

# StockAnalysis

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July 8th 2009  
Issue 15, Vol 6

By Peter Strachan

## This Week

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### Bi-monthly Lucky Draw!

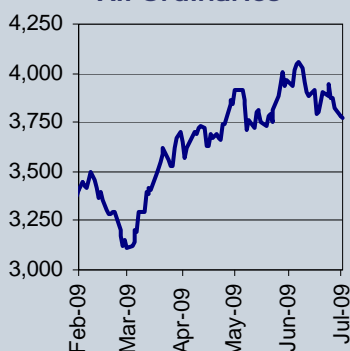
If you renew your subscription (or, as an ex-subscriber, you re-subscribe to StockAnalysis), you stand in line to win a case of premium wine by the award-winning Swings & Roundabouts Wine Estate in Margaret River.

For July 2009, we would like to congratulate our lucky winner Richard Louder of SA. A case of mixed wines is on the way ... enjoy!

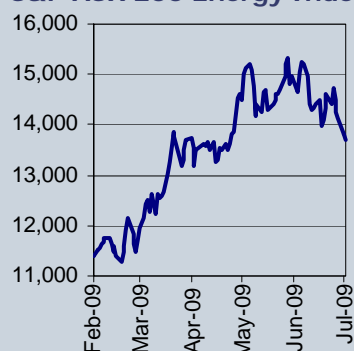
### Indices & Prices

All Ordinaries	3,767.80
Energy Index	13,681.20
Brent AU\$/bbl	78.31
AUS\$/US\$	0.7894
As at Close July 7th	

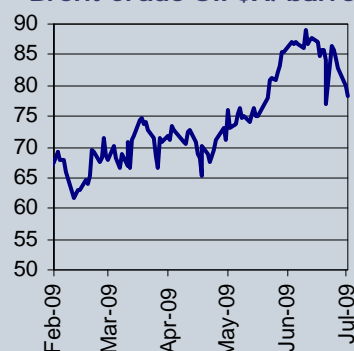
### All Ordinaries



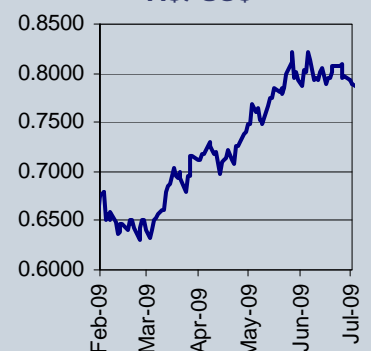
### S&P ASX 200 Energy Index



### Brent Crude Oil \$A/barrel



### A\$/US\$



## In this Issue

**Market Moves:** Market due for a pullback, commodities under pressure, earnings in focus as taxation worries mount

**Trading idea:** Telstra making a pattern to push higher

**Antares:** Looks to test and then commercialise Yellow Rose gas project

**Taranaki Tango:** AWE looks cheap and has strong exploration upside appeal

## Travel

I will be in Melbourne on Thursday the 23rd and Friday the 24th of July. Please give me a call if you would like to catch up.

## Market Moves

Australian and global stock markets face increasingly tough trading conditions, while prices for commodities such as copper and oil look over extended and too expensive in the medium term. On cue, the oil price has fallen US\$10/bbl and copper has begun a fall which looks certain to take the price back towards US\$1.95/lb and could take it to US\$1.60/lb. After a spectacular and steep recovery from extremely oversold conditions, it would be understandable if the market now took a pause to look at the environment for corporate earnings into 2010 and beyond. A growing awareness by market participants in the economies of OECD nations that taxation will have to rise in coming years to service mountains of debt that are currently being racked up by governments, is likely to weigh negatively on the outlook for corporate earnings.

The StockAnalysis crystal ball is still extremely clouded and there are a few good reasons to expect further market weakness in the medium term:

- ⇒ We continue to see **huge volumes of new shares** arriving on the market as companies seek to recapitalise following the 21st Century credit bust (21CCB).
- ⇒ **Corporate executives in the USA have been large net sellers** of their stock, indicating that they don't feel very confident about the earnings outlook. This is also understandable since many executives are now looking to take some cash off the table after having been large net buyers when stocks became so undervalued late last year and early this year.
- ⇒ Following a strong run-up in **equity prices**, there is technically room for some pullback.

