

1 September 2011

Produced by: RBS Equities (Australia) Limited

Buy

Target price
A\$3.04

Price
A\$1.92

Equity | Australia | Metals & Mining

Flashnote

Alkane Resources

Purchase highlights niobium necessity

Three Chinese firms have jointly acquired 15% of CBMM, the world's largest niobium producer for US\$1.95bn. While niobium is very much a boutique metal, in our view the deal highlights the importance of niobium in steel making and the appeal of an often overlooked component of ALK's Dubbo zirconia project.

Chinese move to secure niobium supply

- Taiyuan Iron and Steel, CITIC and Baosteel have jointly acquired a 15% stake in Brazilian company, CBMM for US\$1.95bn. CBMM produces roughly 80kt of niobium p.a., representing about 75 - 80% of global supply.

Deal mirrors move by Japanese and South Korean steel mills

- The deal by the Chinese consortium mirrors a move by a consortium of Japanese and South Korean steel mills, which acquired 15% of CBMM in March for US\$1.95bn. On a tonnes of future niobium capacity basis, the deal implies a value of US\$490m for ALK's 100% owned Dubbo Zirconia Project (DZP). This excludes value attributable to rare earth or zirconia production.

Deals highlight the importance of niobium in steel making process

- Niobium is very much a boutique metal which is not widely discussed in Australian equity markets. In our view, the separate acquisitions highlight the importance of niobium in the manufacture of high-strength-low-alloy (HSLA) steels. HSLA product is a higher quality steel which offers equivalent strength to mild steel with lower weight. Applications include bridge construction, crane booms, auto manufacturing and sectors where high strength low-weight properties are desirable.

Niobium represents roughly 30% of DZP future revenues.

- Based on our forecasts, niobium sales will account for about a third of long term revenues from the DZP. The balance of revenues being from zirconia and rare earths. Niobium production diversifies ALK's revenue steam and market exposures. Niobium prices are historically very stable, reflecting a managed market. In our view the stability of the niobium market balances rare earth and zirconia prices, which have exhibited sharp price moves over

(Continued on page 2)

Key forecasts

	FY09A	FY10A	FY11F	FY12F	FY13F
EBITDA (A\$m)	2.12	7.51	-8.30	-10.0	13.5
Reported net profit (A\$m)	11.0	7.79	-5.39	-10.4	-50.9
Normalised net profit (A\$m)	2.30	7.79	-5.39	-10.4	-50.9
Normalised EPS (c)	0.85	2.90	-2.00	-3.86	-18.91
Normalised EPS growth (%)	n/a	239.0	n/a	92.7	390.0
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)	224.8	66.3	-95.8	-49.7	-10.2
EV/EBITDA (x)	241.4	68.2	-59.9	-89.7	104.8
Price/net oper. CF (x)	-1588	66.4	-80.8	-56.0	-37.6
ROIC (%)	5.26	13.4	-14.2	-17.7	-1.59

Pre non-recurring items and post preference dividends
Accounting standard: GAAP
Source: Company data, RBS forecasts

year to Dec, fully diluted

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Important disclosures can be found in the Disclosures Appendix.

the last 12 months.

Financial Summary

Number of shares (m)		269	Dec Year End		2009A	2010A	2011F	2012F	2013F	2014F	2015F
Market capitalisation (A\$m)		527	NPAT Reported (A\$m)		11.0	7.8	-5.4	-10.4	-50.9	175.0	218.4
Enterprise value (A\$m)		508	NPAT Normalised (A\$m)		2.3	7.8	-5.4	-10.4	-50.9	175.0	218.4
Enterprise value (US\$m)		513	EPS (A¢)		0.9	2.9	-2.0	-3.9	-18.9	65.0	81.2
			CFPS (A¢)		-0.2	-0.8	-2.4	-148.4	-192.8	94.9	99.9
			DPS (A¢)		0.0	0.0	0.0	0.0	0.0	0.0	0.0
			P/E (x)		229.5	67.7	-97.8	-50.8	-10.4	3.0	2.4
			P/CF (x)		-1189.1	-236.0	-82.5	-1.3	-1.0	2.1	2.0
			EV/EBITDA (x)		242.2	68.3	-61.9	-51.3	38.0	1.5	1.3
			EPS Growth		n/m	n/m	-169%	93%	390%	-444%	25%
			Yield (%)		0%	0%	0%	0%	0%	0%	0%

Resources		Tonnes	Grade	Ounces	2009A		2010A	2011F	2012F	2013F	2014F	2015F
		(kt)	(g/t)	(koz)								
Gold resources		66,747	1.34	2,883								
Gold reserves		3,600	1.80	208								
EV/oz Gold resource (A\$/oz)				176								
EV/oz Gold reserve (A\$/oz)				2,439								

Valuation		Description		A\$m	A\$ps	2009A		2010A	2011F	2012F	2013F	2014F	2015F
DZP				675	2.51								
Tomingley				2	0.01								
McPhillamys				50	0.19								
Total Operations				727	2.70								
Net cash / (debt)				22	0.08								
Hedge				26	0.10								
Corporate overheads				-7	-0.03								
Exploration				64	0.24								
Total Valuation				832	3.04								

P/NPV		Description		A\$m	A\$ps	2009A		2010A	2011F	2012F	2013F	2014F	2015F
					0.64								

