StockAnalysis

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May 27th 2009
Issue 9, Vol 6

By Peter Strachan

This Week

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 May 2009, we would like to congratulate our lucky winner Brian Gordon of Kalamunda, WA. A case of mixed wines is on the way ... enjoy!

Indices & Prices	
All Ordinaries	3,781.60
Energy Index	14,485.20
Brent AU$/bbl	76.89
AUS$/US$	0.7850
As at Close May 26th	

In this Issue

Market Moves — Hold fire on Neptune Marine, cheaper prices to come!

Commodities riding for a fall, oil & copper could fall 15-20% rapidly before more sustained price action into 2010.

Obama's new auto emissions standards boost Galaxy and others in that space, ACE & ATJ.

Rest of the World in Deep Recession, but earnings outlook will drive the markets.

Trading Techniques — A few tips for beginners

Global Health Calls for the Doctor — New issue

Alkane Resources — Undervalued gold developer

Market Moves

Following last week's report on **Neptune Marine (NMS)**, which said that the stock had value below 80 cents but downside support at 40 cents, it is important to note that the stock appears to have now begun a short term reversal of form on the market. NMS looks like it could trade down to 44/45 cents over the coming weeks, at which point it will represent a better entrance price.

Commodities riding for a fall: Recent data out of the USA's housing industry, combined with ongoing slow economic growth numbers coming out of Europe and Japan, point to a false dawn for commodity prices. High copper and oil prices could easily retrace much of their recent gains and a 20% fall over a couple of days is possible and would certainly create better opportunities for long-term accumulation.

Construction of houses and flats in the USA continues to fall from a peak of around 2 million dwelling units pa in late 2005 to around 400,000 pa currently. There is a lot of copper and aluminium used in house construction. Activity numbers out of the USA, combined with similar weak news from remaining OEDC nations, should act as a warning signal that the current price of copper, which has risen from around US$1.35/lb to US$2.10/lb, is not sustainable. Aluminium inventories have risen to an historically high 10 weeks of consumption, but copper inventories appear low, only because the Chinese Government is buying the metal as a way to diversify its financial reserve base away from holding US dollars. Copper is easier to store than aluminium, since it is less likely to corrode, it is worth about three times as much per pound as aluminium and takes up one third of the space, since it is three times as dense as aluminium.

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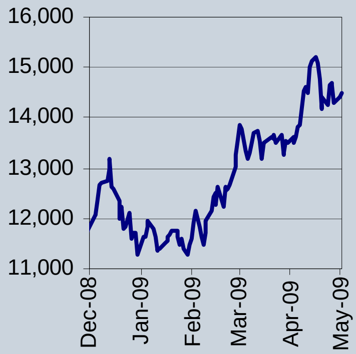
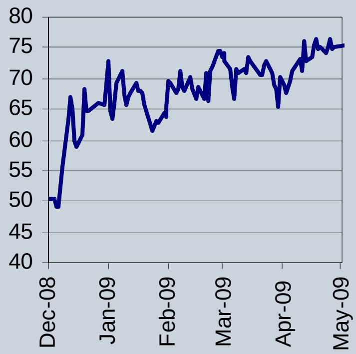
All Ordinaries

S&P ASX 200 Energy Index



Brent Crude Oil $A/barrel



A$/US$

Meanwhile, the oil market is awash with the stuff. StockAnalysis continues to predict an oil price of US$65/bbl during H2 2009, but the trajectory will not be straight up. Supply still outweighs demand and inventory levels are high. Falling non-OPEC oil production during the September quarter will bring the market back into balance and gradually reduce inventories, but this would only allow OPEC to relax its current tight restrictions. The oil price could easily fall $10/bbl over 3 or 4 days trading before regaining composure. Trading opportunities will abound!

The Obama administration's move to cut auto emissions has had a big impact on stocks looking to alternative fuels and auto technologies. Prime amongst these is **Galaxy Resources** (GXY), which is moving towards supplying the world's lithium-ion battery makers. Others include cash strapped natural gas engine system producer, **Advanced Engine Components** (ACE) and equally impoverished turbocharger maker **Automotive Technology Group** (ATJ) whose engine technologies would go a long way to close the emissions gap.

