

2 June 2011

Produced by: RBS Equities (Australia) Limited

Buy

Target price
A\$3.01

Price
A\$2.14

Equity | Australia | Metals & Mining

Flashnote

Alkane Resources

Things are getting heavy

Rare earth prices continue to ascend apace. It seems the introduction of Chinese export quotas on rare earth alloys is having a marked positive impact on spot transactions. This is most apparent in the heavy rare earth space, supporting our ALK buy recommendation.

- The Chinese State Council recently announced it will start imposing export quotas on alloys containing more than 10% rare earth minerals by weight. This is in addition to existing quotas applicable to the metal oxides. Rare earth alloys cover a wide range of products including ferro silicon, used in steel manufacturing, as well as a dysprosium and terbium alloys which have applications in permanent magnets and optics.
- In effect, the inclusion of rare earth alloys in the China's export quota's further concentrates control of the industry within China and will add tension to a market already in deficit.
- This is most acute in the heavy rare earth space. The dysprosium price has increased by 145% since the end of the March quarter 2011. Terbium and Europium have both increased by about 120% over the same period.
- At present, we forecast heavy rare earth prices declining in line with lighter rare earths. However, this appears unlikely due to the absence of a meaningful supply response for heavy rare earths.
- At 1Mtpa of plant throughput, we forecast ALK will produce about 90tpa of Terbium, Dysprosium and Europium combined. At present, spot prices imply annual revenues of about US\$82m for those three elements after factoring in a 30% discount for concentrate processing (ALK doesn't intend to produce separate rare earth elements). These three elements represent only 0.4% of total product volume, while application of spot prices generates 30% of project revenues. This compares with 1.5% of revenues in our base case.
- In our view, ALK's Dubbo Zirconia Project (DZP) offers the greatest leverage to zirconia as it is DZP's most voluminous product and determines the scale of the project. However, the rapid accent of heavy rare earth prices is heightening the strategic appeal of ALK's asset in our view, and is likely to stand ALK in good stead as it moves to secure project debt financing in 2H11.

Key forecasts

	FY09A	FY10A	FY11F	FY12F	FY13F
EBITDA (A\$m)	2.12	7.51	-8.30	-10.0	73.9
Reported net profit (A\$m)	11.0	7.79	-5.39	-8.94	26.4
Normalised net profit (A\$m)	2.30	7.79	-5.39	-8.94	26.4
Normalised EPS (c)	0.85	2.90	-2.00	-3.32	9.83
Normalised EPS growth (%)	n/a	239.0	n/a	65.8	n/a
Dividend per share (c)	0.00	0.00	0.00	0.00	0.00
Dividend yield (%)	0.00	0.00	0.00	0.00	0.00
Normalised PE (x)	250.6	73.9	n/m	n/m	21.8
EV/EBITDA (x)	269.4	76.0	n/m	n/m	12.1
Price/net oper. CF (x)	-1770	74.1	-90.1	-66.2	11.6
ROIC (%)	5.26	13.4	-14.2	-17.7	20.4

Pre non-recurring items and post preference dividends

Accounting standard: GAAP

Source: Company data, RBS forecasts

year to Dec, fully diluted

Analyst

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Important disclosures can be found in the Disclosures Appendix.

Income statement

A\$m	FY09A	FY10A	FY11F	FY12F	FY13F
Revenue	4.49	9.79	0.00	0.00	120.5
Cost of sales	-2.37	-2.28	-8.30	-10.0	-46.6
Gross profit	2.12	7.51	-8.30	-10.0	73.9
Operating costs	n/a	n/a	n/a	n/a	n/a
EBITDA	2.12	7.51	-8.30	-10.0	73.9
DDA & Impairment (ex gw)	-0.05	-0.05	0.00	0.00	-4.03
EBITA	2.07	7.46	-8.30	-10.0	69.9
Goodwill (amort/impaired)	n/a	n/a	n/a	n/a	n/a
EBIT	2.07	7.46	-8.30	-10.0	69.9
Net interest	0.23	0.33	0.60	-2.77	-32.1
Associates (pre-tax)	n/a	n/a	n/a	n/a	n/a
Other pre-tax items	0.00	0.00	0.00	0.00	0.00
Reported PTP	2.30	7.79	-7.70	-12.8	37.8
Taxation	0.00	0.00	2.31	3.83	-11.3
Minority interests	0.00	0.00	0.00	0.00	0.00
Other post-tax items	8.69	0.00	0.00	0.00	0.00
Reported net profit	11.0	7.79	-5.39	-8.94	26.4
Tot normalised items	8.69	0.00	0.00	0.00	0.00
Normalised EBITDA	2.12	7.51	-8.30	-10.0	73.9
Normalised EBIT	2.07	7.46	-8.30	-10.0	69.9
Normalised PTP	2.30	7.79	-7.70	-12.8	37.8
Normalised net profit	2.30	7.79	-5.39	-8.94	26.4