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- ⇒ **Unemployment** is rising globally and industrial production is still very weak.
- ⇒ **Too much hope rests on economic recovery in China**, where the government is doing a great job of papering over any ongoing weakness but ultimately, when exports were down 17.5% in January, down 25.7% in February, and down 17.1% in March, while electricity consumption was down and profits from State owned enterprises were down, it is hard to remain confident.

**Galaxy Resources**, which StockAnalysis recommended as a speculative buy at around 38 cents last October and again in December last year, has moved up to over 70 cents, following a series of small capital raisings to facilitate its feasibility work, along with rapid movement towards commencement of development of its Mt Cattlin lithium mine at Ravensthorpe in WA. Galaxy has established a plant location and supply contracts for major chemical inputs to a proposed lithium carbonate refinery in China and has expanded its permit position around the proposed mine, where early work indicates potential for a long life project, running well beyond an initial 15 year open pit reserve.

**StockAnalysis continues to see value below \$1 per share for Galaxy.** The market for lithium, used in Li-ion batteries, is set to see substantial growth over the coming decade, pushing prices higher. StockAnalysis expects that Galaxy will now be drawing close to finalising a funding arrangement for its ~\$100 million project, most likely drawing in an off-take and funding partner from the Asian region to assist.

## Trading Idea

TLS - TELSTRA CORPORATION.



Telstra is making headway under new leadership. The company has re-engaged with the Federal government about the needs of a National Broadband network for the country and has vowed to work, not only in the interest of its shareholders but for the interests of a wider stakeholder network.

Currently, Telstra's share price appears to be edging up and if it breaks \$3.45 in the next month, it looks set to travel at least to \$3.60 and most likely to \$3.90 per share. A pullback to around \$3.20 is likely during the current market weakness, which should represent an attractive buying opportunity.

## Antares Energy - Yellow Rose Rises (AZZ)

**Recommendation:** Antares is a speculative buy, ahead of proof-of-concept flow testing at its Yellow Rose Project in Texas. A positive result from testing of its Frances Dilworth No. 2 well during July, along with the outcome of drilling of Petrohawk's horizontal well, which is presently on target towards the Eagle Ford Shale in Antares' term assignment acreage, 5 km to the south east, would establish Yellow Rose as a company making venture for Antares. StockAnalysis discounts potential gas in the Eagle Ford to 42 Bcf and gas in the Edwards to 10 Bcf to calculate a value of 64 cents per share for underlying petroleum assets. Risked exploration upside brings the current, total risked target valuation to 90 cents per share. Failure of flow testing at Frances Dilworth is possible, but is seen as unlikely, given the positive log responses recorded. The company has a target value of 64 cps with upside to over \$1.

### AZZ - Capital Structure

Shares	184.5 m.
Options	2.0 m.
Convertible notes	9.3 m.
Performance rights	4.0 m.
<b>Total</b>	<b>199.9 m.</b>
Cash (est) \$m.	4.0
Price	\$ 0.34
Market Cap \$m.	\$ 63 m.

(Continued on page 3)

## Valuation

The market is currently factoring in only half of the value calculated for Antares' Yellow Rose Project by StockAnalysis.

Early indications from the Yellow Rose project suggest that both the Edwards and Eagle Ford plays will produce commercial hydrocarbons, but flow testing is required to finally determine production and valuation parameters.

The price of natural gas in the USA is presently unattractive for this type of development at around US\$3.50/Mcf. Development may need to rely on the relatively high production of liquids from the formations over the medium term, but over a 2-3 year timeframe, US domestic gas prices are likely to rebound in response to lower levels of field development, resulting from the current weak price environment. However, domestic natural gas in the USA is seen as being capped at around US\$5/Mcf over the coming two years. Domestic supply should begin to decline in response to lower rates of field development but supply of imports from Canada, plus spot LNG cargoes from Qatar will ensure an adequate delivery of low cost gas. Ultimately, a lack of domestic field development will curtail domestic supply capacity while growth of nearby Asian demand will divert Qatari LNG to more lucrative markets, resulting in rising US domestic gas prices by 2012.