Rest of the World in Deep Recession: With the benefit of hindsight, it is clear that the gut wrenching stock market collapse, which occurred globally over just two months during the December quarter of 2008, during which the All Ords Index plummeted 32% from 5,000 to 3,400 points, was in fact predictive of massive GDP falls seen around the world during the March 2009 quarter. Japan's economy fell by 4%, equal to an annualised rate of over 12%, while the UK and Germany had similar falls.

All of this is ancient history of course. Once corporate solvency is resolved, the stock market will be more interested in how earnings will respond during early 2010. The jury is out on just what is going on in China, where March quarter GDP numbers came out just 15 days after the end of the period, raising eyebrows about the accuracy of those calculations. However, there can be no doubt that China is back in action with shiploads of iron ore and other goods now making their way to its shores and boosting the Baltic Dry Index.

Trading Techniques

Triggers & Traps to Watch For

How to select trading opportunities

A number of readers have asked for an explanation of how to go about finding **share trading opportunities** and what criteria StockAnalysis might use to select stocks that show potential to move rapidly in the share market. This follows strong performances in the market by a few stocks mentioned earlier this year, including gold mine developer **Integra**, lithium project developer **Galaxy**, oil producer **Roc Oil** and junior oil company **Mosaic**. While the question is easy to formulate, the answer comes with 26 years of experience in capital markets and is difficult to distil into a short report such as this. There are libraries of books devoted to the topic and there are many ways of getting started.

Firstly, let me say that if I knew all the answers, I would be sending this report to you from a villa in the south of France, where I would be sitting with my feet in a bucket of champagne! While I am not holding myself out as some sort of market guru, I think I understand enough of the techniques used to be able to give a reasonable summary.

No-one trades stock profitably over the long term

The first thing to understand is that only liars consistently make money trading in the market. Sure, some folks have a good year or two, but the market is a great leveller. After a few wins, traders usually become overly confident of their skills, forget to be humble in the face of the market and most likely lose the lot. Inevitably, traders sell too early, hold their dog stocks and sell their winners while getting too emotionally involved with their investments. The real winners in stock markets are those who search out value which is not recognised by the market and invest for the long term. Investors like Warren Buffett and Kerr Neilson show that long-term outperformance of the market is possible.

Best to take a long-term investment approach

There are two broad categories of investors. It's a sort of rich man, poor man divide. The poor man wants to 'work the market' to his advantage to make money, but inevitably ends up converting his hard won capital into brokerage. The **market will not be worked!** It has its own agenda, as we have witnessed over the past 18 months.

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Traders who may have made a few bob on some speculative iron ore or uranium play during 2006 and 2007 have almost certainly given all their gains back to the market over the past two years. Traders often tend to make an investment and then sit around trying to urge the shares to move higher. They will trade momentum, buying a stock that is rising and chasing stocks to high prices, which inevitably leads to a rapid price fall. Some resort to internet chat rooms in an effort to create a bit of buy-side interest in their favourite stock, in the hope that others will buy and push up the share price.

Patient stock selection required

A patient investor or rich man does not need the market to make money. He is willing to wait and let the market work for him. When he sees exceptional value he acts, but he does not have to trade incessantly. So the first rule is to let the market work for you and don't ever try to second guess the market. If there is a company whose business model looks good, watch and wait until a buying opportunity arises. If it does not arrive, feel no stress, as there is always another opportunity in the market, just around the corner.

The best trading situations can be found in stocks that are already trading at a discount to fair value. The problem here is to determine just where fair value sits. This can be value per share, relating to the price which a company's assets could be sold if there was a willing buyer. If there is no willing buyer, then the value which might accrue to a patient seller can also be estimated.

Reasons for short-term share price movements include:

