

# Stock Analysis

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By Peter Strachan

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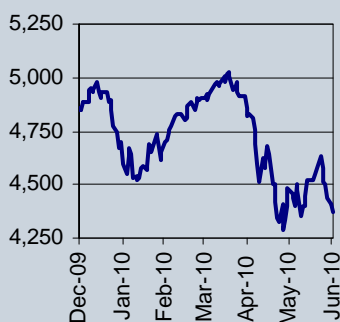
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## Indices & Prices

All Ordinaries	4,370.60
Energy Index	14,185.17
Brent AU\$/bbl	87.44
AUS\$/US\$	0.8481

As at Close June 29th

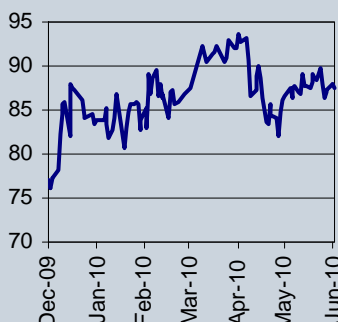
### All Ordinaries



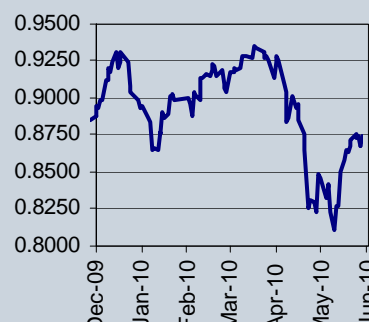
### S&P ASX 200 Energy Index



### Brent Crude Oil \$A/barrel



### A\$/US\$



## In this Issue

- Mining Tax:** Down to the wire ahead of early election
- Leaders' Style:** Bring your colleagues with you or risk getting the boot!
- Integra Mining:** Re-rated, remains a buy
- Green River Basin:** Entek, Sundance & Samson making waves  
Some speculative interest
- AWE:** Bargain stock. Buy
- CuDeco:** Large regional mineralisation potential. Buy
- ADX Energy:** Drilling time approaches

## Fair Tax on Miners

At the heart of calls for reform of mining taxation is a belief that royalty payments, which are currently applied like an additional cost of mining and are payable to Australian States even if a mining operation is losing money, do nothing to encourage investment. The argument goes that extraction of non-renewable resources should attract a special payment for the right to dig up and take away, while profits on this activity should then be subject to the normal corporate taxation. Currently, royalty payments are a complete mishmash of different rates and conditions in an industry where it is now acknowledged that one size does not fit all. As demonstrated last week, the current system of royalties and taxation results in a total payment of between 37% and 40% of hard-rock mining company pre-tax profits to various governments in Australia. Also, it is clear that higher margin operations pay a lower overall rate of taxation/royalties, since the impact of royalty on the final percentage is diluted as the pre-tax margin, which is subject to the 30% corporate rate, expands.

**If the government is going to get hung-up on percentage payments, they should all emigrate to Cuba where payment is 100% of very little, however if they are more focused on achieving the largest dollar value to the public purse over time, consistent with making Australian mining attractive to investment, then an optimal taxation level must be struck.**

The quest for a fairer taxation system for Australia's mining sector has a few chapters yet to be written and the outcome is far from clear. While there may be a new mood of optimism in Canberra surrounding proposed taxation changes, readers should remember that the new PM, Julia Gillard, is an unreconstructed wealth distributor, who cut her teeth in the world of big business as a former emissary of the downtrodden, during time spent as a partner and industrial law advocate at the law firm and formidable class action specialist, **Slater and Gordon**.

(Continued on page 2)

These are not great credentials for economic reform, especially as she is joined in this task by a Treasurer who strongly defended his pre-emptive RSPT model and who just does not understand the processes undertaken by investors and business operators. Wayne Swan is clearly fed data by his staff, but he has no idea what that data means.

Meanwhile, the new PM's CV clearly shows that while she has a pleasant personality and a nice smile, Julia Gillard is no friend of business. Negotiations with the mining industry are likely to be tortuous, especially as folks from the wealth distribution side of the ledger seem to have little understanding of how business is financed and how wealth is created in the first instance.

The reality of this policy move is that an election will be called for late August, once a deal on mining taxation has been agreed and after Kevin Rudd has had time for a two week holiday in the northern hemisphere somewhere. That election will now, most likely, be won by the current Labor government, so the mining industry will be hell bent on cutting a deal that is the best it can get, prior to having something worse imposed by a Green/Labor cartel in a post election environment.