### AZZ — Valuation Matrix

Asset	Value \$m	\$ per Share	Comment
USA production	18	0.10	3.3Pj 2P + 5.6Pj Poss
Eagle Ford	99	0.52	33% of NPV for 125 Pj
Yellow Rose	24	0.13	33% of NPV for 30 Pj
Cash (est)	4	0.02	Estimate
Convertible note	(19)	(0.10)	
Other	(5)	(0.03)	Corporate
	121	0.64	
Exploration Value	49	0.26	Risk adj
Total Value	169	0.90	

Source: Strachan Corporate Pty Ltd

StockAnalysis values Antares' existing 3P reserves of 10.2 Bcfe at \$18 million. The Eagle Ford play is estimated to have an ultimate value potential of over A\$400 million to the company, but it is valued at \$99 million or 52 cps at this stage of evaluation. The Edwards play is estimated to hold potential value of over \$120 million to the company, but is valued at \$24 million or 13 cps prior to final flow testing, required to confirm its commercial potential.

## Eagle Ford Shale — 50%

Antares Energy has established a strong foothold in the USA's latest shale oil and gas play, along the Eagle Ford Shale in SW Texas, to the north of Corpus Christi. It has an interest in licenses covering a total of 16,700 acres over the play.

Shale plays are a foreign concept in Australia, where most geologists think of shale formations as a source for hydrocarbons rather than a reservoir. Advances in drilling and well completion technologies have enabled commercial production of petroleum from previously uneconomic shale formations in many parts of the world. Shales produce gas and oil in various places in the USA. The Barnett Shale, near Dallas, was one of the first to become commercial, followed by the Woodford as well as other shales along the Appalachian Mountains and the Bakken Shale in the Williston Basin of North Dakota, stretching across the border into Canada.

This type of play is called a resource play and is somewhat analogous to coal seam gas, which has become such big business in Queensland over the past decade. In resource plays, discovery is not the issue since the existence of hydrocarbons is established. Commerciality is all about development cost and gas deliverability per well. Emphasis is placed on reducing the cost of development and production with a systematic and low-cost production-line approach to drilling and well completion, along with establishment of the most appropriate and cost effective well completion technology, so as to reduce costs and maximise production per well.

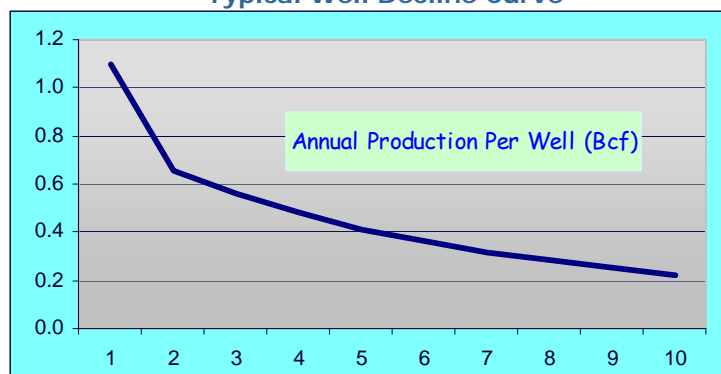
To achieve commercial success, horizontal sections of up to and over 2 kilometres in length are drilled within the shale unit. Hydraulic fracturing of the shale is undertaken at multiple sites along horizontal sections by pumping fluids at extreme pressure through perforations in the casing tubes. Fractures propagate as much as several hundred metres out into the surrounding shales and are held open by the insertion of a porous bed, consisting of specially manufactured small grains of high strength silicate granules, thus creating a large surface area for petroleum collection.