1. Possible takeover: when another company or investor sees underlying or synergistic value.
2. Upcoming exploration which has potential to add value, as in the case of **Otto Energy**, **Global Petroleum's** Ugandan well or **Integra's** gold exploration programme.
3. Profit reports: An unexpectedly strong result can move a share price.
4. Dividend announcements: A sustainable or improved payout can lift a share price.
5. Production reports.
6. Commodity price movements, for example the iron ore boom pushed up all companies operating in that sector.
7. Tight share register when good news arrives, for instance **Cedar Woods Properties** currently trades by appointment, because its register has become very tight. With an NTA of $1.35 per share, any positive news will move the company more than if the stock had a more liquid list, but selling is difficult until the sector or stock regains favour.
8. Stock has fallen well below NTA. Stocks such as **Macquarie Office Trust** (MOF) and **Challenger Diversified Trust** (CDI) continue to trade at well below 'value' because of funding fears and an accurate belief that their asset values will need to be marked down further. They offer trading opportunities while long-term value may still be a serious risk.
9. Unrecognised strategic value, for instance **Mosaic Oil's** $50 to $100 million hidden value for CSG storage in its depleted gas reservoirs.
10. Selling or buying by a significant holder or a group of shareholders. Often, forced selling by a large shareholder or group of holders of a small company or a company with a tightly held share register can push its share price down to very attractive levels. This has recently been the case for UXC Ltd and Cedar Woods Properties. Conversely, small companies on a well defined growth path will attract institutional capital as smaller holders sell, ensuring an upward trajectory. This might have been part of the reason why Fortescue was so strong during 2007, since most institutions were underweight the stock and many were required to buy it.

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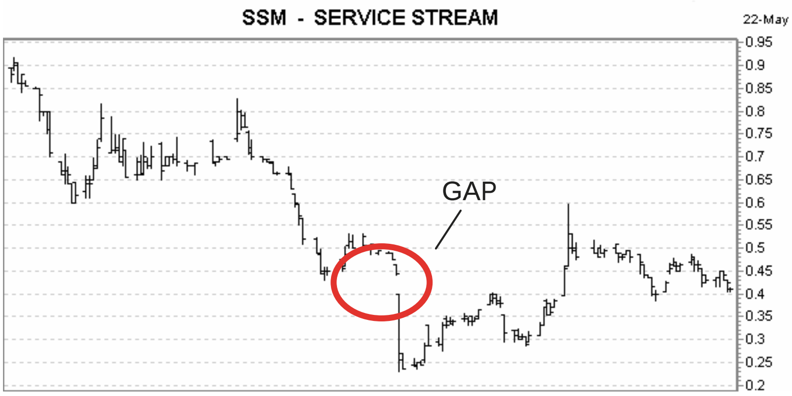
So trading opportunities may be takeover targets, leveraged to commodity price movements or tightly held by a supportive group of shareholders. This trading mode involves protecting your downside risk through buying shares in a company which trades below real net asset values. If you buy a company like this and it continues to weaken, there should be less stress, because ultimately the underlying value is more likely to be secure.

Recently StockAnalysis recommended **Carnarvon Petroleum** when it traded at around 30 cps, saying that its underlying value for cash and assessed value of oil resources in the ground was at least 65 cents per share. Since that call, the company has made a significant oil discovery and the shares now trade at closer to 64 cents.

Another example is beleaguered local engineering company **RCR Tomlinson**. Despite providing assurance to the market that its operating issues are being addressed and are under control, RCR continued to report a series of profit downgrades leading to a share price collapse. The company also kept a low profile about the arrival of its new Managing Director, who has only this week arrived to take up the reins, just as it signs a significant and long-term design and construct project for BHP Billiton Iron Ore. With knowledge of this 'trouble at mill', we can look deeper for hidden value. The company has a net tangible asset base worth 80 cents per share, mostly industrial property. Even if the value of its inventories and receivables are discounted by 30%, the shares are still backed by 48 cents per share of real asset value, compared with a trading price closer to 43 cents. The company has capacity to generate revenue of about $600 million pa when times recover, after which earnings of $20-24 million or 16-19 cps should be possible. However, earnings of $7 million or 5.5 cps are forecast for FY 2009, so the company clearly offers situational value, not perhaps for a rapid trade (unless it is taken over), but a patient hold over two to three years.

Technical analysis backs up fundamentals

Charting is another major source of trading inspiration. Much can be gleaned by looking at a company's share price chart. At a most basic level, is it moving higher or going lower or just going sideways? Chartists look for patterns within the share price movements of companies to detect common patterns such as triangles, wedges, pennants and flags. These common share price formations provide a clue to whether the share price is going to move higher or if it may be changing direction.



Another common chart pattern is the trading gap. This occurs when a share price opens on a new trading day with a price gap either higher or lower than the last price, creating a gap in the share price chart. Time and again we see that eventually, the share price will trade up or down to 'fill in' a share price gap.