StockAnalysis suggests that a new tax format to replace royalties should be the larger amount of either:

- ⇒ a minimum payment, equal to 5% of the mined value of any mineral in an unprocessed form, after allowance for payback of mine capital invested;
- ⇒ or 25% of any amount at the EBITDA level, above a 12% return on total capital invested over time, prior to a corporate taxation rate of 28% on pre-tax income.

The finer points can be debated, such as should the uplift rate be 10% or 15% or should the rent tax rate be 25% or 30%, but this sort of format would replace the current royalty system, provide incentive for capital spending because miners would be able to achieve payback of capital spent prior to hitting the minimum payment threshold for royalty/resource rent tax and should profits rise to a very high level, such that a 12% return on capital was achieved, then part of that additional profit could be skimmed from the top at the rate of 25% of EBITDA, replacing royalty payments prior to the imposition of corporate tax at a lower rate than is current. Recognition by such a tax system of a need to achieve financial payback and a modest return on capital, prior to hitting the resource tax threshold would of course enable the imposition of a higher overall rate of taxation payment by mining operations than is currently levied. Under the StockAnalysis proposed scheme, marginal projects would end up paying much the same dollar amount as they do now, with the added benefit of an effective royalty/RSPT holiday on early cash flows, while high margin operations would be burdened with higher overall rates and dollar amounts going to the Treasury, but would also get a break on 'royalty' payments from early cash flow. With tweaks around the edges, this system would also be acceptable retrospectively.

The big winners out of all of this will be accountants, while the losers will be mining analysts like me, who will have to try to analyse projects with complex tax takes!

## *Lessons & Leaders from Chairman Rudd*

Our recently departed 'Dear Leader' Chairman Kevin Rudd and his predecessor John Howard both learnt that if you start ruling the country on your own, with no reference to your colleagues, you will soon lose the backing of your colleagues and the electorate at large. We live in a democracy. Anyone who rules by decree and does not consult with the ruling executive team, let alone stakeholders in the community, is bound to lose touch with the issues and lose authority with his or her political party and the electorate.

StockAnalysis detects a possible job opportunity for Kev, working with his mate Andrew Forrest at Fortescue. Mr Rudd speaks Mandarin and reportedly knows a bit about rodent copulation, which should fit him well for negotiating iron ore sales in China. Alternatively, he could be pensioned off to the UN, where he will feel more comfortable, strutting the global stage. What will not happen is that he goes and gets

a real job, where he has to create wealth, because he would not know how to do this and has no experience in this area.

## Integra Mining – Update (IGR)

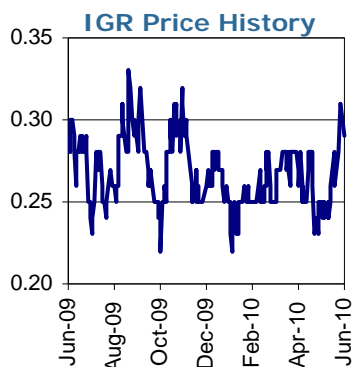
### IGR - Capital Structure

Shares	755.8 m.
Options	19.2 m. Av 34 cts
	<u>774.9 m.</u>
Cash (est)	\$ 20 m.
Price	\$ 0.285 per share
Market Cap'tln	\$ 215 m.
Market Cap/oz	\$ 120 per oz Resource
Est M' cap/oz	\$ 539 per oz Reserve

**Recommendation: BUY.** *Integra's target value has risen to 42 cps on the back of its expanding open pit and underground gold Resources and a rising gold price.*

*Integra is a low risk, new gold miner, backed by a solid group of skilled managers. StockAnalysis believes that the company will embark on a growth journey in 2011, fuelled by an operating margin, estimated to approach \$120 million over its first two years of operation.*

Integra Mining is moving towards commissioning its Randalls Gold Project, located adjacent to the Salt Creek open pit operation approximately 45 kilometres South East of Kalgoorlie. The plant will begin to turnover in September, initially processing 800Ktpa of ore and ramping up to an annualised production rate of 90Koz Au pa over the first 6 quarters of operation. Early mill feed will be sourced from the high-grade Salt Creek and Maxwells deposits, averaging over 3.5 g/t gold.



