

19 September 2011

Produced by: RBS Equities (Australia) Limited

# Alkane Resources

## Dubbo shoulders costs, capex

### Buy

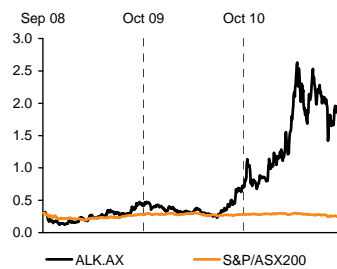
**Target price**  
A\$2.25 (from A\$3.20)

**Price**  
A\$1.805

**Short term (0-60 days)**  
n/a

#### Price performance

	(1M)	(3M)	(12M)
Price (A\$)	1.76	2.39	0.65
Absolute (%)	2.6	-24.5	177.7
Rel market (%)	5.0	-18.5	208.2
Rel sector (%)	9.2	-13.1	171.2



**Market capitalisation**  
A\$484.25m (US\$496.07m)

**Average (12M) daily turnover**  
A\$2.70m (US\$2.81m)

Sector: BBG AP Mining  
RIC: ALK.AX, ALK AU  
Priced A\$1.80 at close 16 Sep 2011.  
Source: Bloomberg

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Results from the definitive feasibility study into development of the Dubbo Zirconia Project were below our expectations. Higher capex and costs have lowered our valuation, but the project maintains an economically robust argument for development. Maintain Buy.

#### Key forecasts

	FY09A	FY10A	FY11F	FY12F	FY13F
EBITDA (A\$m)	2.12	7.51	-8.30	-10.0	17.00
Reported net profit (A\$m)	11.00	7.79	-5.39	-9.86 ▲	-48.3
Normalised net profit (A\$m) <sup>1</sup>	2.30	7.79	-5.39	-9.86 ▲	-48.3
Normalised EPS (c) <sup>1</sup>	0.85	2.90	-2.00	-3.66 ▲	-17.9
Normalised EPS growth (%)	n/a	239.0	n/a	82.90	390.2
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)	210.8	62.20	-89.8	-49.1	-10.0
EV/EBITDA (x)	226.2	63.90	-56.0	-76.4	81.30
Price/net oper. CF (x)	-1,489	62.30	-75.8 ▼	-53.3 ▼	-49.4 ▼
ROIC (%)	5.26	13.40	-14.2	-17.7	-1.17

Use of ▲ ▼ indicates that the line item has changed by at least 5%.

year to Dec, fully diluted

1. Pre non-recurring items and post preference dividends

Accounting standard: GAAP

Source: Company data, RBS forecasts

#### Costs and capex increase

The definitive feasibility study (DFS) into development of ALK's 100% owned Dubbo Zirconia Project (DZP) assumes a base case throughput of 400ktpa. The study confirms ALK's intention to move to 1Mtpa throughput, in line with our base case. For the larger plant, capex of A\$893m was above our forecast of A\$800m, which we thought was conservative. The operating cost of A\$196m or A\$196/t ore processed was also above our forecast of A\$146/t. The figures for the 1Mtpa plant will be bedded down as part of ongoing feasibility work, which ALK expects to complete in the March quarter 2012.

#### Commercial production mid-2014

The company expects environmental permit approval will take roughly 6 months from the time of submission (March 2012), implying construction will commence in 2HCY12, with first production in 2014. ALK guides to first commercial production (post commissioning) by mid-2014. We have pushed back our 2014 production numbers as a result of updated guidance.

#### Strategic partnership may lead to capex improvement

We were surprised by the capital and operating cost numbers. We acknowledge that the DZP is a complex project. As a comparison, ALK's updated capex exceeds LYC's forecast for stages I and II of its Mt Weld and LAMP development. Should ALK be successful in introducing a strategic partner to the project, which the company flagged as a financing option, we believe that third party expertise may lead to capital cost forecasts being optimised lower through tighter engineering design.

#### Investment view – high grade long life appeal remains

Factoring in figures from the DFS has put a dent in our project valuation and we lower our target price to A\$2.25. However, the high-grade outcropping mineralisation of the DZP easily supports the higher capital and operating cost forecasts. Maintain Buy.

Important disclosures can be found in the Disclosures Appendix.

## Changes to earnings and valuation

We have increased operating costs, which has lowered earnings substantially from FY14. We have increased capex in line with company guidance, lowering our valuation. The net impact of our adjustments is a 30% decrease in our NPV to A\$2.25ps.