A classic case is IT service company **Service Stream**, which has Telstra as its main client. Last February, Service Stream gapped down from 45 cents to 40 cents and continued to fall to 24 cents, following Telstra's disastrous handling of its bid for the National Broadband network. It was clear to StockAnalysis that Service Stream would eventually trade up between 40 and 45 cents, which it did in early April, before continuing to 60 cents.

Other factors to watch include, most importantly, the quality of a company's management and its access to cash. Even the best products and business models require adequate funding to achieve their goals. A company may look cheap on the basis of the assessed value of a development asset, such as an oil field, but without funding the share price will wallow. A classic case of this sort is Nexus Energy, which owns the valuable Crux condensate resource, but lacks security of funding to ensure that it can be developed in a reasonable timeframe.

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Global Health Calls for the Doctor (GLH)

Summary: Global Health is a minnow in an industry dominated by massive corporations. While it appears to have achieved a position of operating cash flow surplus, it is likely to remain cash starved. Its long term outlook is uncertain, but if current performance can be maintained, an EBITDA estimate of around $0.85 million in FY 10 would support a proposed new issue price of 1.7 cents and offers long term growth potential. GLH operates in a sector which is generally seen as having favourable growth characteristics and the company is well entrenched as a significant provider of e-health products and operating systems. Overall, StockAnalysis believes that while there are better opportunities for investment than GLH's new issue, the current 1:1 offer at 1.7 cents is well priced and could result in a more active and liquid share register. However, I doubt whether I will be adding to my stake.

WSS Capital Structure		
Shares	246.1	m. post issue
Options	124.1	m. @ 1.7 cts Dec '10
Price	1.7	cts @ issue
Market Cap	$ 4.2	m.
Working Capital	$ 0.5	m. Post issue
net cash	$ 1.7	m. Post issue

Underperforming micro-cap, Global Health, has had no choice but to raise additional equity to support its business growth. The company presently has negative equity of $1.59 million, negative working capital of $0.27 million after allowing for an unearned income current liability of $1.2 million and net debt of $0.26 million. This poor state of financial position was beginning to hinder the company's ability to convince potential clients that it would remain solvent.

The company has recorded operating cash flow surpluses over the past 6 months and the June quarter is usually its strongest period, so this trend should continue, with potential to record a near break even result for the '09 year as a whole. GLH's revenue and EBITDA is expected to continue to rise by 10% to 15% pa during 2010, with revenue heading towards $8 million. The company is following new projects in Australian and Malaysia, with the potential to add up to $25 million of new work in coming years, over and above its existing contract income and its organic growth path.

Addition of this new equity, which is underwritten, will give GLH flexibility to look at potential acquisitions to provide step change and bolt-on expansions to its growing e-health operations.

Alkane Resources Ltd (ALK)

Recommendation: Alkane is a speculative buy; ahead of finalisation of development plans for its 50Koz pa Tomingley gold mine in NSW. StockAnalysis values the shares at 51 cps.

Development of the 100% owned Dubbo Zirconia project should add to earnings post 2011, assisted by equity from an industry partner. The massive McPhillamys gold discovery, in partnership with Newmont, has potential to be a multi-million ounce project.

ALK - Capital Structure		
Shares	244.6	m.
Options	4.4	m.
	249.0	m.
Cash (est)	$ 6	m.
Investments	$ 6	m.
Price	$ 0.29	per share
Market Cap'tln	$ 71	m.
Market Cap/oz	$ 50	per oz Resource
Est M' cap/oz	$ 134	per oz Reserve
Substantial Shareholders		
Ian Gandel		28.8%

