIVE

A rail system is not ruled out at this stage. In order to keep this option open, the company has applied for the requisite permitting. Similarly, road haulage may form at least a part of early production for the local market. A coal fired power plant, complete with overhead transmission power lines, will be constructed and represent a significant portion of the capital cost as shown below. Temporary diesel powered generator sets will be used during construction and will assist with commissioning, should the main power plant not be fully operational at the time of completion of the infrastructure. The breakdown of costs identified by the company following the feasibility reads as follows.

**Rail not ruled out at this stage**



## POST FEASIBILITY ESTIMATE OF PROJECT CAPITAL REQUIREMENTS

| Post feasibility estimate of project capital requirements | US\$m        |
|---|--------------|
| Mine infrastructure                                       | 24           |
| Coal supply chain infrastructure                          | 737          |
| Power generation & transmission                           | 333          |
| Pre-development   | 65           |
| Indirect costs  | 167          |
| Contingency   | 266          |
| <b>Total cost</b>   | <b>1,592</b> |

Source: Company/FS

## LAND ISSUES

Churchill has been proactive in addressing the key land compensation issue. Whilst the company would normally require an access corridor of approximately 100m in width, additional space has been acquired ranging between 200m to 4km. This provides considerable scope to navigate around difficult areas of hilly terrain, wet areas or other obstruction. Acquisition of the land has been managed in a very discrete manner, with the communication of intended use and potential buyer being kept low key. The land Owners and local community have been very supportive.

**Proactive in addressing land compensation**

## NEAR-TERM WORK PROGRAMME

Additional geotechnical drilling in the north is expected to enhance the understanding of the potential to extend mine life beyond the 25 years currently modelled. The existing 25 year period is conformably covered by the 961m tonne JORC Probable In-Situ reserve (we estimate around 722m tonnes will be produced in that period). The mine production rate is currently optimised at 30mt/pa and there may also be scope for upside with development facilities capable of supporting between 40-45m tonnes per annum. The company will also investigate the potential for In-Pit crushing for the removal of over and inter-burden waste as well as the potential introduction of electric shovels and haul trucks.

**Potential to extend mine life beyond 25 years**



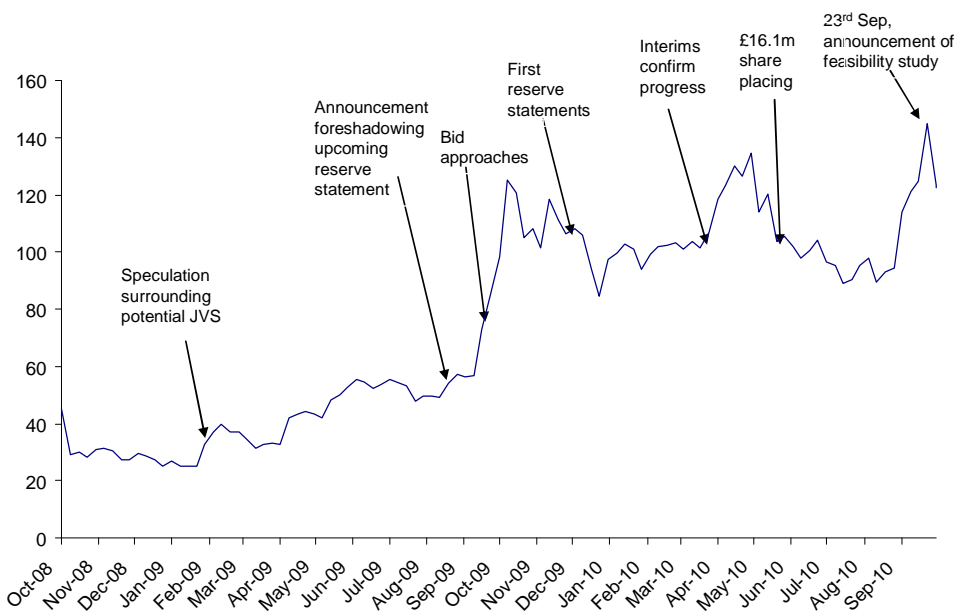
## HISTORY AND TRACK RECORD

Significant progress has been made since admission to AIM in 2005 at effectively 20p (accounting for subsequent 10:1 consolidation). Progress in the upward trend indicated to the share price chart below which has created significant shareholder value. The East Kutai licence was purchased in April 2007 and the company began its scoping study a year later in March 2008. Shortly after, in April 2008, the first JORC resource of 350mt was outlined. This has since been upgraded to a Probable In-Situ reserve of 961m tonnes from a total JORC resource of 2.7bn tonnes.

