StockAnalysis
Written under AFSL: 259730
October 29th, 2008
Issue 30, Vol 5
By Peter Strachan

This Week

Indices & Prices

All Ordinaries	3,755.40
Energy Index	11,624.30
Brent AU$/bbl	94.54
AUS$/US$	0.6252

As at Close October 28th

Feedback

Remember to keep your questions coming to the Feedback session and log on to listen each Thursday.

What a Week

StockAnalysis is tempted to call a bottom to this current market cycle, if not in absolute time, then very close, in actual value levels. By this I mean that we may see lower market levels over the next 6 months, but I doubt that those levels will be much below the levels we witnessed on Tuesday the 28th of October, when the All Ords traded below 3,700 points. StockAnalysis still sees a downside target of 3,450 points, but this may not be reached.

StockAnalysis Stuff

The Bullpen is in its final stages of modification and I hope that it will be up and running next week!

Letters are about to go out explaining our **Bribe to re-subscribe** deal, where every two months, we offer one lucky re-subscriber the chance to win a box of Margaret River's finest, Swings & Roundabouts wine.

Remember, if you are having any problems with access or paying for new subscriptions, please contact Laura on Laura@pex.com.au or 08 9272 6555.

Market Moves

Are Property trusts. Over geared? (MGR)

The market certainly thinks they are, but then again, the market is currently valuing cash at a discount, so I would not be looking too closely to the market for a real estimate of value. As an example, in July Mirvac announced its NTA was $3.65 per share and earnings for FY 09 were estimated at 23-25 cps, resulting in a 20 cent estimate for its distribution. However, the stock is now trading at $1.28 per share, representing just 35% of its NTA and a prospective yield of 15.6%. Clearly the world has changed, even in the three months since July, but StockAnalysis doubts that Mirvac is seriously in trouble with its cash flow, to the extent that it should attract this sort of dud rating.

Transfield and BHP Contracts (TSE)

In past editions, StockAnalysis pointed to the strong position of Transfield, whose business is largely involved in bread and butter types of engineering service operations, supplying maintenance services to water, power and gas utilities and to the mining sector, as well as property management services.

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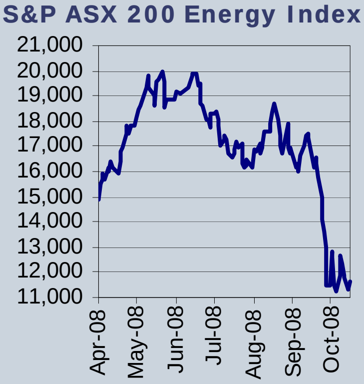
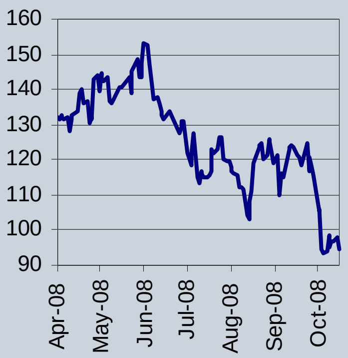
All Ordinaries

S&P ASX 200 Energy Index



Brent Crude Oil $AU/barrel



AU$/US$

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At a price of $3.15 per share, Transfield trades on a PER of 5.9 times last year's earnings and a fully franked, historical yield of 11.3%. Now we know that Transfield has gearing of around 80% and we suspect that its $120 million, 3 year contract to provide maintenance services to BHP's Ravensthorpe nickel laterite project may well be looking shaky if the nickel price remains at current levels, but the company has recently given guidance for earnings growth of around 10% this year and has a 7 year history of delivering double digit earnings growth. StockAnalysis suspects that Transfield is trading at about half real value and offers a good, long-term investment.

BHP and smaller companies

If BHP is thwarted in its bid for Rio Tinto, it may well cast its gaze at other, smaller opportunities in the sector. Oz Minerals may provide some synergies in South Australia, with its existing operations while non-core bits could be flogged into a better market in 3-4 years time. Mirabela or Albidon, with whom BHP already hold several exploration JV's, would also complement the company's involvement in global nickel production. There are also some smaller iron ore juniors whose position would fit well with BHP, should the Rio opportunity become unattainable.

StockAnalysis expects a raft of merger activity during 2009 as companies with cash are wooed by those with projects.

