StockAnalysis

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By Peter Strachan

This Week

Reminder:

For every friend or colleague who signs up to StockAnalysis and quotes you as a referee, we will add two months to your subscription, free of charge.

Indices & Prices	
All Ordinaries	4,510.30
Energy Index	14,500.30
Brent AU$/bbl	107.52
AUS$/US$	1.0815

As at Close August 2nd, 2011

In this Issue

Market Moves

Markets remain very risk averse. A resolution of sorts to the US debt ceiling issue simply acts to focus attention on the US government's seemingly intractable deficit and towards the mounting friction and ideological differences within its government. No one believes that the US' 'Tea Party' ideologues will now lie down or disappear from sight, emboldened as they are by the debt ceiling victory.

More financial instability in the US is likely to spill over into bond markets and could manifest in international tensions and unhappiness by creditor nations such as China and OPEC countries, which hold large quantities of fast shrinking, US dollar denominated debt.

Over the 12 months to late July while the US Dow Jones Index rose 21.6%, the US dollar has fallen 22% against the little Aussie battler. This currency move totally obliterated any positive action on underlying equities. An Aussie investor, whose US portfolio exactly replicated the US market, would have seen that portfolio decline in AUD terms. So much for the US market being relatively strong! Local investors who invested in the USA would have done better just holding Aussie dollars in a tin under the bed, without receiving any interest on that cash, let along investing in the local market, which has risen 18% over that period.

The Aussie market outperformance versus the US market in AUD terms over the past 12 months is thus close to 40% in currency adjusted terms. So don't fall into the trap of believing what mainstream media peddles, when it points to outperformance by the DJI.

Locally, Australian manufacturing and housing performance indicators point to contraction and recession conditions in the Australian market. The strong AUD is killing everything from exports of oranges, wine and seafood to tourism and educational services. Tropical North Queensland tourist destinations, Cairns and Kuranda are as quiet as a graveyard, while upmarket Port Douglas still has a subdued buzz, but the action is nothing like the normal peak-period scrum of visitors from southern states and overseas.

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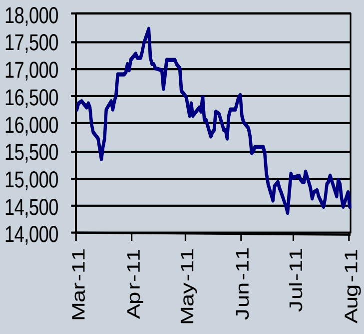
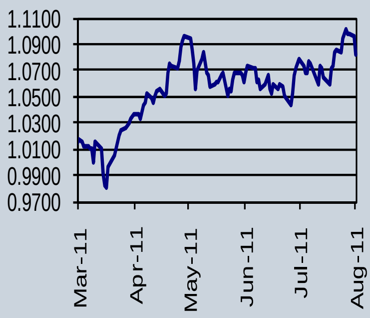
All Ordinaries

S&P ASX 200 Energy Index

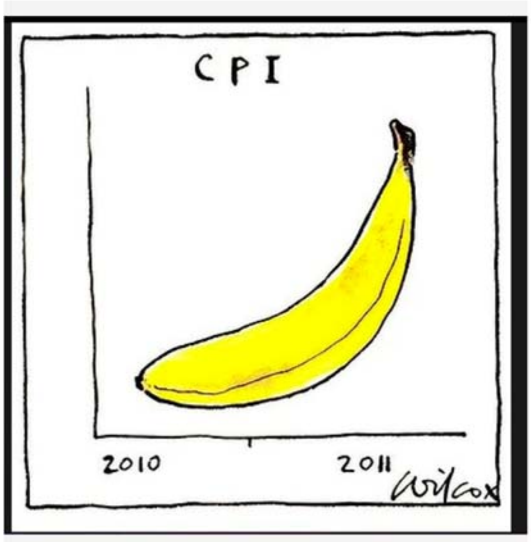


Brent Crude Oil $A/barrel

A$/US$



Local house construction and sales activity remain anaemic, despite Wespac's attempt to buoy the market with predictions of interest rate decline. StockAnalysis agrees that, outside of the energy and mining sectors, the Aussie economy is as sick as a dog, but inflation remains a risk as we head for stagflation, with a stagnant economy, but inflation from rising food and other commodity prices, caused not by buoyant demand but limits to supply.



In a previous edition, StockAnalysis commented that Australia's inflation was arcing up like a banana. I have found this illustration (see alongside) to underling this point.