Operational NPV split		Valuation inputs		2009A		2010A	2011F	2012F	2013F	2014F	2015F
Tomingley 0%		Rf rate 5.3%		Sales revenue		0	0	0	66	515	609
McPhillamys 7%		MRP 6.0%		Other revenue		4	10	0	0	0	0
Net cash / (debt) 3%		Equity beta 1.36		Total revenue		4	10	0	66	515	609
DZP 90%		Ke 13%		Operating costs		-2	-2	-8	-10	-52	-208
		Kd 7.5%		EBITDA		2	8	-8	-10	14	352
		Gearing 30%		Depreciation		0	0	0	-21	-33	-37
		Tax rate 30%		EBIT		2	7	-8	-10	-8	319
		WACC 11%		Net interest benefit / (expense)		0	0	1	-5	-65	-53
		DCF (A\$) 3.04		Pre-tax profit		2	8	-8	-15	-73	250
		Prem/disc 0%		Tax benefit / (expense)		0	0	2	4	22	-75
		Target (A\$) 3.04		Profit after tax		2	8	-5	-10	-51	175
				Minorities		0	0	0	0	0	0
				NPAT (underlying)		2	8	-5	-10	-51	175
				Significant items		9	0	0	0	0	0
				NPAT (reported)		11	8	-5	-10	-51	175

Sensitivity (US\$m)		NPV(A\$)	2012F	2013F	2009A		2010A	2011F	2012F	2013F	2014F	2015F	
NPV / NPAT		3.09	-10.4	-50.9	EBIT margin		n/m	n/m	n/m	n/m	62%	60%	
zr +10% increase (\$m)		3.25	-10.4	-50.9	EBITDA margin		n/m	n/m	n/m	n/m	68%	66%	
zr +10% increase (%)		5%	0%	0%	Effective tax rate		0%	0%	-30%	-30%	-30%	-30%	
nb +10% increase (\$m)		3.29	-10	-51	ROA - EBIT / (total assets - cash)		5%	18%	-20%	-2%	34%	40%	
nb +10% increase (%)		6%	0%	0%	ROE - NPAT / equity		5%	17%	-9%	-17%	-93%	61%	
reo +10% increase (\$m)		3.34	-10	-51	Cashflow		2009A	2010A	2011F	2012F	2013F	2014F	2015F
reo +10% increase (%)		8%	0%	0%	EBITDA		2	8	-8	-10	14	352	402
AUD + 10% (\$m)		-0.60	0.00	-1.78	Operating cashflow		0	-1	-6	-9	-14	264	278
AUD + 10% (%)		-20%	0%	3%	Capex		-1	0	0	-390	-505	-9	-9
AUD + 1cent (\$m)		-0.08	0.0	-0.2	Free cashflow		-1	-1	-6	-399	-519	255	269
AUD + 1cent (%)		-3%	0.0	0.0	Investing cashflow		-5	1	0	-390	-505	-9	-9
					Financing cashflow		2	0	21	450	575	-200	-150
					Net Change in cash		-3	0	15	51	56	55	119

Production and costs		Balance Sheet Analysis		2009A		2010A	2011F	2012F	2013F	2014F	2015F
kt		Debt		0		0	0	450	1025	825	675
AS\$		Equity		44		46	59	59	55	286	529
Zirconia products		Assets		45		47	61	512	1082	1114	1205
LREO concentrate		Cash		5		5	19	70	126	182	300
HREO concentrate		Net debt		-5		-5	-19	380	899	643	375
Nb products		Gearing - net debt/equity		-12%		-11%	-48%	86%	94%	69%	41%
revenue per tonne - RHS		Net debt / EBITDA		-228%		-61%	231%	-3801%	6654%	183%	93%
cash costs per tonne - RHS		EBIT / net interest		9		23	-14	2	0	-5	-7
		EBITDA / net interest		9		23	-14	2	0	-5	-8

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.

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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 01 Sep 2011)

	Global total (IB%)	Asia Pacific total (IB%)
Buy	846 (12)	550 (3)
Hold	418 (7)	227 (4)
Sell	80 (6)	48 (0)
Total (IB%)	1344 (10)	825 (3)

Source: RBS

Trading recommendations (as at 01 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)

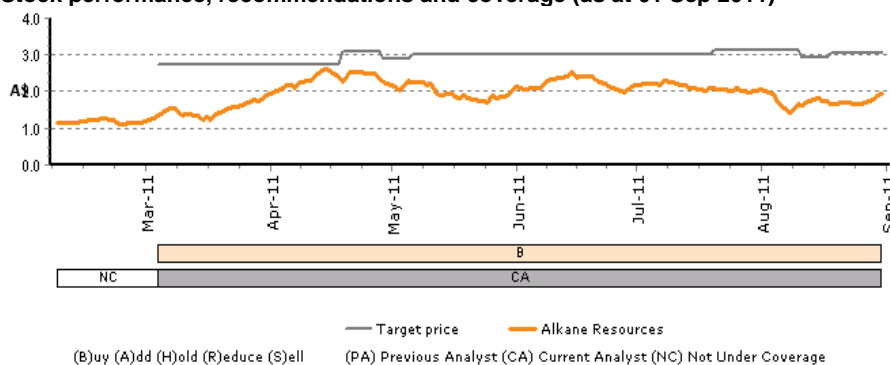
Source: RBS

Valuation and risks to target price

Alkane Resources (RIC: ALK.AX, Rec: Buy, CP: A\$1.925, TP: A\$3.04): 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 (ALK.AX, ALK AU)

Stock performance, recommendations and coverage (as at 01 Sep 2011)



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 31 Aug 2011)

	(1M)	(3M)	(12M)
Price (A\$)	2.00	2.07	0.45
Absolute (%)	-3.5	-7.0	327.8
Rel market (%)	-0.6	1.9	338.5
Rel sector (%)	6.8	4.0	261.6

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

Regulatory disclosures

None

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