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The process is high-tech and expensive, operating at the limits of material capabilities, with the process typically raising the total cost per well to US\$5.5 million. Reasonable economics can be achieved, so long as the oil price is above US\$60/bbl and the gas price is over US\$5/Mcf.

Antares is in good company on the Eagle Ford play. ConocoPhillips has secured 300,000 acres of permits while NYSE listed Petrohawk, which rates the Eagle Ford as the highest quality shale reservoir in the USA, is working on 160,000 acres along the trend, including 4,840 net acres with Antares.

Typical Well Decline Curve



Source: Strachan Corporate estimate

A typical well in this environment can show initial production of 5-8 mmcft per day, falling to about 0.9-1.2 mmcft per day after one year and then declining slowly, so that after 10 years, a well might still be producing 500-600 Mcf of gas per day. As an example, Petrohawk's nearby Donnell No. 1H well showed initial production of 3.8 mmcft per day plus 395 bbls of condensate per day, equal to 6.2 mmcft/day of gas equivalent.

At the current gas price, wells would payback in an unattractive 36 months while at US\$7/Mcf, a typical well would payback in about 10 months.

Experience along the Eagle Ford indicates that recovery of about 20 Bcf of gas can be expected from each 640 acre section, requiring 4 wells, so the company's 16,700 acres of permits in the region, could yield over 500 Bcf of gas from about 105 wells.

### Model Eagle Ford Development

Y/E June	2009	2010	2011	2012	2013	2014	2015	2016	2017-28
<b>Production Schedule</b>									
<b>Wells</b>	<b>No.</b>								
Wells	4	4.4	2.6	2.2	1.9	1.7	1.4	1.3	6.4
Wells	8	6.1	6.3	4.9	4.0	3.5	3.0	2.7	13.4
Wells	8		6.1	5.3	4.5	3.8	3.3	2.9	15.3
Wells	8		4.4	6.8	4.9	4.0	3.5	3.0	16.1
Wells	8			6.1	5.3	4.5	3.8	3.3	18.2
Wells	8			4.4	6.8	4.9	4.0	3.5	19.1
Wells	10				6.6	7.9	6.1	5.0	28.3
Wells	10					6.6	7.9	6.1	33.3
Wells	10						6.6	7.9	38.0
<b>Total BCF pa</b>		<b>10.5</b>	<b>19.4</b>	<b>29.7</b>	<b>34.0</b>	<b>36.8</b>	<b>39.7</b>	<b>35.7</b>	<b>188.3</b>
<b>TJ per day</b>		<b>28.8</b>	<b>53.3</b>	<b>81.5</b>	<b>93.1</b>	<b>100.9</b>	<b>108.8</b>	<b>97.8</b>	
<b>Condensate Kbbbls</b>	12 per TJ	126	233	357	408	442	477	429	2259.4
<b>Capital Sched</b>									
<b>Cost per well</b>		5.5	5.5	5.5	5.5	5.5	5.5	5.5	
<b>No. of Wells</b>		12	16	16	10	10	10		
<b>Drill costs</b>		66	88	88	55	55	55		
<b>Processing plant</b>		7							
<b>Civils</b>		5	2						
<b>Total Capital</b>		<b>0</b>	<b>0</b>	<b>78</b>	<b>90</b>	<b>88</b>	<b>55</b>	<b>55</b>	<b>0</b>
<b>Price US\$/Mcf</b>		4.00	4.08	5.50	7.00	7.93	8.41	8.91	11.65
<b>Condensate US\$/bbl</b>		70.0	74.2	81.6	89.8	95.2	100.9	106.9	140
<b>Revenue Gas</b>	\$m	42	79	164	238	292	334	318	2088
<b>Condensate</b>	\$m	9	17	29	37	42	48	46	301
<b>Total</b>		<b>51</b>	<b>97</b>	<b>193</b>	<b>274</b>	<b>334</b>	<b>382</b>	<b>364</b>	<b>2389</b>
<b>Less Royalty</b>	25%	(13)	(24)	(48)	(69)	(84)	(96)	(91)	(597)
<b>Net Revenue</b>		<b>38</b>	<b>72</b>	<b>145</b>	<b>206</b>	<b>251</b>	<b>287</b>	<b>273</b>	<b>1792</b>
<b>Op cost</b>	\$ 0.45 per Gj	(4.7)	(8.8)	(13)	(15)	(17)	(18)	(16)	(85)
<b>Op Margin</b>		<b>33.4</b>	<b>63.7</b>	<b>131</b>	<b>191</b>	<b>234</b>	<b>269</b>	<b>257</b>	<b>1707</b>
<b>EBIT</b>		<b>22</b>	<b>43</b>	<b>99</b>	<b>154</b>	<b>195</b>	<b>226</b>	<b>219</b>	<b>1506</b>
<b>Taxation</b>	33%	(7)	(14)	(33)	(51)	(64)	(75)	(72)	(497)
<b>Net Profit</b>		<b>15</b>	<b>29</b>	<b>67</b>	<b>103</b>	<b>130</b>	<b>152</b>	<b>147</b>	<b>1009</b>
<b>Cash Flow</b>		<b>(52)</b>	<b>(40)</b>	<b>10</b>	<b>85</b>	<b>115</b>	<b>139</b>	<b>185</b>	<b>1210</b>