**Table 1 : Changes to earnings and valuation**

	2010A	2011F	2012F	2013F	2014F NPV (A\$ps)	
Normalised NPAT (A\$m) - revised	7.8	-5.4	-9.9	-48.3	37.3	2.25
Normalised NPAT (A\$m) - previous	7.8	-5.4	-10.4	-48.4	176.8	3.20
Change (A\$m)	0.0	0.0	0.5	0.1	-139.5	-0.96
Change (%)	0%	0%	-5%	0%	-79%	-30%

Source: Company data, RBS forecasts

## Comparing apples with oranges

Finding a direct comparison for the DZP is difficult due to the variance in mineralisation type, grade and location of peer deposits. We realise that we may be comparing apples with oranges in compiling the table below but we have trouble reconciling the capex figure with the relatively modest requirements of DZP plant and infrastructure. We believe the introduction of a strategic partner into the project could result in capex cost savings.

**Table 2 : Project capex comparison**

Project	DZP	Tomingley	Mt Weld (stage I + II)
Company	ALK	ALK	LYC
Commodity	Zr, REE, Nb	Au	REE
Ore throughput (Mtpa)	1.0	1.0	0.3
<b>Capex (A\$m)</b>			
<b>Process plant</b>	<b>543</b>	<b>41</b>	<b>484</b>
Infrastructure	165	25	65
Other	185	29	253
<b>Total</b>	<b>893</b>	<b>95</b>	<b>802</b>

Source: Company data

**Table 3 : Comparison ALK and RBS base case forecasts for DZP**

Item	ALK	RBS
Throughput (Mtpa)	1.0	1.0
Capex (A\$m)	893	900
Operating costs (A\$m pa)	196	190
Revenue (A\$m pa)	508	433
WACC (%)	8%	11%
<b>NPV (A\$m)</b>	<b>1207</b>	<b>609</b>
NPV (A\$ps)	4.49	2.26
<b>RBS base case (30% discount to DZP NPV)</b>		
NPV (A\$m)		426
<b>NPV (A\$ps)</b>		<b>1.58</b>

Source: Company data, RBS forecasts

## Valuation and target price

Our DCF valuation for ALK has decreased to A\$2.25ps from A\$3.20ps. We base our valuation on developing a 1Mtpa operation at the DZP and first production by 2014. We apply a 30% discount to our DZP valuation to reflect development risk. We do not factor in the development of the McPhillamy gold deposit, and we apply nominal option values for these. Upside risks to our valuation include lower capex and operating costs than we have forecast and higher commodity prices. Downside risks include delays in the finalisation of the DFS, securing project finance and lower commodity prices than we forecast.