StockAnalysis assumes that development and mining of underground ore below the Maxwells and Cock-Eye Bob deposits, averaging +6.5 g/t Au will commence in FY 2013, at which time the plant's capacity will also be enhanced to process 1.2 mt pa of ore. Integra's ongoing drilling is also likely to establish deeper pits on existing deposits and new sources of open pit ore within trucking distance from its Randalls Plant, so that a 10 year planning horizon will be established for an operation to produce over 1.1 million ounces of gold from its current Resource base of over 1.8 moz of gold.

The company has hedged ~91,900 ounces of gold at a price of A\$1,359/oz, on which price it is currently down about \$2.8 million at a current gold price of around A\$1,390/oz. Hedging may have been required by banking finance providers but, in reality, Integra's cash cost of production will be in the lowest cost half of global producers and should not require hedging protection to support its debt commitment.

Recent drilling below Maxwells supports rapid development of low cost underground mining. Drilling results from Maxwells Deep include:

- 2.95 metres at 39.29 g/t gold from 221 metres drill depth**
- 4.6 metres at 21.36 g/t gold from 189 metres drill depth**
- 2.7 metres at 27.87 g/t gold from 120 metres drill depth**
- 1.45 metres at 32.01 g/t gold from 227 metres drill depth**
- 5.6 metres at 8.03 g/t gold from 139 metres drill depth**
- 3.35 metres at 12.75 g/t gold from 150 metres drill depth**

**2.45 metres at 17.06 g/t gold from 180 metres drill depth**

	Phase I Salt Ck	Phase I & II
Gold Production Koz	281	1171
Mine Life Years	4	10
Total Capex \$m.	67	136
Ore Processed Kt pa	800	1043
Average grade g/t Au	3.13	3.72
Net Cash Flow \$m	80	565
Post tax NPV \$m @ 8% pa	\$53	\$324
NPV/oz \$/oz	\$189	\$276
NPV per share		\$0.42
Average cash cost \$/oz	\$ 572	\$ 603
Gold Price \$A/oz	\$ 1,184	\$ 1,184

Post 2013, an expanded Randalls mill will be able to process open pit ore with a grade over 1.9 g/t from within a 30 kilometre radius and will blend this mineralisation with ore from underground operations, grading at least 6 g/t and up to 10 g/t of gold.

StockAnalysis believes that Integra will use its initial strong cash flow to first repay project debt and it may also turn its eyes to the acquisition of neighbouring companies, such as Carrick Gold.

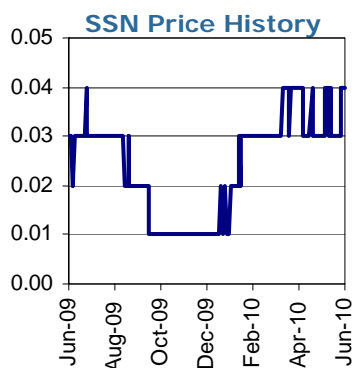
The company has recently been re-rated, following revelations of higher expectations for initial gold production. StockAnalysis believes that further re-rating will occur when updated Resources and Reserves are announced and also when its plant

is successfully commissioned and cash flow is established during September.

## Colorado & Montana – New US Petroleum Hotspots SAMSON, ENTEK & SUNDANCE ENERGY

Investors continue to focus on USA resource plays while the issues facing deep water projects in the Gulf of Mexico are likely to increase the attractiveness of terrestrial developments.

StockAnalysis has covered developments by ASX listed companies on the Eagle Ford Shale play, which has come from nowhere in the space of just two years. Mineral rights were able to be bought for ~US\$250 an acre in 2007 but the price is now US\$10,000 per acre and AWE's bid for Adelphi set a price of about US\$21,750/acre for a producing project. Along the Eagle Ford Shale play there are now about 40 rigs busily drilling and the number is set to increase by at least 50% within the next 12 months. Likewise, the Niobrara Formation in Colorado's DJ Basin is coming in for more attention as horizontal drilling lifts productivity from this prolific formation. The formula always seems to be the same for these resource plays, no matter how deep or prolific. If you spend a dollar, you get three back. In the Eagle Ford, spending US\$6 million will generate about \$15 million of discounted cash flow from production of about 400,000 BOE, while in the Niobrara, spending \$3.5 million on a horizontal fraced well, generates an NPV of about US\$3.1 million from production of about 290,000 BOE.