StockAnalysis expects that Australia will see a further period of negative GDP growth during the September quarter, especially when expressed in GDP per capita. Population growth has overwhelmed economic expansion, leaving the average Tom, Dick and Betty feeling poorer. The only section of the economy that is really pumping is the mining sector. Without that impetus and the royalty revenues it drags into the public purse, Australia's economy would resemble that of Britain's.

Should China stumble along the way to a great leap southwards, as StockAnalysis is expecting in 2012, Australia's miracle economy will begin to look sick.

Meanwhile, US manufacturing is showing only modest growth, when its low dollar should see it performing at a much stronger pace. The US, like Australia, seems to be suffering from low consumer and investor confidence, which is understandable given the political ructions in both nations, as their politicians take position to raise taxes. No wonder folks are keeping their wallets closed! More wealthy Americans are abandoning the US dollar, leaving their nation to find a home in Asia.

Antares has reported that its 67.5% held, Harrison-3 well was successfully stimulated and is now producing at around 200 BOEPD plus 320 Mcf of gas per day. This outcome supports an early evaluation which pointed to possible damaged reservoir at the lowest production horizon. Antares is likely to lift its production from its current ~ 700 BOEPD to over 1,100 BOEPD by the end of September as at least 4 new Permian wells come on stream and the Harrison well adds about 200 BOEPD. Antares remains a buy below $1 per share.

Otto Energy OEL

Recommendation: ***Otto remains a speculative buy from exploration action in 2012. Underlying oil and cash assets support a value of 4.2 cps while risked exploration adds 45 cps. Target share price is 17 cps.***

Capital Structure	m.	
Code	OEL	
Shares (est)	1135	m.
Performance Shares	10.0	m.
Options	48	m.
Total	1193	m.
Share Price	$0.087	
Market Cap $m.	99	

The data acquired from Otto's successful 2D seismic campaign over the Lampos and Lampos South prospects confirmed the presence of two sizeable reef structures. These prospects are located adjacent to the Calamangan Trough which is modelled to generate both oil and gas. Some direct hydrocarbon indicators were evident on the 2D seismic data, supporting this theory. Current "success case" estimates of oil initially in place in the combined structures range between 22 mmbbls and 713 mmbbls with a mean un-risked in place volume of 290 mmbbls. StockAnalysis models a discovery of 175 Bcf of gas plus 40 mmbbls of oil, which is 69 mmBOE, or 24% of mean estimated insitu resources.

Otto – Risked Exploration

Well	Equity	Prospect Size		POS	Discovery Value
		Pj	mmbbl	%	$/share
SC 55 Hawkeye	33.2%	100	190	25%	0.799
Cinco SC 55	33.2%	2100	74	25%	0.426
Nido targets SC 55	33.2%	0	200	14%	0.835
Lampos SC 69	39.5%	175	40	13%	0.311
SC 51 Duhat	40.0%	0	6	17%	0.036
Galoc North	18.3%	0	7	40%	0.016

Source: Strachan Corporate Pty Ltd

Discovery at Lampos would be worth about 31 cps to Otto, for its current 40% equity. Prospects are located in shallow water and might be drilled for less than $35 million. Given Otto's requirement for around $30 million for its share of Galoc oilfield redevelopment and appraisal drilling, it could seek to further farm-down its interests for drilling to reduce exploration risk.

Buru Sorts its Registry

Buru - Capital Structure	
Shares	182.8 m.
Options	24.3
	207.1 m.
Price	$ 0.75
Market cap	$ 137

Buru Valuation	$m	$ per Share
Oil Producing Field	6	$ 0.03
Yulleroo	168	$ 0.81
Valhalla	63	$ 0.30
Cash	47	$ 0.23
NSE Investment	4.4	$ 0.02
Alcoa loan	(22)	-$ 0.10
Un-issued Equity	8	$ 0.04
Corporate	(10)	-$ 0.05
	264	$ 1.28
Risked Exploration	73	$ 0.35
	337	$ 1.63
Price target	241	$ 1.16

Source: Strachan Corporate Pty Ltd

As predicted, AWE has sold its holding in Buru, opening up Buru's register to acquisitive players. The stock will now digest implications of its new structure, ahead of further funding initiatives late this year to support the 2012 drilling season.

Recent drilling at both Yulleroo and Valhalla indicates that these discoveries will prove to be commercial, albeit that they will need several appraisal wells and further engineering work to determine the best way to complete wells in a tight reservoir and shale targets. Most likely, the fields will require expensive horizontal drilling and multi-stage stimulations to deliver the large volumes of gas required to support a 450 kilometre, Great Northern pipeline to Dampier, linking the fields to gas markets further south.