Source: Company data, RBS forecasts

year to Dec

Balance sheet

A\$m	FY09A	FY10A	FY11F	FY12F	FY13F
Cash & market secs (1)	4.83	4.55	19.2	260.5	131.1
Other current assets	6.15	0.44	0.44	0.44	0.44
Tangible fixed assets	1.08	2.07	2.07	202.1	385.1
Intang assets (incl gw)	n/a	n/a	n/a	n/a	n/a
Oth non-curr assets	32.5	39.8	39.8	39.8	39.8
Total assets	44.6	46.8	61.4	502.7	556.4
Short term debt (2)	0.00	0.00	0.00	450.0	450.0
Trade & oth current liab	0.71	1.09	2.58	2.58	84.1
Long term debt (3)	0.00	0.00	0.00	0.00	0.00
Oth non-current liab	0.15	0.19	0.16	0.16	0.16
Total liabilities	0.86	1.28	2.74	452.7	534.3
Total equity (incl min)	43.7	45.6	58.7	50.0	22.1
Total liab & sh equity	44.6	46.8	61.4	502.7	556.4
Net debt	-4.83	-4.55	-19.2	189.5	318.9

Source: Company data, RBS forecasts

year ended Dec

Cash flow statement

A\$m	FY09A	FY10A	FY11F	FY12F	FY13F
EBITDA	2.12	7.51	-8.30	-10.0	73.9
Change in working capital	-2.67	0.00	0.00	0.00	0.00
Net interest (pd) / rec	0.23	0.26	0.50	-1.46	-25.2
Taxes paid	0.00	0.00	1.41	2.76	0.93
Other oper cash items	n/a	n/a	n/a	n/a	n/a
Cash flow from ops (1)	-0.33	7.77	-6.39	-8.69	49.6
Capex (2)	-0.12	-1.03	0.00	-200.0	-179.0
Disposals/(acquisitions)	0.00	0.00	0.00	0.00	0.00
Other investing cash flow	-8.81	-7.81	0.00	0.00	0.00
Cash flow from invest (3)	-8.93	-8.85	0.00	-200.0	-179.0
Incr / (decr) in equity	1.31	0.00	21.0	0.00	0.00
Incr / (decr) in debt	n/a	n/a	n/a	n/a	n/a
Ordinary dividend paid	0.00	0.00	0.00	0.00	0.00
Preferred dividends (4)	n/a	n/a	n/a	n/a	n/a
Other financing cash flow	0.36	0.16	0.00	0.00	0.00
Cash flow from fin (5)	1.66	0.16	21.0	0.00	0.00
Forex & disc ops (6)	n/a	n/a	n/a	n/a	n/a
Inc/(decr) cash (1+3+5+6)	-7.59	-0.91	14.6	-208.7	-129.4
Equity FCF (1+2+4)	-0.44	6.74	-6.39	-208.7	-129.4

Lines in bold can be derived from the immediately preceding lines.

Source: Company data, RBS forecasts

year to Dec

Recommendation structure

Absolute performance, short term (trading) recommendation: A Trading Buy recommendation implies upside of 5% or more and a Trading Sell indicates downside of 5% or more. The trading recommendation time horizon is 0-60 days. For Australian coverage, a Trading Buy recommendation implies upside of 5% or more from the suggested entry price range, and a Trading Sell recommendation implies downside of 5% or more from the suggested entry price range. The trading recommendation time horizon is 0-60 days.

Absolute performance, long term (fundamental) recommendation: The recommendation is based on implied upside/downside for the stock from the target price and, except as follows, only reflects capital appreciation. A Buy/Sell implies upside/downside of 10% or more and a Hold less than 10%. For UK-based Investment Funds research, the recommendation structure is not based on upside/downside to the target price. Rather it is the subjective view of the analyst based on an assessment of the resources and track record of the fund management company. For research on Australian listed property trusts (LPT) or real estate investment trusts (REIT), the recommendation is based upon total return, ie, the estimated total return of capital gain, dividends and distributions received for any particular stock over the investment horizon.