Long out of favour, US focused oil & gas developer **Samson Oil & Gas (SSN)** has pulled off a coup which has the potential to get its bankers, Macquarie off its back. Samson is proposing to sell 24,166 acres of its Green River Basin permits for somewhere between US\$61 and \$79 million, or about A\$3,000 per acre. Samson would retain about 16,300 acres which, on this metric, would have a value of about A\$49 million. The combined value of this deal, should it proceed, less the repayment of about \$13 million of Samson's debt to Macquarie, should leave the company with assets notionally worth about 6.9 cps.

Samson has been struggling for relevance over the past few years. The company has blown out its shares on issue to around 1,557 million and holds debt, net of cash following a recent issue at 1.2 cents per share, of about \$10 million. Net income each quarter of around \$1 million is just enough to service the debt and pay for a nice lifestyle for the company's MD in Denver, but leaves little for shareholder wealth creation.

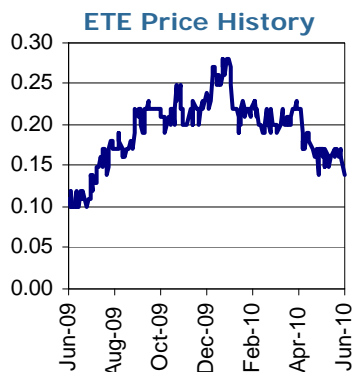
Last time Samson was left with a war chest of funds, it managed to blow the lot with little to show. There is no reason to believe that Samson's net \$60 million will do any more, which is why the company now trades at notional cash asset backing of 3.9 cps.



**Sundance Energy (SEA)** recently hosted a tour of its projects in the Williston Basin and the DJ Basin, which may explain why the stock has recovered from 13 to 17 cents. Sundance currently generates revenue of about \$7 million pa, the net income from which is insufficient to maintain the company with minimal ongoing shareholder support, but an aggressive drilling commitment and the sight of brokers crawling over its permits is a sure signal that an issue is in the wings. The company has a market capitalisation of \$38 million representing just \$266 per acre for its permit holdings. If Sundance were to close up shop and sell all its assets, StockAnalysis believes that it could return at least 35 cents per share (cps) to shareholders, based on a modest value for its 143,000 acres of permits, many of which would have values of over \$3,000 per acre, especially the 8,800 acres over the Bakken Shale in North Dakota and also its 51,000 acres over its DJ Basin permits. On success, Sundance should be able to show a value of over 50 cps to the market, without further short term dilution, relying on an estimated \$7 million of cash and an ongoing operating cash surplus.

Sundance has outlined a plan to participate in the drilling of up to 35 wells on its permits by December 2010, so as to boost its oil reserves, thus unlocking value of over \$76 million for proven, developed and producing petroleum.

(Continued on page 5)



Sundance has a track record of buying out-of-favour permits, proving up petroleum reserves and selling out or down for a handsome return on investment. While this is a great way to stay alive corporately, it delivers a lumpy cash flow existence and ultimately only rewards shareholders who are prepared to trade the stock for news on successful asset sales, which boost underlying cash assets. While Sundance trades at a huge discount to its underlying value base, the only way StockAnalysis could recommend the stock as a buy is if its Board declared that it would return a large proportion of the capital generated by its asset trading activity to shareholders. In the absence of any other reward for shareholders, Sundance is at best a speculative buy for progress on its Bakken Shale projects and Niobrara formation drilling.

**Entek (ETE)** is diversifying its interests, using its cash flow from GoM gas production to expand into the Green River Basin on the borders of Colorado & Wyoming. Entek is earning a 55% WI in over 66,000 acres, developing known tight conventional sands, coal bed methane and Niobrara shale plays.

Location map



Source: Entek

Entek is managing its funding closely, but still may need additional support.

## AWE at Bargain Levels (AWE)

**Recommendation:** *AWE remains a buy with a target valuation of around \$3.85 per share. The company has long term production assets with a pipeline of development opportunities and a strong exploration culture.*

AWE Capital Structure	
Shares	522 m.
Options	17 m.
Share Price	\$ 1.73
Market Cap'n	\$ 903 m.
Net cash (est)	\$ 110 m.



AWE is looking very cheap. StockAnalysis assesses a valuation for the stock of \$3.85 per share. The company has had some exploration successes, despite dusters on its first two Taranaki Basin wells and continues to unfold its 2010 drilling programme. AWE predicts that new production from onshore Perth Basin, Yemen, onshore Texas Gulf Coast and the Bass Basin, along with expanded equity in projects, will maintain its annual production at around 6 to 7 million barrels a day for the remainder of this decade. Production from the Eagle Ford Shale will add to these projections.