### ALK – financial summary

	269	Dec Year End			2009A	2010A	2011F	2012F	2013F	2014F	2015F		
Number of shares (m)	269												
Market capitalisation (A\$m)	484	NPAT Reported (A\$m)			11.0	7.8	-5.4	-9.9	-48.3	37.3	173.3		
Enterprise value (A\$m)	465	NPAT Normalised (A\$m)			2.3	7.8	-5.4	-9.9	-48.3	37.3	173.3		
Enterprise value (US\$m)	470	EPS (A¢)			0.9	2.9	-2.0	-3.7	-18.0	13.8	64.4		
		CFPS (A¢)			-0.2	-0.8	-2.4	-111.2	-228.5	-0.2	88.9		
		Tonnes	Grade	Ounces	DPS (A¢)	0.0	0.0	0.0	0.0	0.0	0.0		
<b>Resources</b>		<b>(kt)</b>	<b>(g/t)</b>	<b>(koz)</b>	P/E (x)	210.8	62.2	-89.8	-49.1	-10.0	13.0		
Gold resources	66,747	1.34	2,883	P/CF (x)	-1092.0	-216.7	-75.8	-1.6	-0.8	-828.7	2.0		
Gold reserves	3,600	1.80	208	EV/EBITDA (x)	221.7	62.6	-56.6	-47.0	27.7	2.9	1.3		
EV/oz Gold resource (A\$/oz)	161	EPS Growth			n/m	n/m	-169%	83%	390%	-177%	365%		
EV/oz Gold reserve (A\$/oz)	2,232	Yield (%)			0%	0%	0%	0%	0%	0%	0%		
<b>Valuation</b>					<b>Production</b>	<b>2009A</b>	<b>2010A</b>	<b>2011F</b>	<b>2012F</b>	<b>2013F</b>	<b>2014F</b>	<b>2015F</b>	
<b>Description</b>	<b>A\$m</b>	<b>A\$ps</b>	Gold (koz)			0	0	0	0	43	54	54	
DZP	426	1.58	Zirconia (kt)			0.00	0.00	0.00	0.00	0.00	4.46	14.90	
Tomingley	27	0.10	LREO (kt)			0.00	0.00	0.00	0.00	0.00	1.07	3.14	
McPhillamys	50	0.19	HREO (kt)			0.00	0.00	0.00	0.00	0.00	0.33	0.95	
<b>Total Operations</b>	<b>503</b>	<b>1.87</b>	FeNb (kt)			0.00	0.00	0.00	0.00	0.00	1.05	3.06	
Net cash / (debt)	22	0.08	Total (kt)			0.00	0.00	0.00	0.00	0.00	6.90	22.04	
Hedge	22	0.08											
Corporate overheads	-8	-0.03	<b>Costs</b>			<b>2009A</b>	<b>2010A</b>	<b>2011F</b>	<b>2012F</b>	<b>2013F</b>	<b>2014F</b>	<b>2015F</b>	
Exploration	64	0.24	Tomingley (A\$/oz)			0	0	0	0	966	964	964	
<b>Total Valuation</b>	<b>604</b>	<b>2.25</b>	DZP cash cost (A\$/t ore)			0	0	0	0	0	213	207	
P/NPV	0.80	DZP cash cost (US\$/t ore)			0	0	0	0	0	0	209	180	
<b>Operational NPV split</b>	<b>Valuation inputs</b>			<b>Assumptions</b>			<b>2009A</b>	<b>2010A</b>	<b>2011F</b>	<b>2012F</b>	<b>2013F</b>	<b>2014F</b>	<b>2015F</b>
Tomingley 5%	Rf rate	5.3%	Zirconia (US\$/kg)			0.0	3.6	7.6	11.8	12.0	11.2	10.4	
McPhillamys 10%	MRP	6.0%	LREO (US\$/kg)			0	28	171	250	150	100	50	
Net cash / (debt) 4%	Equity beta	1.3	HREO (US\$/kg)			0	56	191	270	220	170	120	
DZP 81%	Ke	13%	FeNb (US\$/kg)			0	35	35	35	35	35	35	
	Kd	7.5%	AUD/USD			0.79	0.92	1.05	1.08	1.08	0.98	0.87	
	Gearing	30%	<b>Profit &amp; Loss (A\$m)</b>			<b>2009A</b>	<b>2010A</b>	<b>2011F</b>	<b>2012F</b>	<b>2013F</b>	<b>2014F</b>	<b>2015F</b>	
	Tax rate	30%	Sales revenue			0	0	0	0	70	296	609	
	WACC	11%	Other revenue			4	10	0	0	0	0	0	
	DCF (A\$)	2.25	Total revenue			4	10	0	0	70	296	609	
	Prem/disc	0%	Operating costs			-2	-2	-8	-10	-53	-131	-258	
	Target (A\$)	2.25	EBITDA			2	8	-8	-10	17	165	351	
			Depreciation			0	0	0	0	-23	-38	-42	
			EBIT			2	7	-8	-10	-6	127	309	
			Net interest benefit / (expense)			0	0	1	-4	-63	-74	-61	
			Pre-tax profit			2	8	-8	-14	-69	53	248	
			Tax benefit / (expense)			0	0	2	4	21	-16	-74	
			Profit after tax			2	8	-5	-10	-48	37	173	
			Minorities			0	0	0	0	0	0	0	
			NPAT (underlying)			2	8	-5	-10	-48	37	173	
			Significant items			9	0	0	0	0	0	0	
			NPAT (reported)			11	8	-5	-10	-48	37	173	
			<b>Profitability Analysis (%)</b>			<b>2009A</b>	<b>2010A</b>	<b>2011F</b>	<b>2012F</b>	<b>2013F</b>	<b>2014F</b>	<b>2015F</b>	
			EBIT margin			n/m	n/m	n/m	n/m	n/m	43%	51%	
			EBITDA margin			n/m	n/m	n/m	n/m	n/m	56%	58%	
			Effective tax rate			0%	0%	-30%	-30%	-30%	-30%	-30%	
			ROA - EBIT / (total assets - cash)			5%	18%	-20%	-3%	-1%	12%	31%	
			ROE - NPAT / equity			5%	17%	-9%	-17%	-80%	29%	51%	
			<b>Cashflow</b>			<b>2009A</b>	<b>2010A</b>	<b>2011F</b>	<b>2012F</b>	<b>2013F</b>	<b>2014F</b>	<b>2015F</b>	
			EBITDA			2	8	-8	-10	17	165	351	
			Operating cashflow			0	-1	-6	-9	-10	108	248	
			Capex			-1	0	0	-290	-605	-109	-9	
			Free cashflow			-1	-1	-6	-299	-615	-1	239	
			Investing cashflow			-5	1	0	-290	-605	-109	-9	
			Financing cashflow			2	0	21	450	575	-200	-150	
			Net Change in cash			-3	0	15	151	-40	-201	89	
			<b>Balance Sheet Analysis</b>			<b>2009A</b>	<b>2010A</b>	<b>2011F</b>	<b>2012F</b>	<b>2013F</b>	<b>2014F</b>	<b>2015F</b>	
			Debt			0	0	0	450	1025	825	675	
			Equity			44	46	59	60	60	131	338	
			Assets			45	47	61	512	1088	959	1015	
			Cash			5	5	19	170	130	-70	19	
			Net debt			-5	-5	-19	280	895	895	656	
			<b>Gearing - net debt/equity</b>			<b>2009A</b>	<b>2010A</b>	<b>2011F</b>	<b>2012F</b>	<b>2013F</b>	<b>2014F</b>	<b>2015F</b>	
			Gearing - net debt/ (net debt + equity)			-12%	-11%	-48%	82%	94%	87%	66%	
			Net debt / EBITDA			-228%	-61%	231%	-2799%	5276%	544%	187%	
			EBIT / net interest			9	23	-14	2	0	-2	-5	
			EBITDA / net interest			9	23	-14	2	0	-2	-6	