**Significant progress since 2005 AIM admission**

The feasibility study in September was a significant milestone, establishing the potential commerciality of the reserve. Looking forward, progress on the funding front is likely to represent the next significant news flow. The following chart summaries the major news events for the last two years in relation to share price performance.

## SHARE PRICE PERFORMANCE IN RELATION TO RECENT NEWSFLOW



Source: Fidessa/RNS



## KEY MANAGEMENT

**David Quinlivan – Chairman** is CEO of Mt Gibson Iron Limited a mid-tier iron ore producer in Australia. David has 30 years experience development projects throughout the world and was involved with the operation and corporate reconstruction of Sons of Gwalia. He is a non-exec of ASX-listed Avoca Resources.

**Paul G. Mazak – Managing Director** worked in Indonesia from 1990-1997 in various industry positions in particular in relation to mining where he has been advisor to a number of investment funds. Paul moved to Indonesia 3 years ago in order to effectively manage Churchill. He was managing Director of Hastings and Associates for the past 20 years with considerable experience in leading financial, investment and governmental teams in Asia. Paul created and managed the successful B. Vijakumar Diamond mining consortium bid for the world class Madhya Pradesh diamond property in India. Paul was also a director of ASX-listed Majestic Resources between 2001 and 2003.

**Jan Castro – Non-Executive Director** has extensive experience in M&A, capital raises, strategy, and finance and of development stage mining projects. He is founder and current Managing Director of Pala Investments. He also currently serves on the Boards of Anatolia Minerals, Avoca Resources, Gemcom Software, Norcast Castings and Dumas Contracting. Prior to founding Pala in 2006, he was Senior Vice President of Investments and Corporate Affairs for Mechel OAO, a NYSE-listed company and one of Russia's largest coal companies leading the IPO in 2004.

**Faroek Basrewan – Non-Executive Director (Indonesia)** is a specialist in Indonesian central, provincial and local government law with a distinguished career in general mediation and dispute resolution, government and regulatory relations within Indonesia. He is currently Special Advisor and Special Assistant to Dr Alwi Shihab, the Indonesia President's Special Envoy to the Middle East. He has also served as Special Staff to the Minister of Defence and as Special Assistant to the first democratically elected Indonesian President, Abdul Rachman Wahid (Gus Dur).

## KEY EXECUTIVES

**Paul Benjamin – President** has an extensive career encompassing experience in project development as a senior officer in a number of major international companies in the industrial goods and energy sectors. He has established an extensive network of contacts with government institutions and major private companies in Indonesia and internationally.

**Brad Gartman – Chief Operating Officer/Project Director** has over 34 years experience as a senior manager and consultant in the resources sector. Brad has extensive overseas Engineering Procurement, Construction and Project Management (EPCM) experience in a number of major projects in Indonesia and Australia. Brad's comprehensive EPCM experience encompasses all ends of the spectrum from conception, establishing commercial contractual arrangements to the completion of bankable feasibility and delivery of facilities



**Paul Graus – Chief Financial Officer** has over 30 years experience in accounting with nearly 10 in the relation to the global mining industry. Paul has extensive knowledge of the Indonesian coal industry, previously acting as an Advisor to one of its largest companies, PT Tambang Batubara Bukit Asam where he assisted in financial and corporate restructuring. Prior to that Paul was senior advisor to the Board of PT Tambang Timah TBK, one of the world’s largest tin mining companies and recently Group Finance Manager for dual TSX/LSE listed First Quantum Minerals Ltd, capitalised at c.£4bn.

## INDONESIAN ADVISORY BOARD

The company has augmented its Indonesian presence by adding a high powered Indonesian advisory board. The board is chaired by Dr Alwi Shihan the Indonesian President’s Special Envoy to the Middle East and a previous Indonesian Foreign Minister. Fellow advisory board member Mr Suhanjono is a previous Attorney General of Indonesia with over 40 years of legal experience with the Indonesian government whilst Mr Faroek Basrewan is a previous Special Aid to the former President of Indonesia.