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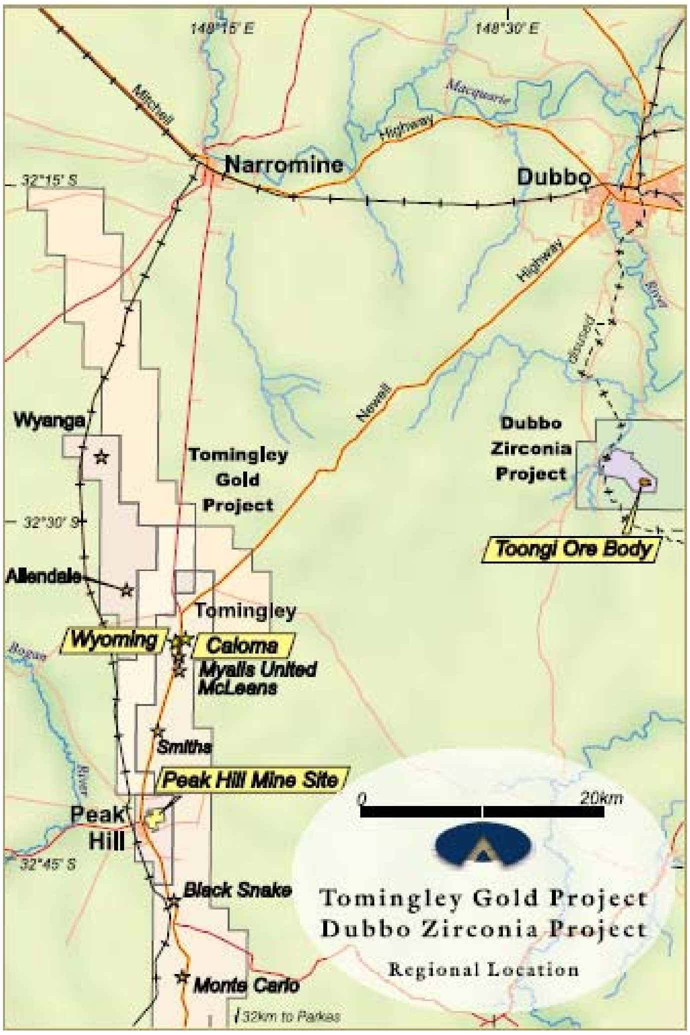
Alkane is a long surviving gold exploration company with renewed vigour, provided by the financial support and general enthusiasm of its major shareholder, property developer Ian Gandel. The company has three main exploration and development assets, all located in New South Wales. Alkane has a strong tenement position in this exciting region, which contains some of Australia's largest gold and gold/copper deposits, such as the 50 moz Cadia-Ridgeway goldfield, Northparkes copper/gold and the Cowal goldmine.



Source: Alkane

The company's projects are well located with respect to low cost water and power infrastructure and there is a local population of over 55,000, so there would be little requirement for additional housing or the provision of high cost fly-in, fly-out rosters

Tomingley Gold Project 100%, less overriding royalties

The Tomingley project comes encumbered with royalties of 75 cents per tonne on the first 500kt of ore mined, then 3% of gold on the first 150,000 oz produced and 5% of any additional gold produced, once 150,000 oz of gold has been delivered. Alkane is examining opportunities to buy these royalty obligations at a price which would significantly enhance project value for shareholders.

At Tomingley, 14 kilometres north of Peak Hill in Central NSW, Alkane has outlined a significant gold resource of about 850koz at three separate deposits along about 4 km of mineralised strike. The mineralisation has only been drilled to about 150 metres depth at the Wyoming Three and Caloma deposits but deeper drilling below 350 metres at the Wyoming One deposit shows results such as **66 m grading 19.5 g/t Au**, indicating that this deposit will have major resource potential at depth. StockAnalysis expects that about 460 koz of gold will be targeted by open pits on all three deposits and a further 140 koz will be mined by underground methods, primarily from Wyoming One, with secondary appeal at Caloma.

Tomingley Gold Resources

Mineral Resource	Tonnes mt.	Grade g/t Au	Koz Au
Wyoming One	6.48	2.5	523.4
Wyoming Three	0.84	2.0	53.5
Caloma	4.07	2.1	271.9
Total	11.39	2.3	848.8

The mineralisation shows excellent metallurgical recovery, with over 35% of gold reporting to a gravity circuit. Alkane plans to construct a 750,000 tpa processing plant, which will produce about 50koz pa of gold from open pits at a head grade of around 2 g/t Au for 5 years prior to underground mining at 250,000 tpa. Gold production could then be boosted to 70koz pa, if sufficient open pit material is outlined along about 14 km of prospective strike, between Tomingley and Peak Hill.