Source: Company data, RBS forecasts

## 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 19 Sep 2011)

	Global total (IB%)	Asia Pacific total (IB%)
Buy	855 (11)	554 (3)
Hold	409 (7)	224 (4)
Sell	85 (5)	49 (0)
Total (IB%)	1349 (9)	827 (3)

Source: RBS

### Trading recommendations (as at 19 Sep 2011)

	Global total (IB%)	Asia Pacific total (IB%)
Trading Buy	1 (100)	1 (100)
Trading Sell	0 (0)	0 (0)
Total (IB%)	1 (100)	1 (100)

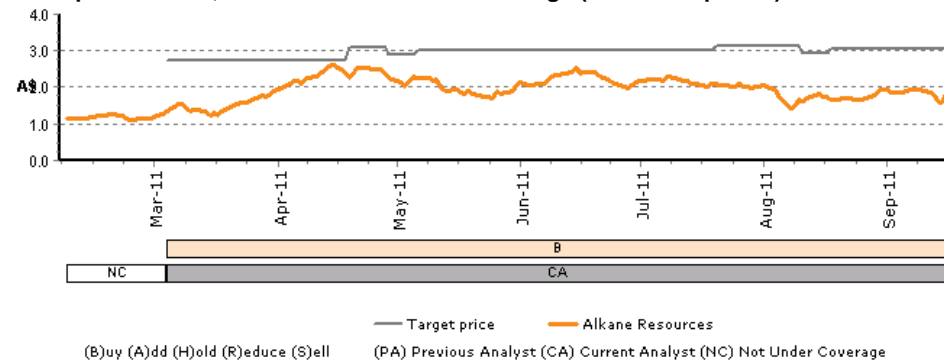
Source: RBS

## Valuation and risks to target price

**Alkane Resources (RIC: ALK.AX, Rec: Buy, CP: A\$1.805, TP: A\$2.245):** We value ALK using a DCF methodology. Upside risks to our valuation include lower capex and operating costs than we have forecast and higher commodity prices. Downside risks include delays in the finalisation of the DFS, securing project finance and lower commodity prices than we forecast.

## Alkane Resources coverage data

### Stock performance, recommendations and coverage (as at 18 Sep 2011)



### Trading recommendation history (as at 19 Sep 2011)

Date	Rec	Analyst
	n/a	

Source: RBS

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

## Regulatory disclosures

## Global disclaimer

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