Performance parameters and horizon: Given the volatility of share prices and our pre-disposition not to change recommendations frequently, these performance parameters should be interpreted flexibly. Performance in this context only reflects capital appreciation and the horizon is 12 months.

Market or sector view: This view is the responsibility of the strategy team and a relative call on the performance of the market/sector relative to the region. Overweight/Underweight implies upside/downside of 10% or more and Neutral implies less than 10% upside/downside.

Target price: The target price is the level the stock should currently trade at if the market were to accept the analyst's view of the stock and if the necessary catalysts were in place to effect this change in perception within the performance horizon. In this way, therefore, the target price abstracts from the need to take a view on the market or sector. If it is felt that the catalysts are not fully in place to effect a re-rating of the stock to its warranted value, the target price will differ from 'fair' value.

Distribution of recommendations

The tables below show the distribution of recommendations (both long term and trading). The first column displays the distribution of recommendations globally and the second column shows the distribution for the region. Numbers in brackets show the percentage for each category where there is an investment banking relationship. These numbers include recommendations produced by third parties with which RBS has joint ventures or strategic alliances.

Long term recommendations (as at 02 Jun 2011)

	Global total (IB%)	Asia Pacific total (IB%)
Buy	791 (13)	513 (3)
Hold	409 (7)	227 (3)
Sell	90 (2)	55 (0)
Total (IB%)	1290 (10)	795 (3)

Source: RBS

Trading recommendations (as at 02 Jun 2011)

	Global total (IB%)	Asia Pacific total (IB%)
Trading Buy	2 (0)	2 (0)
Trading Sell	2 (0)	2 (0)
Total (IB%)	4 (0)	4 (0)

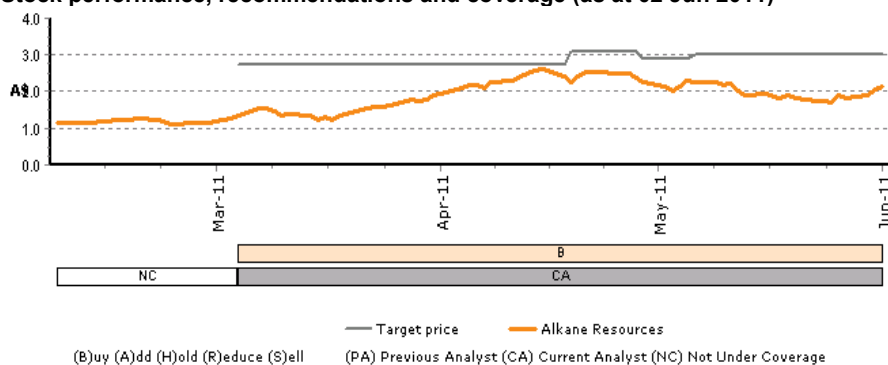
Source: RBS

Valuation and risks to target price

Alkane Resources (RIC: ALK.AX, Rec: Buy, CP: A\$2.14, TP: A\$3.01): We value ALK using a DCF methodology. Upside risks to our target price include production and commodity prices exceeding our expectations. Downside risks include higher-than-forecast capex, commissioning and development delays, and lower-than-forecast commodity prices.

Alkane Resources coverage data (ALK.AX, ALK AU)

Stock performance, recommendations and coverage (as at 02 Jun 2011)



(B)uy (A)dd (H)old (R)educe (S)ell (PA) Previous Analyst (CA) Current Analyst (NC) Not Under Coverage

Sam Berridge started covering this stock on 3 Mar 11. New recommendation structure from 7 November 2005. Source: RBS

Trading recommendation history

Date	Rec	Analyst
n/a	n/a	n/a

Source: RBS

Price perf (at Close 01 Jun 2011)

	(1M)	(3M)	(12M)
Price (A\$)	2.24	1.18	0.28
Absolute (%)	-4.5	81.4	664.3
Rel market (%)	-2.1	85.9	616.5
Rel sector (%)	0.2	85.6	452.4

Source: Bloomberg
Market: S&P/ASX200
Sector: Gold Mining

Regulatory disclosures

None

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