StockAnalysis now calculates a value of $264 million for Buru's oil and gas discoveries, with a further $73 million of risked exploration upside, taking the total risked value to $1.63 per share, with a medium term price target of $1.16 per share for Buru.

Gold Sector Review

StockAnalysis has analysed 23 ASX listed gold producers as well as 16 exploration or near production companies. Where companies, such as Alkane, Havilah, Matsa and Oceanagold hold significant assets outside of their gold assets, StockAnalysis sets a value for those assets and subtracts that value from enterprise value, so that their EV relates only to gold assets.

Corporate valuation is attempted using the Baring method, subtracting total costs of operating, capital, taxation, hedging and royalties from revenue generated at today's gold price, applied to total proven gold Reserves. This free cash flow generation, when added to net cash, gives an undiscounted measure of expected future cash generation, which can be compared with current EV to get a feel for whether the stock is cheap or expensive. The method does not reveal an absolute value but enables us to rank companies and to see companies that might be very cheap and those that could be too expensive.

Clearly some allowance must be made for expected gold Reserve upgrade from Resource drilling, but the beauty of this method is that it is purely mathematical, taking out emotional attachment and management quality issues which can be overlain by a skilled and experienced analyst.

Amongst producers, Newcrest (NCM), Alacer (AQG), Kingsgate (KCN) and Regis (RRL) lead the field in market capitalisation, with Perseus (PRU) about to join them during the September quarter. Resolute and Oceanagold (OGC) stand ahead of the producer field in market size and then there is a rump of companies with market capitalisation of between $200 and $400 million, with only Northern Star (NST) looking like it can threaten that bunch in the near term. Noble (NMG) is included in the producers since it is about to commission its plant in Ghana, but contemporaries, such as Azumah (AZM) and PMI Gold (PVM) will aim to graduate into the top table by 2013.

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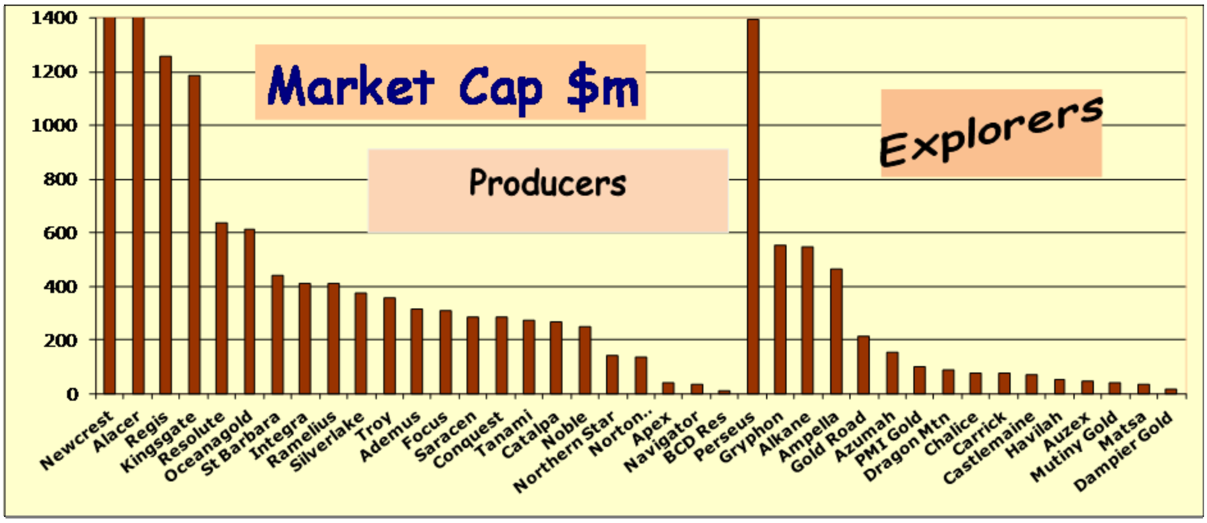
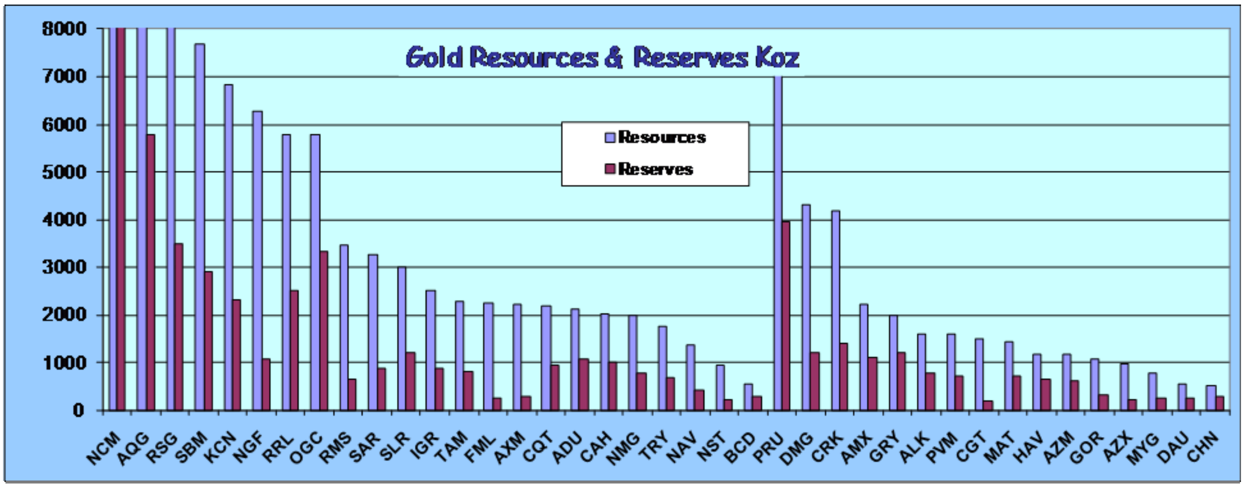