AWE has increased its holding in the BassGas project from 42.5% to 57.5%. This project will go on delivering to the company about 6.7 Bcf of gas and associated LPGs, plus about 0.5 million barrels of oil for many years. BassGas project is likely to be upgraded, linking in development of the nearby Trefoil and newly discovered Rockhopper fields post 2014, to ensure a project life extending out beyond 2020.

In the Otway Basin, the 25% held Casino project is under no pressure to continue to develop any of the many prospects which remain to be drilled. Low gas prices in SE Australia mean that the project can tick along for several years until the gas

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price environment improves before more capital needs to be spent. In the short term, spot sales of gas from BassGas & Casino are likely to achieve higher prices during winter's peak demand, while Longtom production is offline, ahead of installation of a mercury filter.

The Tui field has now produced about 30 million barrels of oil and has about 20 million barrels of remaining oil reserves. Drilling at the adjacent Kahu prospect holds potential for a Tui look-a-like. Even a 12 million barrel find here would significantly boost AWE's value by about 28 cps. Regionally in New Zealand, AWE is about to test a Maari field look-a-like at Tuatara, where 100 million barrels is possible. Discovery of 75 mmbbls at this play would be worth \$2 per share to AWE.

In Yemen, AWE has made one oil discovery at Al Meashar, where oil was tested at up to 600 BOPD from fractured basement. The project is now trying to replicate its success at Jebel Al Milh, where a +25 million barrel target is being tested. Success would add about 10 cps to AWE's value and could form the basis of a multi-field development.

In the Perth Basin, AWE and Origin are preparing to connect gas to the grid from two wells at the Redback discovery and will move on to drill the Wolf prospect. These small gas fields will be highly profitable for AWE, over the next two to three years. AWE is a 33% partner in the permit. The company maintains oil production from onshore and offshore, while continuing to explore the shale oil & gas potential of three, thick shale sequences in the basin. The offshore Cliff Head oilfield could be boosted by discovery at nearby prospects. Drilling in the area is always fraught, since weather delays can add significantly to costs, so it is best to drill in late autumn when the winds are more favourable.

In Indonesia, AWE is drilling on the Liyun prospect, which has potential for 100 million barrels of oil in a pinnacle reef formation. A 75 mmbbl discovery would be worth 30 cps for AWE's 42.5% interest. The company has also made a gas discovery which could form the basis of a development project in that energy hungry nation.

AWE's recent purchase of an expanded interest in Adelphi, looks like being a total takeover, unless there are a significant minority who hold out for a greenmail position. Adelphi's 10% interest in the Sugarloaf project in Texas opens a new business opportunity for AWE, which could be followed by more acquisitions in the sector. AWE has exposed itself to a possible 70 and up to 130 Bcfe of petroleum production in the USA by this move on Adelphi.

<b>AWE Valuation</b>	<b>\$m</b>	<b>\$ ps</b>	<b>%</b>
<b>BassGas</b>	544	\$ 1.04	27%
<b>Bass Exploration</b>	392	\$ 0.75	20%
<b>Perth Basin</b>	138	\$ 0.27	7%
<b>Otway Basin</b>	98	\$ 0.19	5%
<b>EF Shale</b>	225	\$ 0.43	11%
<b>NZ</b>	542	\$ 1.04	27%
<b>Net Cash (est)</b>	110	\$ 0.21	5%
<b>Corporate</b>	- 40	-\$ 0.08	-2%
<b>Total</b>	<b>2,009</b>	<b>\$ 3.85</b>	<b>100%</b>

Source: Strachan Corporate Pty Ltd

Following its purchase of an extra 15% interest in BassGas (\$80 million), expanded ownership of Adelphi (\$47 million) and spending on exploration, AWE's cash position is estimated to have fallen to around \$110 million, providing a strong platform to support further growth of its business.