AVIVA/NEMI Merger (AVA)

Aviva has announced its intention to merge with Canadian listed coal miner NEMI. NEMI owns approximately 17% of a coal mine in the frozen north of British Columbia. Production is expected to lift to 1.3 mt next year and 2 mt pa the following year, generating about A$25 million in cash flow and about $10 million of free cash for the merged group in CY 2009.

StockAnalysis believes that Aviva has bought NEMI at less than half its value, but then AVA also has huge upside potential from both the mining and sale of its coal and also the development of integrated power projects.

The merged group will have net cash of slightly less than AVA's current A$17 million, but it will become an operating company with a sustaining cash flow from the sale of high quality, metallurgical coal.

Aviva remains a speculative BUY.

Horizon Oil's PNG Update (HZN)

Recommendation: ***Horizon Oil is a buy, even in the current market and oil price environment. StockAnalysis estimates that Horizon Oil has a total risk adjusted target value of 47 cps and sees the value of its hard assets of oil and gas, plus cash, less debt, underpinning a value of 37 cps.***

HZN -Capital Structure	
ASX Code	**HZN**
Shares	799.0 m.
Employee Options	31.2 m.
Price	$ 0.14
Market Capitalisation	112 $m.

Interestingly, applying the current oil price and exchange rate, results in only a small reduction in the overall estimated value for the company. StockAnalysis believes that the oil price will recover to over US$100 per barrel by early 2010 (once the 2009 recessions are over) and that the AUD is more fairly priced at a trade weighted index of 62 over the long term, which equates to around 78 US cents at the current US$ level.

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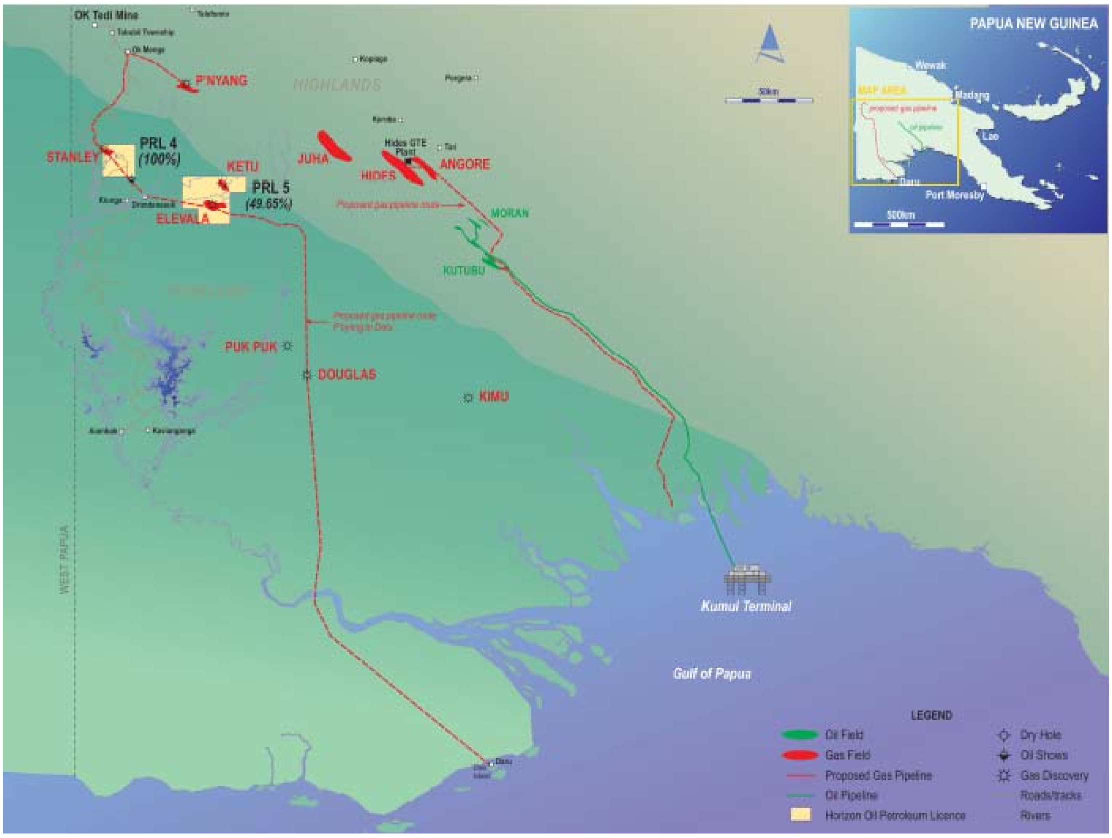
Horizon's PNG Interests