Source: ASX

Gryphon (GRY), Alkane (ALK) and Ampella (AMX) lead the charge by explorers, with market capitalisations of over $500 million but Alkane has more value for its Dubbo Zirconia, rare earths project than it does for gold. A long tail of gold explorers starts at about $100 million with Dragon Maintain (DMG) and finishes with probably the cheapest and most attractive explorer, Dampier Gold (DAU).

Amongst explorers, Carrick Gold (CRK) holds a high level of Resources, but uncertainty surrounds its Reserves, since a wholesale changeover of management brought a new focus on commercial development. Several producers hold Resources of around 6 million ounces or more, with reserves varying from 1 million ounces in the case of Norton to nearly 6 moz for Alacer, over 3 moz for Oceanagold and a whopping 81 moz for Newcrest.



Source: Company Announcements & Strachan Corporate Pty Ltd

Integra (IGR) has reported Reserves of only 480,000 ounces, but its successful drilling and the location and geometry of its ore Resources leads StockAnalysis to boost its Reserves to around 900 Koz from over 2.5 moz of Resources.

Ranking stocks on the basis of EV per ounce of Resources shows that most producers trade at about $100 to $200 per ounce. Low cost producers such as Newcrest, Troy (TRY), Integra, Alacer, Tanami (TAM) and Silverlake (SLR) are ranked ahead of most peers. Catalpa (CAH) scores more highly than it deserves to, largely as a result of a boost to EV from a merger proposal with Conquest (CQT). This proposal seems to have more to do with job security for Catalpa's Board and management, while liberating management at Conquest, than it does for the welfare of shareholders. A straight bid by St Barbara (SBM) for Catalpa promised to deliver more immediate benefits to Catalpa's shareholders, but this was inexplicably batted away by Catalpa's Board.

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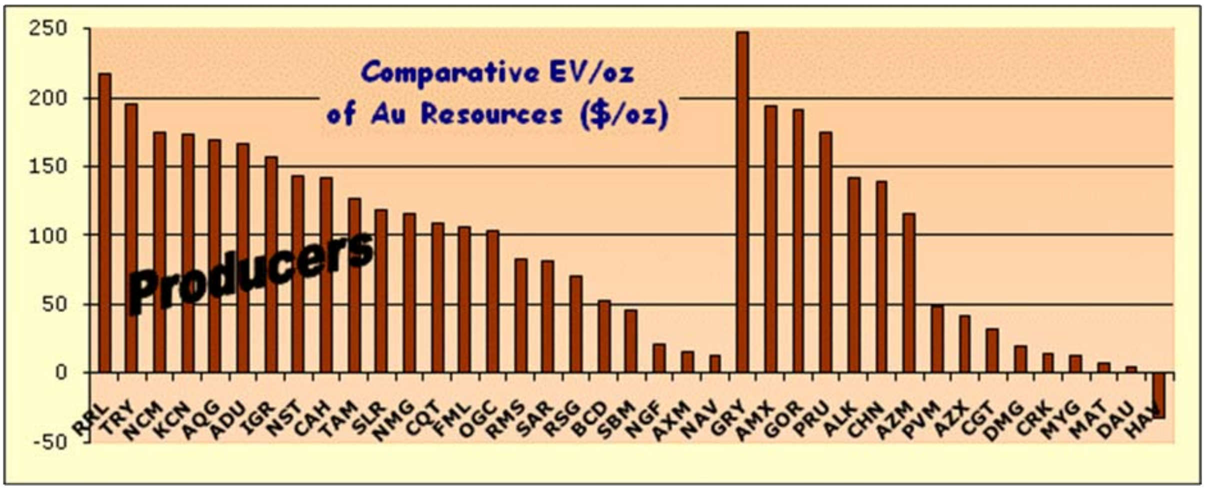
Struggling producers such as Navigator (NAV), Norton Goldfields (NGF) and Apex (AXM) are ranked lowlier than most exploration companies with proven Resources because they are high cost and not particularly cash flow positive.