StockAnalysis has modelled one development scenario at Antares' Eagle Ford project, which assumes that 74 wells are drilled to produce just under 400 Bcf of gas over an 18 year period.

A gas price of US\$4/Mcf is assumed in 2010, rising to US\$7/Mcf by 2013 and then by 6% pa until 2020 and 2% pa thereafter. Steady capital costs of US\$5.5 million per well are assumed for development over a 6 year period.

After total capital costs of US\$407 million, this model produces a post tax cash flow of US\$1.6 billion and a net present value of US\$630 million, or US\$1.60/Mcf, at a 10% pa discount rate. Under this scenario, Antares could expect to earn over 40 cps by 2013 from this project alone. Maximum capital commitments would be about US\$100 million, so Antares would need to raise at least US\$50 million to support such a development.

## **Yellow Rose, Edwards Limestone – 75%**

Underlying the Eagle Ford Shale in this part of Texas is part of a 400 kilometre long, ancient reef system called the Edwards Limestone. The Edwards Limestone was formed as a barrier reef system along an ancient coastal regime in this part of Texas. Antares' recent Frances Dilworth No 2 well intersected 44 metres of net Eagle Ford above 42 metres of net Edwards Limestone, which exhibited excellent hydrocarbon potential. The company is planning a test of this section, probably involving acid stimulation prior to flow testing. The company estimates that the Edwards Limestone on its permits, holds potential for between 40 and 80 Bcf of recoverable gas. Several other successful gas projects in the region have been developed on this Edwards reef system, supporting the company's claim for a commercial Edwards Limestone development at Yellow Rose.

StockAnalysis believes that vertical wells, costing less than \$2.5 million each to drill and complete with an acid stimulation pump job, could be employed to develop this gas resource.

## **Other Projects & Funding**

Antares presently generates revenue of about A\$6 million pa from its producing oil and gas fields, which pays for all corporate running costs. The company is currently estimated to hold about \$4 million of cash and has the ability to raise a further \$20 million of equity via placement of new shares to YA Global Investments at a 2% discount to its 10 day VWAP, as long as its share price is above 21.32 cents. This new equity option effectively offsets a net \$19 million of debt, in the form of \$2 convertible notes. Should the company move to develop its Eagle Ford and Yellow Rose projects, access to this additional equity might support the raising of \$30 million of additional bank debt to fund full field development.

At the Oyster Creek project, Antares holds a 75% working interest (WI) in the Harrison wells, which currently produce about 164 barrels of oil & condensate per day plus 700 Mcf of gas. Additional production zones are held behind casing for completion at a later date and the Harrison-3 well is planned for drilling later in 2009.