Source: Horizon Oil

Horizon plans to develop its 100% owned Stanley plus 49.69% owned Elevala and Ketu projects as condensate stripping operations, producing 4,000 bbls of condensate per day plus 40 tpd of LPG, while reinjecting 140 mmcuft per day of dry gas. The project should deliver 8 mmbbls of condensate over a projected 10 year operating life from an estimated 260 Bcf reserve of gas. The PNG Government has a right to be grandfathered into the project for 22.5%, which is paid from cash flow and acts as an effective additional tax. Drilling of Stanley-2 is planned for 2009, to provide additional security for reserves and appraise the ultimate field potential at Stanley. Subject to the results from this drilling, the plan is to build a 40km oil line to the river port of Kiunga from where oil will be barged to customers. The company has identified markets for power in PNG and West Papua. Gas from the project could ultimately be used to provide regional security for electrical power.

Horizon will be in a strong position to move forward in late 2009, since it should have established cash flows from its 10% owned Maari oilfield in the Taranaki Basin, where the first development well is now scheduled to be linked in for production by the end of 2008. Delays in development of its Beibu Gulf project takes a lot of stress off Horizon's projected cash flow availability, which will see it fund 4-5 exploration wells in the Gulf of Thailand late this year or in Q1 2007, out of additional debt facilities.

HZN – Valuation Matrix

Asset	mmbbl	Value $m	$ per Share	Comment
Net Cash (est)		-$ 18	-0.02	
Maari 10%	5.0	$ 171	0.21	
Block 22/12 14.7%	4.3	$ 80	0.10	60% POS
Block 22/12 Heavy	3.7	$ 41	0.05	40% POS
Bayou Choctaw	2.2	$ 4	0.01	
PNG	39.3	$ 34	0.04	40% POS
Option cash		$ 6	0.01	
Other		-$ 14	-0.02	Corporate
			0.37	
Risk Adjusted Exploration Value			0.10	
Total Value			0.47	

Source: Strachan Corp. Pty Ltd.

Galaxy Resources (Quest) (GXY)

Powering up the Lithium Battery Market

Introduction

Lithium/tantalum project focus

Galaxy Resources listed on the ASX in early 2007, following its purchase of the central portion of the Mt Cattlin project from the receivers of Sons of Gwalia. The company maintains exploration interests on permits which are prospective for iron and manganese, base metals, uranium and gold, but its major focus remains to evaluate lithium and tantalum projects, centred on the Mt Cattlin deposit, located just 4 kilometres north of the town of Ravensthorpe and 450 km southeast of Perth, in the south west of Western Australia. Following favourable findings from a preliminary feasibility study, the company embarked on a Bankable Feasibility Study (BFS) for Mt Cattlin in early 2008, from which results are scheduled to be finalised in December 2008.

Growth in demand for lithium ion batteries expected to keep price firm

A switch by auto makers to expand production of battery operated, electric and hybrid vehicles sees strong growth in demand for lithium minerals, used in the manufacture of lithium ion/polymer batteries.

The company has developed a robust business plan which sees it becoming a major supplier of minerals to feed high tech industries such as ceramics, high temperature glassware, batteries and electronics. The company has established mineral resources which will support a project life of 13 years and potentially over 20 years of operations.

Deeper drilling recently discovered repetitions of mineralised pegmatite, below known zones, opening up potential for underground mining at the site, should grades and commodity prices provide support.

While Galaxy is a small company with just $1.9 million of cash, the strategic nature of its resources in the booming lithium market opens up funding opportunities which could limit potential dilution resulting from multiple share issues or dilution of equity in the project.