Model Production for Tomingley

Y/E 31 December		2009	2010	2011	2012	2013-19
O/Pit Tonnes treated	mt		0.0	0.75	0.80	4.60
Grade Au	g/t		0.00	2.10	2.05	2.05
Recovery	%		93.0%	93.0%	93.0%	93.0%
U/Ground tonnes	mt				0.0	1.00
Grade Au	g/t					4.42
Recovery	%				95%	95.0%
Gold Production	Koz		0.0	45.6	47.4	405.8

Source: Strachan Corporate Pty Ltd

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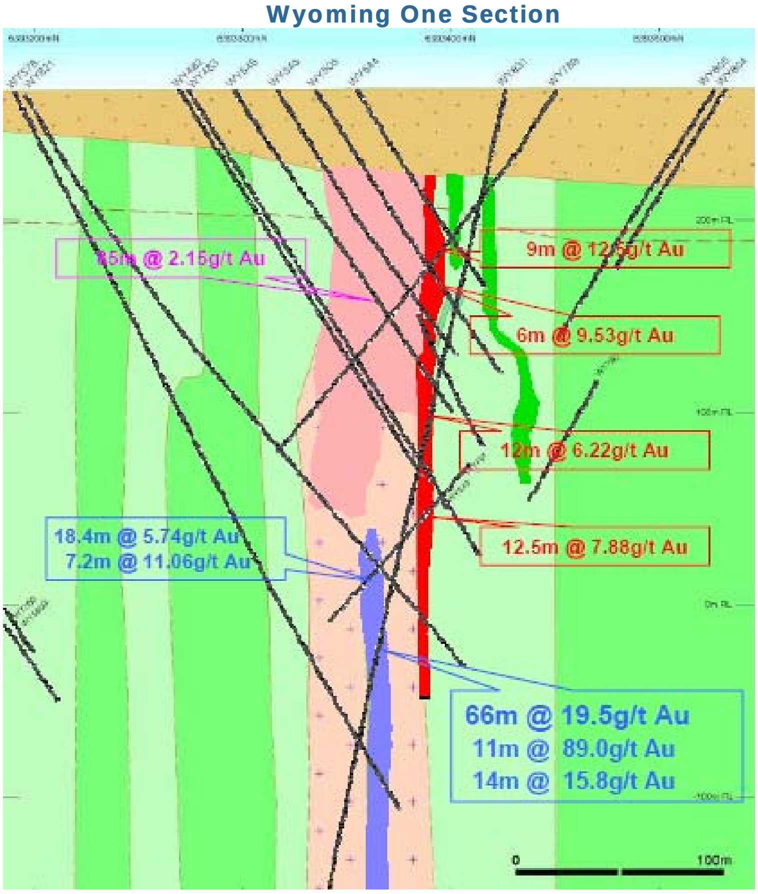
Wyoming One Section



Source: Alkane

Overall capital costs, including initial pit development should amount to about $60 million and cash operating costs of less than A$700/oz are expected. Wyoming One will be mined later in the sequence, since it lies below up to 40 metres of transported cover. StockAnalysis believes that this deposit has only been scratched at the surface and could manifest into a much larger orebody over time, providing the base for a long-life project.

The Caloma deposit consists of as many as 12 separate ore zones. Deeper intersections including 5m at 30.4g/t Au shows potential for underground mining from the base of a planned open pit. Wyoming Three is a small deposit at present, but deep drilling is required to establish further potential, once cash flow is available. Regional exploration would gain a boost from an ability to apply cash surpluses from Tomingley to deeper drilling and exploration along strike.

Financial modelling by StockAnalysis indicates that the project holds potential to generate an operating margin of about $26 million in its early years and a profit of around $13 million pa, which should support a market capitalisation of at least $150 million, given the other projects it is developing.

StockAnalysis gears its model and assumes that $20 million of new equity will be raised, giving the project an NPV of $65 million, or 21 cps on expanded capital.