Antares has a 26.25% WI in the West Wharton project where its Outlar well produces about 2.2 mmcft of gas plus 125 bbls of condensate per day and holds potential for over 5 Bcf of gas, according to the company.

Antares has development potential at its 50% held Shaeffer Ranch project and a sizeable prospect with an estimated 100 Bcf target at the 100% held Big Kahuna project, where farm-out funding support is presently being sought.

## **Exploration Upside**

StockAnalysis calculates that Antares has a risk adjusted exploration value of \$49 million, based largely on further potential at Yellow Rose and the potential of its Kahuna prospect.

Well	Equity	Target Pj	Target mmbbl	Risk %	NPV \$m	Discovery Value \$/share	Riskd NPV \$m	AZZ to drill \$m	Riskd NPV \$m
West Warton	26%	16	0.0	50%	32	0.04	16	4.3	0
Yellow Rose upside	50%	100	5	30%	290	0.77	87	9.4	34
Oyster Ck	75%	5	0.4	45%	17	0.07	8	3.0	3
Big Kahuna *	30%	100	0.1	25%	201	0.32	50	3.0	12
* post farmout									49

Source: Strachan Corporate Pty Ltd

## **Reserves**

Antares has Proven and Probable reserves totalling 3.3 Bcf of gas plus 35,819 barrels of oil at existing production projects, plus Possible reserves of an additional 5.6 Bcf plus 182K bbls of oil.

## The Taranaki Trio: AWE, PPP, NZO

**Recommendation:** There does not appear to be any speculative exploration upside priced into AWE's current share price. Failure of the upcoming Taranaki exploration programme is unlikely to see more than a short term decline of ~20 cps, but success holds combined upside of over \$2 per share. The stock is presently underpinned with a value of \$2.76 per share for its petroleum reserves, while net cash adds a further 62 cps and risked exploration is valued at a further 62 cps: **BUY AWE.**

### AWE Capital Structure

Shares	521 m.
Options	17 m.
Share Price	\$ 2.34
Market Cap'n	\$ 1,219 m.
Net cash (est)	\$ 325 m.

Rather than drilling a development well at Tui, AWE has chosen to add value with near field exploration and a test of its Hoki prospect, where discovery could add \$2 per share to its value. AWE remains a well funded oil & gas producer with exciting exploration and development potential around its Tui oilfield, in the Bass Basin and in Indonesia.

### Taranaki Exploration Targets

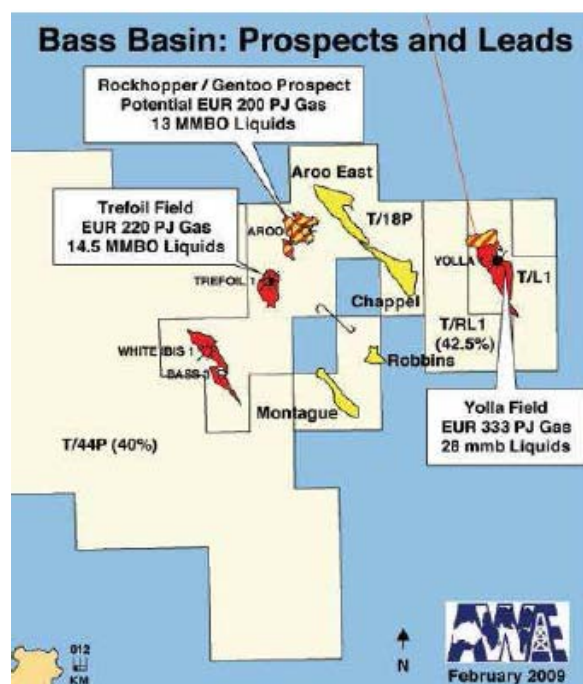
Well	Risk	NPV	NPV
	mmbbl	%	\$m
Tui NE/SW/Kahu	27	25%	810
Hoki	100	14%	2100
			30
			21
Equities		AWE	PPP
PMP 38158		42.5%	10%
PEP 38401 (Hoki)		50%	12.5%

Operator AWE is gearing up to test a couple of near-field prospects, adjacent to its producing Tui oilfield. Three targets have been identified, each of which have potential for about 10 mmbbls of recoverable oil, but at this stage, only two will get a well into them during this programme. Further to the NW lies the Hoki prospect in PEP-38401, which has a mapped extent of 70 km<sup>2</sup> and the potential to hold well over 100 mmbbls of recoverable oil, should hydrocarbons be present.