GXY - Capital Structure		
Shares	54.9	m.
Options	3.8	
	58.7	
Cash (est)	$ 1.9	m.
Price	$ 0.34	
Market Cap'tln	$ 19	
Substantial Shareholders		
StateOne Capital Gp	11.0%	
Directors	10.6%	
Ademsa	5.8%	
Pegmont Mines	5.8%	

Galaxy – Project Location

Source: Galaxy Resources

Investment Drivers

- Galaxy is working with potential off-take customers to arrange the provision of financial support for a 1mt pa, lithium and tantalum mine in the SW of Western Australia. A bankable feasibility study, due for completion by late December '08 will set operating and financial parameters, leading to a possible development decision early in 2009.
- Global demand for lithium minerals is being driven by the steeply rising use of lithium ion batteries for mobile equipment and more recently, electric and hybrid vehicles, which has led to a rising price for lithium carbonate feedstock.
- StockAnalysis estimates that production and sale of lithium (spodumene) and tantalum concentrates over a 13 year mine life, generates a net present value (NPV) of at least $100 million, while further downstream processing of spodumene to lithium carbonate, increases total project NPV to $189 million, which compares favourably with the company's current market capitalisation of $19 million.
- Estimated after tax earnings of over $20 million pa and up to $40 million pa for a lithium carbonate plant, support an estimated market value for Galaxy of over $100 million.
- The project's economics are most sensitive to commodity price, metallurgical recovery and the AUD/USD exchange rate. Estimated value is less sensitive to feed grade and capital costs.

Resource & Potential

>12 years of mine life at 1mt pa . . . insitu value of over $91/t

A total global mineral resource, calculated to a maximum depth of ~60 metres has been estimated at nearly 25 million tonnes, containing 2mt of spodumene and 6.6mlb of Ta_2O_5. When applying a cut-off grade of 0.4% Li_2O or 5.9% Spodumene, a high grade resource of 12.3mt, containing 1.8mt of Spodumene and 3.7mlbs of tantalite is estimated.

Mt Cattlin Resource Estimates & Insitu Values

Mt Cattlin	mt	Spodumene		Li2O		Ta2O5		Total
Global Resource	24.8	8.2%		0.56%		0.012%		
Containing		2.03	mt	306	m lb	6.6	m lb	
High Grade Resource	12.3	14.7%		1.0%		0.014%		
Containing		1.81	mt	271	m lb	3.7	m lb	
AUDUSD	0.78							
Price		$ 400	US$/t	6500		$ 40	US$/lb	
Resource Insitu Value $m.		1,043				336		1,379
Reserve Insitu Value $m.		928				188		1,116
Carbonate Insitu Value $m.				1679		188		1,867

	Insitu A$/t	Rec'd A$/t
Resource value per tonne (Cons)	$ 56	$ 39
Reserve value per tonne (Cons)	$ 91	$ 64
Reserve value per tonne (Carbonate)	$ 152	$ 106

Source: Galaxy, Strachan Corporate Pty Ltd

StockAnalysis calculates an insitu value for high grade resources of $91 per tonne, if concentrates are sold, or $152/t if spodumene is further processed to produce a value-added lithium carbonate product.

Recent drilling to the west and northwest of known mineralisation has expanded known zones of relatively shallow mineralisation with drill intersections, including bore-hole GX849, with an intercept of **14 metres from 50 metres depth, grading 25% spodumene** and bore-hole GX850, which hit **10 metres from 53 metres depth grading 26% spodumene**, showing much higher grades at slightly deeper extensions. StockAnalysis believes that the proposed project will not be resource constrained. Recent drilling indicates that the project should be able to look forward to at least a 20 year project life with further extensions reliant on applying capital to drilling and the presumption of commercial grades and commodity prices over the projected project life.

Lateral & depth extensions offer expanded mine life

The Mt Cattlin ore zone occurs within a layered volcanic sequence of rocks containing hard and brittle mineralised pegmatite, sandwiched between equally hard basalt layers. Mining to depths of about 50 metres should present little difficulty, despite a need for drill and blast mining operations virtually from the surface. More recently, drilling down to about 120 metres has shown repetitions of flat lying, mineralised pegmatite below the presently proposed open pit mineralisation. With the help of its mining and engineering consultants, Galaxy is preparing a mining plan and will examine the possibility of extending mining operations at depth, either by deepening planned open pits or by application of underground mining extraction techniques.

Extensive mineralisation over 1 x 1.5 km zone

On balance, it may prove to be more profitable to mine by underground methods, rather than deepening pits, provided that deeper mineralisation with sufficient lithium and tantalum grades can be established. Final mining studies await receipt of assay results from recent drilling, along with engineering and rock mechanics studies. Mining plans currently envisage the eventual, low cost disposal of waste and tailings into mined voids, following a period of surface disposal.