Tomingley Financial Model

Y/E 31 December			2009	2010	2011	2012	2013-19
Gold Price $US/oz		950					
AUDUSD		0.78					
AUD/oz				1,218	1,218	1,218	1,218
Revenue	$m			0.0	55.5	57.8	494
O/Pit Mining cost	$/t			(17.0)	(17.9)	(18.0)	(18)
U/ground Mining cost	$/t					(50.0)	(51)
Transport							(1)
Processing cost	$/t			(15.4)	(15.7)	(16.3)	(17)
Royalty	4.0%			0.0	(1.5)	(2.7)	(30)
Operating cost	$m.			0.0	(25.2)	(27.5)	(231)
Total Cost	$m.			0.0	(26.7)	(30.2)	(262)
	$/oz				***586***	***636***	***645***
Admin	*$m.*			(0.8)	(0.8)	(0.8)	(7)
Operating Margin	$m			(0.8)	28.0	26.8	226
Capex $m			(3.0)	(50.0)	(3.0)	(0.5)	(26)
Interest charge			(0.1)	(0.1)	(2.5)	(2.1)	(3)
Pre-tax cash flow			(3.0)	(18.8)	47.1	18.4	177
Depn				0.0	(6.3)	(6.5)	(56)
PBT	$m		(0.1)	(0.9)	19.2	18.2	167
Taxation	$m			0.0	(0.7)	(5.5)	(50)
Net Profit	$m			(0.9)	18.5	12.7	117

Source: Strachan Corp. Pty Ltd.

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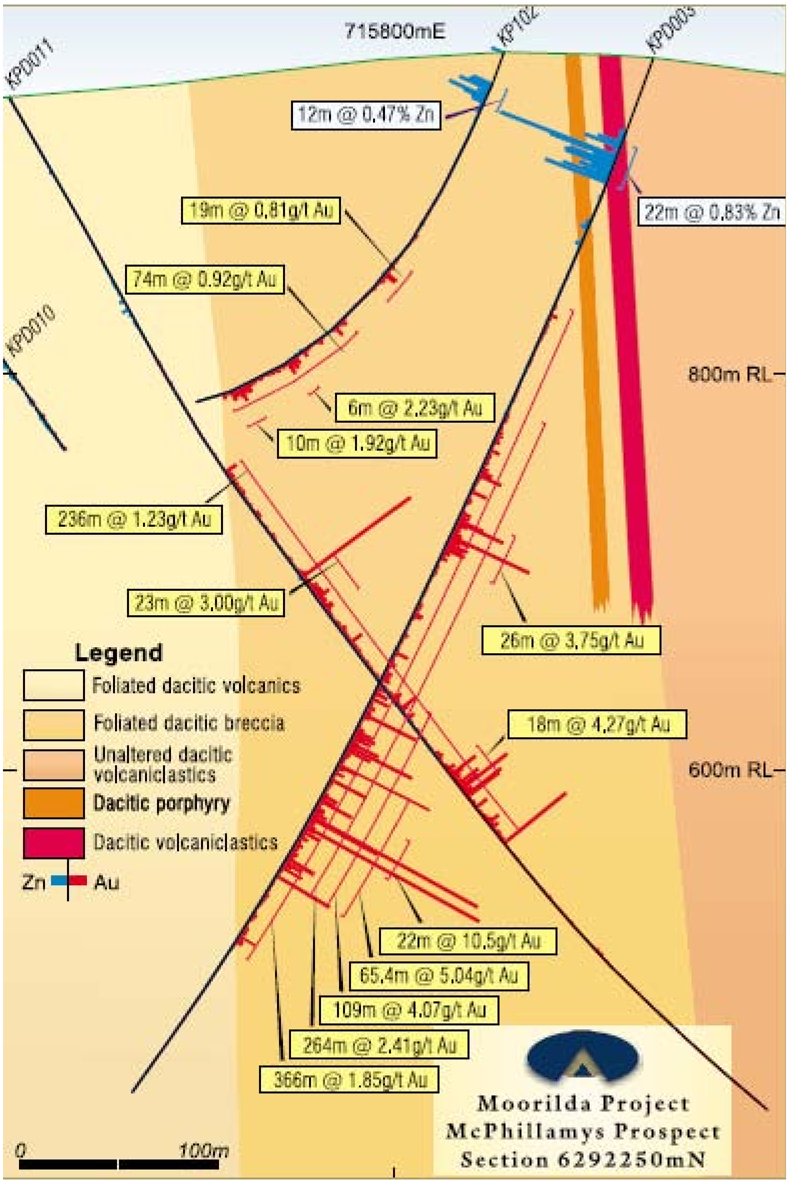
McPhillamys Project



Source: Alkane

Moorilda: 49% going to 25%

At the Moorilda project, Newmont Australia is close to completing farm-in spending of $5 million to earn a 51% interest. Newmont has the option to complete a feasibility study in order to earn a 75% interest in what appears to be one of Australia's most exciting gold discoveries this decade.