Exploration companies with high grade gold Reserves, such as Gold Road (GOR), or which are nearing production, such as Perseus and some of the Ghana based companies can attract an EV/Resource rating equal to that of their producing cousins at around $100 to $200/oz. Most of the exploration tail trade with and EV/Resource of below $50/oz and it is from this list that real value opportunities can be found.

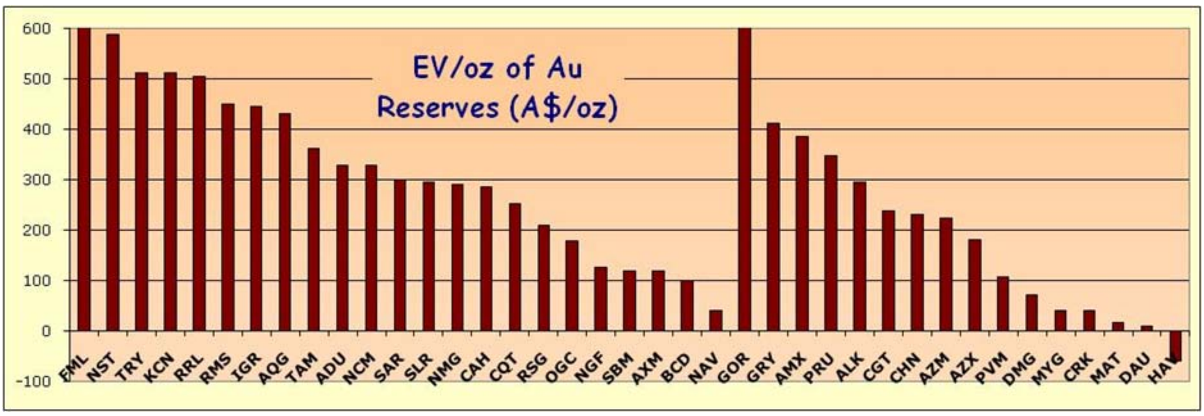


Source: Company Announcements & Strachan Corporate Pty Ltd

PMI Gold (PVM), which is well funded and working to re-establish production from the Obatan gold project, is essentially in the same position as Noble (NMG) and should be at least as highly rated as both Azumah (AZM) and NMG, offering a value proposition. Carrick looks like a sleeper, it must first establish sufficient Reserves at a commercial grade to sustain production, or look to merge with Norton Goldfields to extract synergies between their assets.

Mutiny Gold (MYG), with its high grade Deflector gold and copper project remains undervalued and underfunded. Recent drilling shows promise to double initial open pit mining Reserves, while high grade mineralisation at depth offers a long life, low cost operation with excellent exploration potential in this VMS field.

Producers generally attract an EV of $300 to $500 per ounce of gold in Reserve, which is about 20% to 33% of the current AUD gold price. Producers which are ranked below an EV/Resource ounce of $200 are usually higher cost, such as AXM, NAV and SBM, or have shorter life projects, such as OGC and BCD Resources.



Source: Company Announcements & Strachan Corporate Pty Ltd

EV/Reserve is a proxy for the net present value (NPV) of a company's gold Reserves. It is logical that a company's enterprise value should reflect the NPV of the gold it will produce over time. Low cost producers such as NST, TRY and KCN attract the highest ratings as might be expected, since their gold Reserves are of more value to shareholders.