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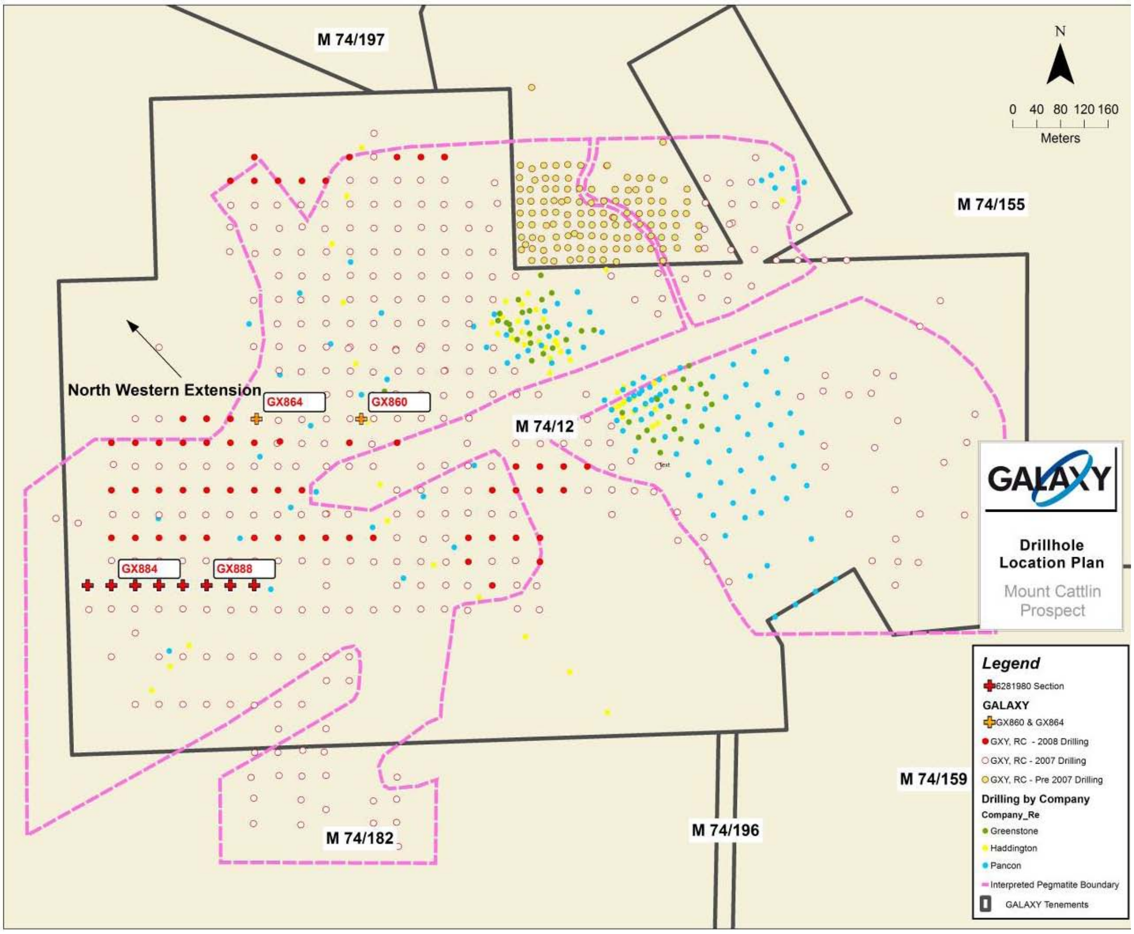
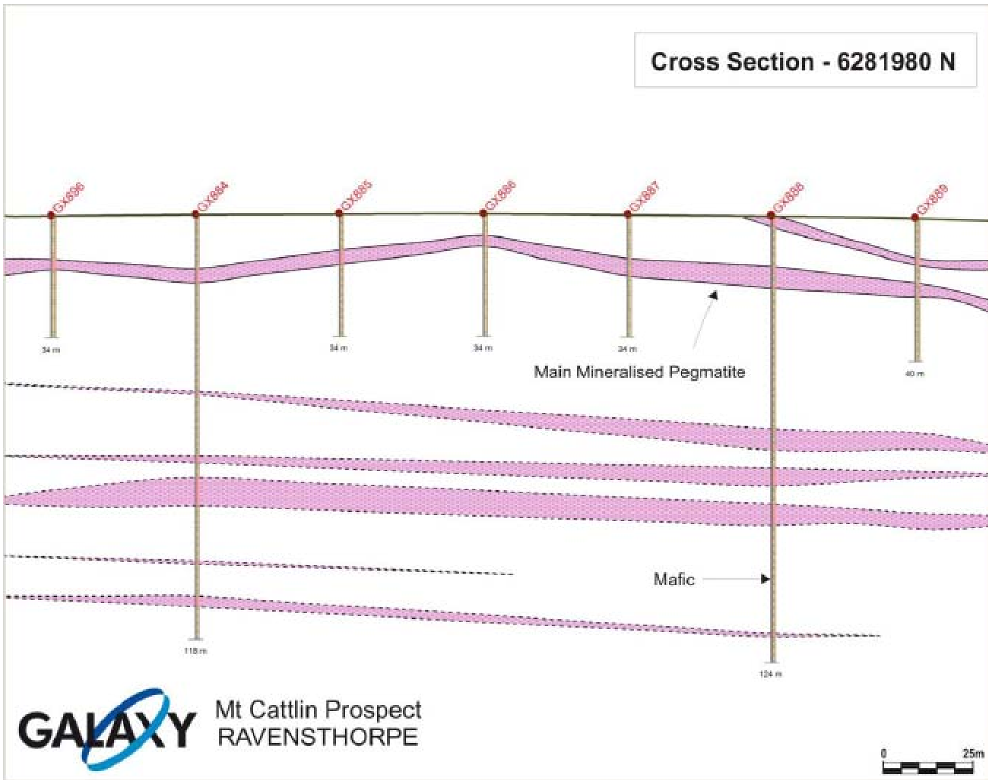
Mt Cattlin Drilling Plan