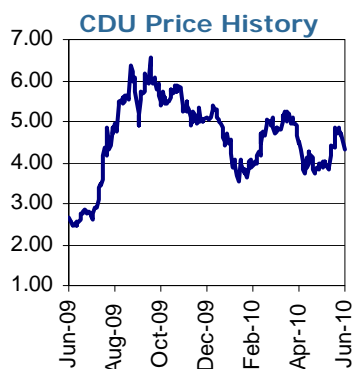
## CuDeco About to Show & Tell (CDU)

### HOW BIG DOES IT THINK IT IS?

**Recommendation:** *CuDeco has discovered a world class copper, cobalt and gold deposit with potential for commercial selenium and uranium content. The company is likely to see a share price upgrade once its ore Resource situation is revealed.*

*Further clarity of finding and off-take arrangements will further de-risk the project and lift market values towards an initial StockAnalysis target of around \$6 per share. Ultimately, StockAnalysis sees potential for a long life, open pit and underground mining operation at Rocklands, which must become a takeover target with a value of over \$1 billion.*

Capital Structure		m.
Shares		137.3
Options		6.25 @ Av. \$5.18
Share Price		\$ 4.23
Market Cap	\$m.	581
Cash (est)		\$ 40 m.



CuDeco is within weeks of announcing updated ore Reserves and Resources at its Rocklands project in Northern Queensland. Following an extensive period of drilling, along with metallurgical and engineering studies, the company is near to finalising its project parameters. In addition, the company hopes to be able to give a global mineralisation target, which will capture recent exploration success.

StockAnalysis assumes that initial Resources will amount to about 52 million tonnes of ore grading 1.75% Cu, 0.05% Co and 0.35 g/t Au, containing Reserves of at least 32 million tonnes at higher overall grades of over 2.1% Cu.

StockAnalysis models a 3 million tpa project assuming that mining starts on oxide feed in FY 2012, followed by establishment of a sulphide ore circuit in FY 2014. The company has said that it plans to produce 90,000 tpa of copper in concentrate, but StockAnalysis models a more modest 70,000 tpa of copper, plus 2,700 tpa of cobalt and 25,000 oz pa of gold contained in concentrate. Given the bonanza grades of copper and gold intersected within the Las Minerale main zone, early mined grades are likely to be spectacular, but a 3 mt pa plant, combined with a need to mine the deposit systematically, will inevitably result in more modest average grades, though StockAnalysis assumes early mill feed grading 2.7% Cu for the first three years of operation.

#### StockAnalysis Estimate - Rocklands Resource

Element	Estimated Grade	Contained Metal	Units	Price	ISV A\$m
Copper	1.75%	0.910	m tonne	\$ 7,602	6918
Cobalt	0.050%	57.3	m lb	\$ 25	1449
Gold	0.35	585	Koz	\$ 1,425	834
					<u>9201</u>

Target Value	% ISV	\$m	\$/share
	5%	460	\$ 3.35
	8%	736	\$ 5.36

Source: Strachan Corporate  
ISV/t \$ 177

Source: Strachan Corporate Pty Ltd

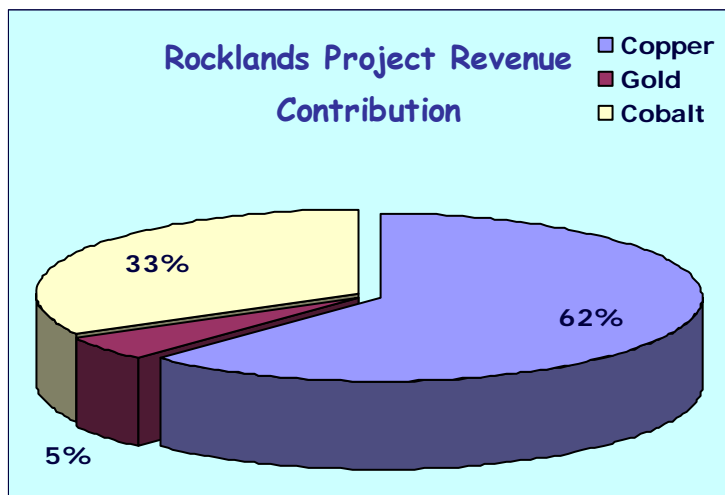
CDU - Valuation Asset	\$m.	\$/share		
		Base	Stretch	Low
Rocklands	969	\$ 6.75	\$ 7.79	\$ 3.35
Net Cash (est)	40	\$ 0.28	\$ 0.28	\$ 0.29
Unissued Equity	32	\$ 0.23	\$ 0.23	\$ 0.24
Debt (est)	(200)	-\$ 1.39	-\$ 1.39	\$ -
Corporate	(20)	-\$ 0.14	-\$ 0.14	-\$ 0.15
<b>Total</b>	<b>821</b>	<b>\$ 5.72</b>	<b>\$ 6.76</b>	<b>\$ 3.73</b>

Source: Strachan Corporate Pty Ltd

The project can be valued in several ways. The most conventional method involves calculation of the project's net present value (NPV) of discounted free cash flows estimated for each year, and then subtracting any debt which will be required to achieve this result. Alternatively, it can be valued by a rule of thumb, as a multiple of the estimated Resource's insitu value (ISV) and finally the company can be valued by capitalising estimated earnings, such as by applying a price to earnings ratio to an estimate of after tax profits.