## SWOT ANALYSIS SUMMARY

| Strengths   |
|---|
| <ul style="list-style-type: none"> <li>• World class deposit</li> <li>• Reserves and Resources</li> <li>• Feasibility study confirms potential</li> <li>• Well located resource</li> <li>• Strong local management and advisory board</li> </ul>  |
| Weaknesses  |
| <ul style="list-style-type: none"> <li>• Capital intensive development/Uncertainty over funding</li> <li>• Reliance on third parties</li> <li>• Uncertain time scale</li> <li>• Sub-bituminous coal is lower grade than bituminous steaming coal</li> <li>• Transportation to coast is costly</li> </ul>  |
| Opportunities   |
| <ul style="list-style-type: none"> <li>• Potential to attract a well moneyed JV partner or acquirer</li> <li>• Likelihood of extending mine life outside feasibility parameters</li> <li>• Access to local and international markets</li> <li>• Strong demand for steaming coal likely to continue</li> <li>• Potential agreement with PLN for local market and coal drying technology</li> </ul> |
| Threats   |
| <ul style="list-style-type: none"> <li>• Exposure to market pricing</li> <li>• Regulatory/Timing risks in attaining licences</li> <li>• Financing risks with third party interest difficult to gauge</li> <li>• Valuation somewhat dependent on third-party validation</li> </ul>   |

Source: Northland Capital Partners Ltd



## KEY RISKS

### FINANCING

The pre-eminent risk for Churchill is financing for East Kutai. The infrastructure requirements for the project are significant with a 7 year pay back meaning a committed long term investor is required. The current marketing campaigning by Credit Suisse is not guaranteed to reach successful conclusion. If the company is unable to achieve project finance on favourable terms then the valuation could be significantly impaired.

Requirements for the project are significant

### MARKET PRICING

Project economics are based on a long term price of \$47/t which is a premium on the current pricing but in line with management expectations based on its market intelligence and on feedback it is receiving from prospective off-takers. The project still looks viable at much lower pricing but, all things being equal on a cost front, the valuation would be significantly lower.

Long term price of \$47/t a premium to current pricing

### REGULATORY RISKS

The company perceives the shifting of the licence a formality and there appears to be few additional hurdles on a regulatory front. However it is possible that issues may arise that we have not considered here and there may be additional bureaucratic hoops in relation to a new potential JV partner/ or shareholder.

Perceives shifting of the licence a formality

### SECURING LAND ACCESS

The company has identified the land owners and will seek to purchase the land necessary for mine site access and its transportation (conveyor) passage to the coast. Whilst compulsory purchase orders do not exist in the same way as for key infrastructure projects in the UK, there is nevertheless a well-developed system for land acquisitions with oversight by the local authorities. The first stage will be for Churchill to negotiate directly with the land owners with the purchase consideration measured against a pre-designated formula which ascribes value (per square metre) to land in accordance with its usage (i.e. fallow land is ostensibly cheaper than cultivated land and in the case of the latter a more mature plantation will attract greater value than a newly planted one etc).

A well-developed process

If the company is unable to achieve resolution in this manner the authorities have the power to force the land owners to the table. Whilst the authorities' powers stop short of the explicit right to force people to sell, it is able to revoke licences where it finds that the land owner may be acting unreasonably (and contrary to the prescribed guidance for land values) which is likely to have a very similar impact.

### OPERATIONAL

Whilst the feasibility estimates should be conservative and contains a healthy margin for contingency, these are merely estimates and there is the risk that operating and capital cost will be higher than anticipated.

Costs are estimates so subject to change



## FINANCIALS

### RESULTS

The import of the results is somewhat overshadowed by the implications of the feasibility study. Notwithstanding, results presented few surprises with losses in line with our expectations. Full year clean pre-tax loss of \$4.6m compared to \$7.1m last year with adjusted loss per share of 5.7 cents against 10.5 cents last year. Reported PBT of \$6.7m (\$14.1m) and loss per share of 8.3c (20.8c) reflect the impairment of non-core assets. The strong cash position of \$23m is sufficient to support our expectation of pre-development activity amounting to around \$18m in in 2011 and central costs at a fairly constant \$4.3m, with some assistance arriving from working capital inflows and interest income.

**In line with expectations**

Administration costs of \$4.1m increased 18% on last year which looks modest given heightened activity including growing the EKCP JORC coal resource to 2.73bn tonnes, raising \$24.3m in capital, creation of the high level Indonesian Advisory Board, negotiation of the off-take MOU with PLN and the transfer of the EKCP mining licences in compliance with new Indonesian Mining Law.

One negative was the reported non-cash impairment of \$1.6m following the cessation of activity at the Sendawar CBM Project in East Kalimantan for which management perceives no economic potential. The project was written down to nil. Whilst the company had been fielding interest in relation to investment in the project, the write off should not come as a complete surprise given that the group impaired the project by some \$5.7m last year.