Source: Galaxy Resources

The plan above illustrates various generations of drilling activity at the project.



Source: Galaxy Resources

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Early studies indicate a waste to ore ratio of between 2.5 and 3:1, depending on cut-off grade, with contract mining set to deliver 1mt pa of pegmatite ore to a ROM pad for processing.

By-product tin and road metal can add value

Tailings material or crushed waste rock is likely to find a market as aggregates for road building or other industrial materials, representing an additional revenue stream for the project.

Project Development Planning

Galaxy has established contracts with a preferred list of key consultants to the BFS, who are progressing various aspects of the study, including:

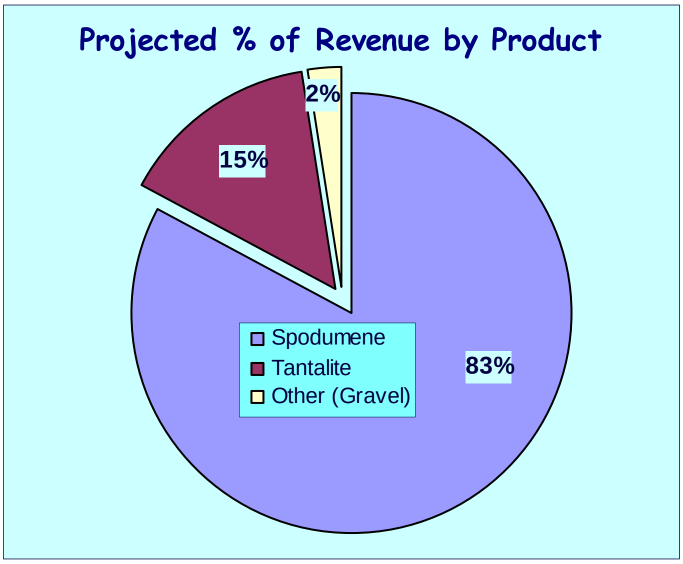
➢ Hellman & Schofield Pty Ltd	Resource estimation & modelling
➢ Orelogy Pty Ltd	Mine design, optimisation and financial analysis
➢ Dempers & Seymour Pty Ltd	Pit geotechnical design
➢ McSweeney Partners Pty Ltd	Plant design – concentrator
➢ Australian Tailings Consultants Pty Ltd	Tailings storage and process water dam design
➢ Water Management Consultants Pty Ltd	Hydrology/Process water supply
➢ Env Australia Pt Ltd	Environmental assessment
➢ Nagrom & Company	Metallurgical test work concentrates
➢ Ammtec Pty Ltd	Metallurgical test work – rock mechanics
➢ Outotec Oyj	Lithium carbonate test work and process design