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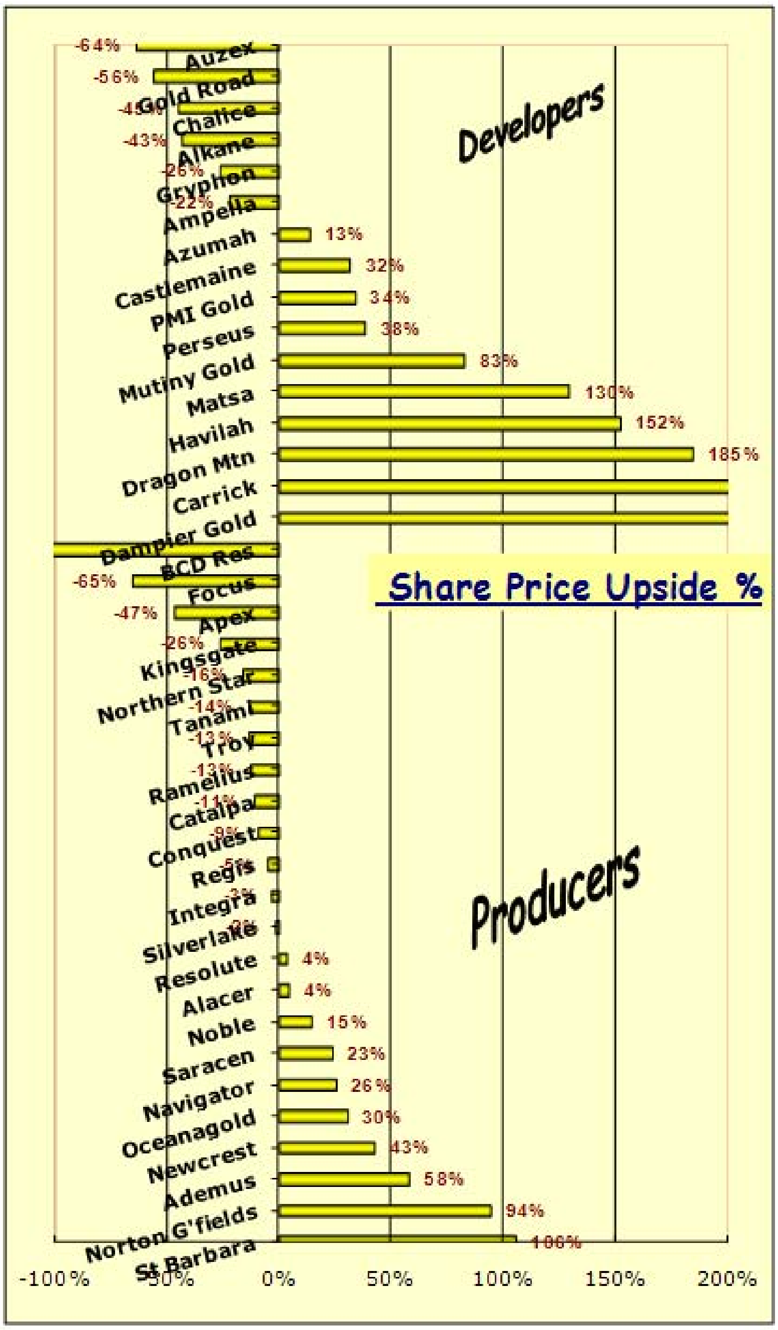
Since Havilah (HAV) has more value for its copper and other mineral assets, the company has a negative notional EV/gold Reserves. Likewise, Matsa (MAT) holds value for the magnetite hosting much of its gold mineralisation near Norseman. Dampier Gold looks very cheap. It has a deal with neighbouring Barrick Gold, which allows it to process ore through the Plutonic Mill. The company is now busy drilling out Reserves to add to its 250Koz and should be able to boost Resources beyond 553 Koz towards 1 moz and take reserves beyond 300 Koz, supporting an initial project life of 6 years at 50 Koz pa, while aiming to pay dividends from low cost gold production.

PMI Gold looks like it could achieve a threefold re-rating as it continues to drill and moves forward with a feasibility study at its Ghanaian project.



Source: Strachan Corporate Pty Ltd

A Baring analysis of the sector ranks stocks but does not provide definitive buy or sell recommendations on its own. This work indicates that amongst producers, St Barbara, Norton, Ademus, Newcrest, Oceanagold, Navigator, Saracen and Noble look undervalued, while BCD, Focus and Apex are most expensive. This analysis can be a little unfair since it gives no value to Resources and only considers Reserves. Focus (FML) and BCD have low Reserves and high Resources, which makes them look expensive. Northern Star (NST) has excellent exploration appeal and a strong cash flow with which to pursue new exploration and acquisitions. NST is as much about backing management as it is about current dynamics.

Some interest is generated with this approach to exploration companies. Dampier looks very cheap, as does Carrick, DMG and Havilah. Dragon Mountain may suffer from this discount because its assets are in China and its Board and management have not been very visible in financial markets.