Drilling at the McPhillamys Prospect within a 4 kilometre mineralised strike, has produced the most extraordinary results, including 366 metres grading 1.85g/t Au, including higher grade zones such as 109 m grading 4.1 g/t Au. This deposit has been identified to a depth of about 450 metres and could be a candidate for low cost mining by block caving, following an initial open pit phase.

Conceptual studies looking at the mineralised envelope, indicates an exploration target of at least 2.5 moz of gold to a depth of about 450 metres. Mineralisation has not been closed off and there are additional targets along strike at Kings Plains.

StockAnalysis believes that it is most likely that Newmont will choose to either earn an additional 24% in the project by spending what StockAnalysis estimates will be at least $15 million on a bankable feasibility study, or it may prefer to buy Alkane outright, thus gaining access to the Tomingley project and its other exploration permits.

Dubbo Zirconia Project DZP 100%

At the DZP, Alkane has outlined 35.7 million tonnes of mineralisation from the surface to a depth of 55 metres, grading 1.96% Zr02, 0.04% HfO2, 0.14% Y2O3 0.46% Nb2O5, 0.03% Ta2O5 , 0.014% U3O8, and 0.75% rare earth oxides. An additional 37.5 million tonnes at similar grades is estimated from 55 metres down to 100 metres. The company is now in the final stages of completing a detailed pilot plant based feasibility study, supported by a research grant. This process is generating large volumes of product for market acceptance studies.

Sample volumes of zirconium and niobium products along with rare earth oxide products will be available to test the market during H2 2009, leading to preparation of a revised feasibility study by mid to late 2010. The DZP will produce high-tech metal oxides which find diverse application where demand is expanding along with rising prices for these oxides.

Alkane expects that a 400,000 tpa plant will cost up to $260 million and generate revenue of close to $100 m pa for over 100 years! The project will be sized to produce up to 9% of global Zirconium and Niobium demand. StockAnalysis expects that the project is worth at least $60 million to the company.

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Alkane is likely to fund this project by bringing in an industry partner to support capital expenditure and provide a pathway to market for the end product mix.

Zirconium is used as a drying agent in paints and as a primer coat of vehicle metalwork, in ceramic pigments, engineering ceramics, catalysts, electronics, solid oxide fuel cells, cladding in nuclear power plants, special alloys and glasses. Hafnium finds application in control rods for nuclear reactors and nextgen microprocessors while rare earths are used in speciality glasses, phosphors, fertilizers, catalysts, lasers, magnets/rechargeable batteries, particularly for hybrid vehicle motors and niobium is used in steels, special alloys and glasses, while yttrium is used as a stabiliser in ceramics, in phosphors for TV/ computer screens, lasers and compact fluoro lights or energy efficient bulbs.

Alkane Valuation Matrix

Asset	$m	$/Shr		Comments
Tomingley	65	$	0.21	Includes $20m new equity
Moorilda	25	$	0.08	$40/oz for 25% of 2.5 moz
Dubbo ZP	60	$	0.19	$50m to $100m range
Option cash	1	$	0.00	
Net Cash	6	$	0.02	
Investment	6	$	0.02	15% BC Iron
Exploration	10	$	0.03	Nominal
Corporate	(12)	-$	0.04	
Total	161	$	0.51	

Source: Strachan Corporate Pty

Valuation

StockAnalysis assesses Alkane to be worth $161 million, compared with its current market capitalisation of $75 million. Assuming new equity of $20 million will be raised to support development of Tomingley and possible purchase of royalty imposts, the company would then be in a strong position to deliver cash flow support for ongoing developments at the Dubbo Zirconia project and at the promising McPhillamy's gold project, in JV with Newmont. The DZP is likely to be funded via a farm-down to an industry partner.

Prior to any exploration expenditure write-off, gold production from the proposed Tomingley project alone, would support earnings of about 4 cps on expanded capital.

Alkane will shortly present its Tomingley feasibility study showing final capital and operating cost estimates. Pilot work at the DZP will be completed by mid 2009. Once samples of zirconium and niobium products are in the marketplace, a technical/ marketing and funding partner could be selected by mid 2010.

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