There was a small, ultimately immaterial contraction, in the company's associate ASX listed Spitfire Resources in which Churchill holds a 21.7% (2009: 28.8%) equity interest. The investment was re-valued at close on 30 June 2010 at \$1.9m (2009: \$2.5m) based on a price of 9c down from 12.5c the previous year (shares closed 26th October at 10c).

Irrespective of the small impairments, the company grew its net assets to \$48.9m (2009:\$29.5m) which reflected both growth in intangible assets of \$7m net (with \$8.6m in additions) and, of course, the not insignificant cash injection of \$24m (gross).

### FORECASTS

Given that Churchill is currently at pre-development stage we have not incorporated production estimates into our thoughts given these will likely fall outside of our forecasting range (though an example of the potential can derived from the valuation section). In terms of central costs, we expect outgoings to be fairly consistent but have forecast a small increase this year given additional advisors (associated with marketing for JV partners etc). Whilst the operating costs seem fairly predictable, capital costs, which are of greater materiality, are more variable.

**Raised \$24m in June**



## **CAPITAL EXPENDITURE**

The company raised \$24m in June backed by its cornerstone investor Pala. Management expects to expend the majority of funds over the next year in preparation for the commencement of operations. We look for capex of around \$18m for full year to 2011 with around \$2.6m falling into the 2012 reporting period.

**We look for capex of  
c. \$18m for 2011**

Land acquisitions are budgeted at \$15m for the next 12 months which includes the access corridor, the port area and initial mining area permits. Engineering and staff are expected to account for a further c.£4m whilst site costs are expected to amount to c.£1.2m and bulk sampling to add a modest \$0.4m.

## **WORKING CAPITAL VARIANTS**

The balance sheet contains a VAT receivable of \$1.2m (\$804k) which will, potentially, be recoverable in the long term on commencement of mining operations. The company also has around \$6.8m of unrecognised tax loss assets but, given uncertainty over group structure going forward, these are considered as unlikely to be realisable. There is also a material receivable of \$4.4m on the balance sheet relating to the shareholders of PT Techno Coal Utama (a 99% held subsidiary) and a corresponding payable of \$3.3m. We assume the position will be reversed out in the coming period culminating in a net benefit to the group of \$1.1m.

**VAT receivable of  
\$1.2m**

## **STRONG BALANCE SHEET**

The net effect of the above is a forecast net cash position of \$2.7m for June 2011 and a deficit (not incorporating financing) for the following year. Thus the company looks to have adequate means to cover at least the 12 months of its 2011 financial year in terms of working capital and capital expenditure. However, while we have reasonable visibility for 2011, 2012 is more opaque. We include that period here, in the interest of completeness but we would not be surprised to see very divergent results, given that stasis seems the least likely outcome. We would expect to have a much clearer appreciation of the project financing options one way or another well before 2012.

**We forecast a net cash  
position of \$2.67m for  
June 2011**

## **RECOMMENDATION TRACKER**

Northland Capital Partners Ltd. does not issue recommendations on companies with which it has a corporate relationship.

## CHL: KEY DATA

### Company Description

The principal activity of the group is the 75% owned world-class East Kutai (sub-bituminous) Coal Project (EKCP) in the Regency of Kalimantan, Indonesia. Churchill has advanced the EKCP to a 961m tonne JORC Probable In-Situ reserve (2.7bn tonne) resource, through a recent feasibility study and is currently evaluating financing routes.

### Website

[www.churchillmining.com](http://www.churchillmining.com)

### Management

|                 |                    |
|-----------------|--------------------|
| David Quinlivan | Non- Exec Chairman |
| Paul Mazak      | Managing Director  |
| Jan Castro      | Non Executive      |
| Faroek Basrewan | Non Executive      |

### Major Shareholders

|                          |     |
|--------------------------|-----|
| Pala Investment AG       | 32% |
| Indo Setubara Ltd        | 15% |
| JO Hambro Investment Mgt | 3%  |
| Lehman Brothers Bankhaus | 4%  |

### Recent News

|                   |           |
|-------------------|-----------|
| Feasibility Study | 23-Sep-10 |
| East Kutai update | 01-Jul-10 |
| £16.1m Fundraise  | 25-May-10 |

### Financial Diary

|               |           |
|---------------|-----------|
| Annual report | 01-Nov-10 |
| Next AGM      | 10-Dec-10 |
| Interims      | 29-Mar-11 |