PMI Gold and Castlemaine also look cheap, but Castlemaine has a short initial production profile of about 4 years and will need to show that it can continue to outline 50Koz pa of gold in Reserves.

Azumah also looks cheap on this ranking but Gold Road, which does not yet state any gold Reserves, has strong gold in Resources and is outlining high grade gold mineralisation at its Yamarna Greenstone Belt project. StockAnalysis has fudged a Reserve for Gold Road, but because much of the newly outlined mineralisation occurs in 1-3 metre thick shoots, further engineering work will be required to determine how much of this Resource can be economically mined and turned into Reserves. So basically, the Baring method may not fairly treat Gold Road at its current stage of exploration.

Operating margin shows a measure of corporate profitability. As expected, highly rated companies, like Newcrest, Alacer, Regis, Ramelius, Integra, Troy and Northern Star, all have very high margin business.

The place to look for buying opportunities is amongst the projected, high margin gold project developers. Perseus, Mutiny, Gryphon, Azumah and PMI Gold stand out as possible low cost entrants into the gold production ranks over the coming two years.

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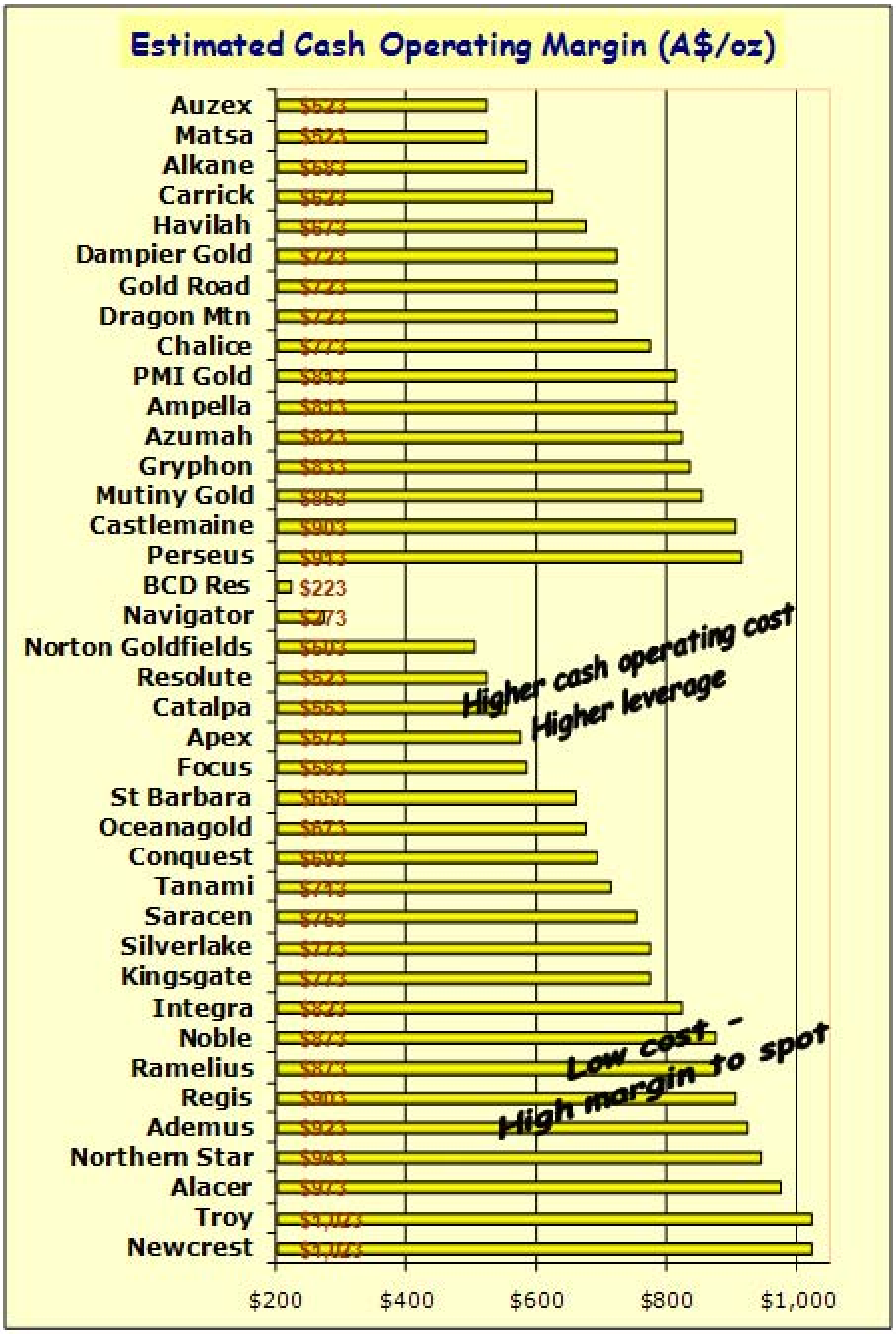

Source: Strachan Corporate Pty Ltd

StockAnalysis Selections

Producers Favourites

Newcrest – for its leading market position and huge Resources and exploration appeal

Noble – for its change of status to producer, low cost and strong exploration appeal around its existing Reserves.