Applying a 5% multiple of the ISV of the estimated Rocklands Resource, produces what can be considered to be a rock bottom base target value of \$3.73 per share for CuDeco, while 8% of the ISV would equate to a target project value of \$5.36 per share. Given that we do have an accurate Resource estimate at this stage; care must be used when applying such a rule of thumb.

(Continued on page 8)



Source: Strachan Corporate Pty Ltd

StockAnalysis' mine model delivers an NPV at a 10% discount rate of \$1.1 billion or \$7.79 per share, which equates to a value target of \$6.76 per share after debt and corporate charges. Capitalising estimated first year earnings with a multiple of 8 times, delivers a value target of \$7.22 per share which is in line with StockAnalysis' stretch value target.

The project will be dominated by returns from copper, but both cobalt and gold will play a significant part in its commercial success. CuDeco is likely to pursue an off-take and funding arrangement with Asian smelters to fund development, which may involve some equity input from a cornerstone corporate.

On balance, because of the uncertainty surrounding ultimate Resource estimates, StockAnalysis is inclined to believe that the company's ultimate value will be well in excess of \$8 per share.

## ADX Energy Update

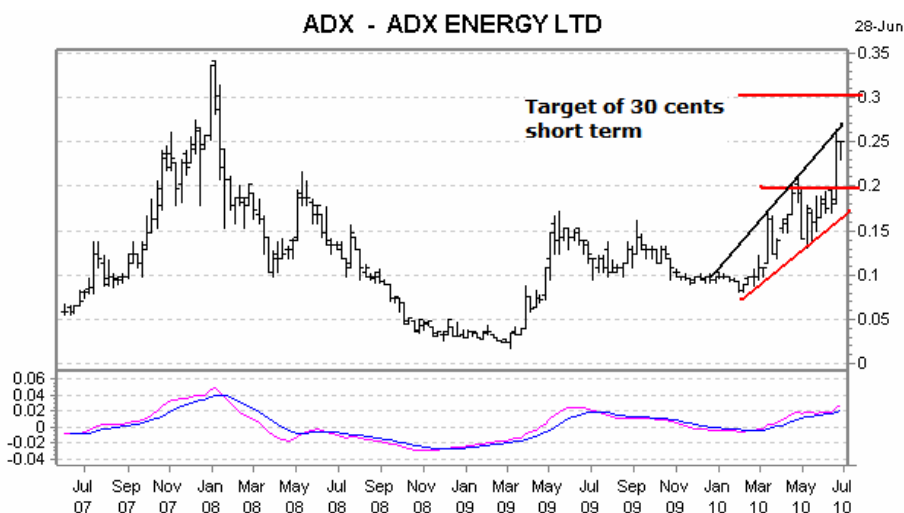
Drilling of the Lambouka prospect in the Mediterranean Sea is scheduled to get underway by mid-July. The shallow Birsa oil prospect at 1,500 meters is likely to be intersected in the last week of July and a deeper test of possible gas in the Abiod carbonates at 2,380 metres by early August.

Leverage/share	ADX	PAA	CAV	GPX	XST
Lambouka	853%	668%	948%	140%	1528%

Source: Strachan Corporate Pty Ltd

All companies involved in the well, with the exception of Gulfsands and Xstate which remains suspended, have seen share price strength in the run up to spud date in mid-July.

ADX broke out of a short-term triangle pattern, setting a short-term trading target of 28-30 cents. This will probably be where ADX rests during drilling. Success could see ADX lift towards \$1 per share, while drilling a duster will see the stock retreat to 14 cents ahead of drilling on its onshore prospect, later in the year.



## SEAAOC – South East Asia Offshore Conference 2010

I will be speaking at the upcoming SEAAOC—South East Asia Australia Offshore Conference 2010— in Darwin on 22-24 September 2010. My presentation will focus on peak oil and gas (Where are we at?) and petroleum investment (How attractive is Australia, who are the upcoming players, and why?).



For more information, click [here](#).

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