### Share Price



Source idessa NS

| Year to September (\$m)                 | 2009A  | 2010A  | 2011E  | 2012E |
|---|--------|--------|--------|-------|
| <b>Profit and loss</b>                  |        |        |        |       |
| Revenues                                | -      | -      | -      | -     |
| Administration costs                    | (3.5)  | (4.2)  | (4.3)  | (4.4) |
| Impairment of exploration assets        | (5.7)  | (1.6)  | 0.0    | 0.0   |
| Total Administration                    | (9.3)  | (5.8)  | (4.3)  | (4.4) |
| operating profit (loss)                 | (9.3)  | (5.8)  | (4.3)  | (4.4) |
| Net Interest                            | 0.3    | (0.1)  | 0.4    | 0.1   |
| FX gains (losses)                       | (3.5)  | 0.0    | 0.0    | 0.0   |
| Total finance costs                     | (3.3)  | (0.1)  | 0.4    | 0.1   |
| Total exceptional                       | (1.2)  | (0.5)  | 0.0    | 0.0   |
| Share of associate loss                 | (0.3)  | (0.4)  | 0.0    | 0.0   |
| Profit (loss) before tax                | (14.1) | (6.7)  | (3.9)  | (4.3) |
| FX translation                          | (0.9)  | 0.3    | 0.0    | 0.0   |
| Attributable loss                       | (4.5)  | (6.4)  | (3.9)  | (4.3) |
| EPS                                     | (22.8) | (8.3)  | (4.1)  | (4.4) |
| Weighted average shares                 | 67.7   | 80.9   | 96.7   | 99.1  |
| <b>Cash flow Statement</b>              |        |        |        |       |
| Operating Cash flow                     | (3.5)  | (3.7)  | (3.1)  | (4.3) |
| Finance income                          | 0.3    | 0.0    | 0.4    | 0.1   |
| Payments for property, plant & equip    | (0.1)  | (0.1)  | 0.1    | 0.1   |
| Exploration/evaluation/land             | (7.3)  | (8.3)  | (18.0) | (2.6) |
| Total cash flow from investing activity | (7.1)  | (8.4)  | (17.5) | (2.4) |
| Net cash outflow                        | (10.6) | (12.1) | (20.6) | (6.7) |
| Issue of shares                         | 9.0    | 24.4   | 0.0    | 0.0   |
| Other                                   | (0.2)  | (0.3)  | 0.0    | 0.0   |
| Total financing                         | 8.8    | 24.1   | 0.0    | 0.0   |
| Net (decrease)/increase in cash         | (1.8)  | 12.0   | (20.6) | (6.7) |
| Cash at start of year                   | 16.1   | 10.9   | 22.9   | 2.3   |
| FX differences                          | (3.4)  | (0.0)  | 0.0    | 0.0   |
| Cash at end of year                     | 10.9   | 22.9   | 2.3    | (4.4) |
| <b>Balance sheet</b>                    |        |        |        |       |
| Cash and cash equivalents               | 10.9   | 22.9   | 2.3    | 0.0   |
| Trade and other receivables             | 0.2    | 4.6    | 0.2    | 0.1   |
| Total current assets                    | 11.1   | 27.5   | 2.5    | 0.1   |
| Property, Plant and Equipment           | 0.2    | 0.2    | 0.2    | 0.2   |
| Other receivables                       | 0.8    | 1.2    | 1.1    | 1.1   |
| Intangible assets                       | 15.4   | 22.5   | 40.5   | 43.1  |
| Other financial asset                   | 0.1    | 0.0    | 0.0    | 0.0   |
| Investments in associates               | 2.5    | 1.9    | 1.7    | 1.7   |
| Total Fixed Assets                      | 19.1   | 25.8   | 43.5   | 46.1  |
| Total Assets                            | 30.1   | 53.3   | 46.0   | 46.2  |
| Trade and other payables                | (0.6)  | (4.4)  | (1.1)  | (1.1) |
| Loans and Borrowings                    | (0.0)  | 0.0    | (0.0)  | (0.0) |
| Total current liabilities               | (0.6)  | (4.4)  | (1.1)  | (1.1) |
| Total non-current liabilities           | (0.0)  | (0.0)  | (0.0)  | (0.0) |
| Total liabilities                       | (0.6)  | (4.5)  | (1.1)  | (1.2) |
| Net assets                              | 29.5   | 48.9   | 44.8   | 45.0  |



## CONTACTS

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|---------------------------------------|------------------|---------------------|-----------------------------|
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