Integra – for low cost and expanding gold production and its good exploration appeal.

Explorer Favourites

PMI Gold - for re-rating as it moves down the feasibility study route and its ongoing active drilling program, which should deliver constant news flow.

Dampier Gold – for results from ongoing exploration and dividend income from projected, low cost gold production.

Havilah – for an under-rated mix of gold copper, cobalt and magnetite assets

Mutiny Gold - for potential low cost gold production and regional exploration appeal.

In Summary

Producers								
Company	ASX Code	Net Cash $m.	price $/shr	EV $m.	Resources '000 oz	Mining Reserve '000 oz	Target Value $/share
Ademus	ADU	(36)	$0.700	351	2110	1,067	$1.11
Alacer	AQG	(25)	$ 8.92	2496	14700	5,800	$9.30
Apex	AXM	5	$0.007	34	2220	286	$0.00
BCD Res	BCD	(21)	$0.010	30	559	294	-$0.003
Catalpa	CAH	(16)	$1.520	287	2032	1,000	$1.35
Conquest	CQT	25	$0.485	236	2180	932	$0.44
Focus	FML	28	$0.068	239	2250	247	$0.024
Integra	IGR	12	$0.490	393	2500	884	$0.48
Kingsgate	KCN	(75)	$ 8.78	1186	6850	2,321	$6.48
Navigator	NAV	17	$0.025	18	1364	420	$0.03
Newcrest	NCM	(60)	$40.21	26626	152000	81,000	$57.43
Norton G'fields	NGF	(14)	$0.160	135	6267	1,062	$0.31
Noble	NMG	(28)	$ 0.64	230	1980	790	$0.73
Northern Star	NST	12	$ 0.48	133	927.5	226	$0.40
Oceanagold	OGC	(2)	$ 2.34	596	5780	3,350	$3.05
Ramelius	RMS	100	$ 1.40	288	3476	640	$1.22
Regis	RRL	(3)	$ 2.91	1262	5800	2,500	$2.77
Resolute	RSG	(100)	$ 1.36	731	10340	3,500	$1.41
Saracen	SAR	17	$0.575	266	3279	885	$0.71
St Barbara	SBM	95	$ 1.36	348	7700	2,900	$2.80
Silverlake	SLR	23	$ 2.11	354	3000	1,200	$2.07
Tanami	TAM	(17)	$ 1.05	290	2300	800	$0.90
Troy	TRY	(5)	$ 4.07	343	1760	670	$3.53

Explorers							
		Net Cash $m.	price $/shr	EV $m.	Resources '000 oz	Mining Reserve '000 oz	Target Value $/share
Alkane	ALK	18	$ 2.03	228	1610	773	$1.16
Ampella	AMX	34	$ 2.26	429	2220	1,110	$1.77
Azumah	AZM	18	$ 0.54	134	1165	600	$0.61
Auzex	AZX	3	$0.480	41	990	225	$0.17
Castlemaine	CGT	18	$0.047	48	1500	200	$0.062
Chalice	CHN	10	$ 0.32	70	504	302	$0.18
Carrick	CRK	19	$0.550	58	4190	1,400	$2.42
Dampier Gold	DAU	13	$ 0.29	3	553	250	$1.34
Dragon Mtn	DMG	1	$0.375	86	4300	1,200	$1.07
Gold Road	GOR	10	$0.675	202	1060	324	$0.299
Gryphon	GRY	50	$ 1.85	496	2000	1,200	$1.36
Havilah	HAV	3	$ 0.69	-38	1180	646	$1.74
Matsa	MAT	2	$0.265	11	1440	700	$0.609
Mutiny Gold	MYG	10	$0.100	10	779	250	$0.18
Perseus	PRU	16	$ 3.14	1377	7860	3,960	$4.35
PMI Gold	PVM	26	$ 0.52	77	1600	720	$0.70

Source: Strachan Corporate Pty Ltd

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