Discoveries at Tui NE, Kahu or Tui SW could each be developed at relatively low cost, via a subsea tieback to production facilities at Tui.

Discovery Value/share \$	AWE	PPP	NZO
Tui NE/SW/Kahu	0.64	0.14	0.26
Hoki	1.96		
Leverage/share	AWE	PPP	NZO
Tui NE/SW/Kahu	26%	30%	21%
Hoki	81%		
	107%	30%	21%

Each of the Tui trio has similar leverage to success for their proposed near field exploration with potential upside to existing share prices of around 25%. A discovery at Hoki has potential to almost double AWE's share price.



In the Bass Basin, AWE plans to appraise its 42.5% held Trefoil discovery where cleaner gas than at Yolla with good liquids content has already been outlined and to test the Rockhopper/Gentoo complex, where a target of 200 Pj of gas plus 13 mmbbls of liquids has been estimated. This work holds long term appeal, despite the very low gas price in this location. Post 2015, once Queensland LNG projects commence operation, the price of gas in SE Australia will rise, rendering any discoveries in this location highly profitable, given the potential to link them into existing production facilities, 30km to the east at Yolla.

In Indonesia, AWE plans to drill some exciting looking pinnacle reef structures in November, looking for biogenic gas. Indonesia has a growing market for domestic gas at close to global market prices.

In the Perth Basin, AWE is developing its oil resources at Hovea and Jingemia and also plans one final wildcat well to test for gas in a market where even small discoveries of 10 Bcf would be very profitable.

Over in Yemen, the company is planning to test a fractured basement oil play in December, which has potential for +100 mmbbls.

(Continued on page 7)

AWE Value Matrix	%	Reserves			Value		
		Owned	Gas Pj	Oil/Cond mmbbl	mmBOE	\$m	\$/share
<b>Bass Basin</b>							
TRL/1	42.5%	123.3	106.3	126.8	359	0.69	
T/18P	42.5%	106.3	11.5	29.2	351	0.67	
<b>Otway Basin</b>							
PEP 44 Expn	25.0%	28.1			10	0.02	
PEP 44	25.0%	70.0	0.56	12.2	71	0.14	
<b>Perth Basin</b>							
WA 286-P (Cliff head)	57.5%		4.4	4.4	108	0.21	
Frankland 286-P	57.5%	28.8		4.8	4	0.01	
WA 286-P (Expn)	57.5%				-	-	
<b>Argentina</b>							
CNQ 16/A	15.0%	2	0.09	0.4	1.3	0.00	
<b>Taranaki Basin</b>							
PEP 38158 (Tui)	42.5%		11.5	11.5	547	1.05	
PEP 38158 (Expn)	42.5%				82	0.16	
PEP 38746	25%				0	0.00	
PEP 38524	100%				72	0.14	
PEP 38483	44.3%				1	0.00	
PEP 38481	40%				97	0.19	
Sth Island 38259	25.0%				63	0.12	
Net Cash					325	0.62	
<b>Total</b>			<b>358</b>	<b>134</b>	<b>189.3</b>	<b>2,091</b>	<b>4.01</b>
<b>Valuation per AWE Share</b>			Reserves		\$ 2.76		
			Exploration		0.62		
			Cash		0.62		

Source: Strachan Corporate Pty Ltd

AWE's strength is its long life reserves and key oil producing assets in the Perth and Taranaki Basins. Gas production from the Otway and Bass Basins provides less cyclical earnings, but low product prices result in poor economics for at least the next 5-7 years.

The company is self funding with no debt and has the ability to continue to grow both organically and by taking advantage of acquisition and farm-in opportunities.

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