Processing

Low cost magnetic & gravity separation of spodumene & tantalum concentrates

Studies so far envisage the production of a concentrate via heavy medium separation from ore crushed to 100% less than 12 mm, using a 2.9 specific gravity cut. This process would also produce a fine aggregate waste product which may be suitable for sale as road metal. The heavy media concentrate is then subject to further grinding followed by wet magnetic and gravity separation to produce about 117,000 tpa of a separate, 6% Li_2O spodumene concentrate and 351 tpa of 25% tantalum concentrate, containing 193,000 lb of Ta_2O_5.

Feasibility test work suggests recovery of over 80% for spodumene and 65% for tantalum, but StockAnalysis has applied a more conservative, 70% recovery for spodumene.



Source: Strachan Corp. Pty Ltd.

If concentrates are the final product, about 83% of project revenue will arise from the sale of a lithium product.

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Galaxy has employed the services of Finnish engineer Outotec Oyj to develop a processing route for its spodumene concentrate, taking the product through to lithium carbonate. A sample of concentrate has been dispatched to Outotec Oyj, which has recently established a similar plant for a Finnish producer, Nordic Mining.

Process design underway

The process involves roasting at 1,000°C followed by leaching with sodium carbonate, which is available from a supplier in South Australia, followed by treatment with carbon dioxide, filtration and product crystallisation. The process, which is energy intensive, should recover 85% of the lithium to a high value product, worth 10-15 times the value of spodumene concentrate. Lower cost energy alternatives are being investigated, which hold the promise of reduced operating costs.

Capital & Operating Cost Projections & Financial Outcomes

Galaxy estimates that development of a simple crushing, grinding and magnetic/gravity processing plant to treat 1mt pa would cost $50 million, but StockAnalysis has used a capital cost of $62 million. Additional processing to carbonate is estimated to cost $40 million, but StockAnalysis applies a capex of $110 million.

$62m for basic concentrate plant, add $40-110m for carbonate plant

Operating costs for an initial concentrating phase have been estimated at $33 per tonne of ore, which includes all mining, processing, plus transport and marketing costs. StockAnalysis applies an operating cost of $35 per tonne to take account of the additional cost of processing waste rock for production of aggregates. The cost of running a roasting and leaching plant to convert spodumene into lithium carbonate has been estimated at less than A$300 per tonne of concentrate processed, but again, StockAnalysis begins with a cost of A$350 per tonne.

Modelled Earnings – Concentrate Production & Sale

Mt Cattlin - Concentrates				2009	2010	2011	2012-22
Ore	tpa				0.5	1.0	11
Grade	Spodumene %				14.0%	14.7%	14.7%
	Tantalum ppm				130	135	135
Recovery	Spodumene %				70%	70%	70%
	Tantalum %				65%	65%	65%
AUDUSD			0.78				
Spodumene Con grade %Li2O				6%			
Tantalum Con grade (% Ta2O5)				25%			
Production	Li Con	Ktpa			55.6	116.7	1,283
	Tantalum Con	tpa			169	351	3,861
	Ta2O5	Klb pa			93	193	2,128
Spodumene	US$/t 6% Li2O				$ 350	$ 350	$ 465
Tantalite	US$/lb Ta2O5				$ 40	$ 40	$ 50
Revenue	Spodumene				24.9	52.4	764
	Tantalite				4.8	9.9	136
	Other (Gravel)				1.0	2.0	22
	Total				30.7	64.3	922
Mining	$/t			12			
Processing	$/t			17.5			
T port & Admin	$/t			5.5			
				35			
Operating costs		$m.			(17.5)	(35.0)	(462)
Royalties				5%	(2.5)	(3.2)	(46)
Operating cash Flow					10.7	26.1	414
Capex				(20)	(42)		
Depreciation					(4.0)	(4.7)	(52)
PBT					6.7	21.4	363
Taxation			30%		(2.0)	(6.4)	(109)
Net Profit					4.7	15.0	254
Cash Flow				(20)	(33)	20	306
Cum Cash Flow $m.				(20)	(53)	(34)	
NPV			10%	$104	million		
IRR				40%			

Source: Strachan Corp. Pty Ltd.

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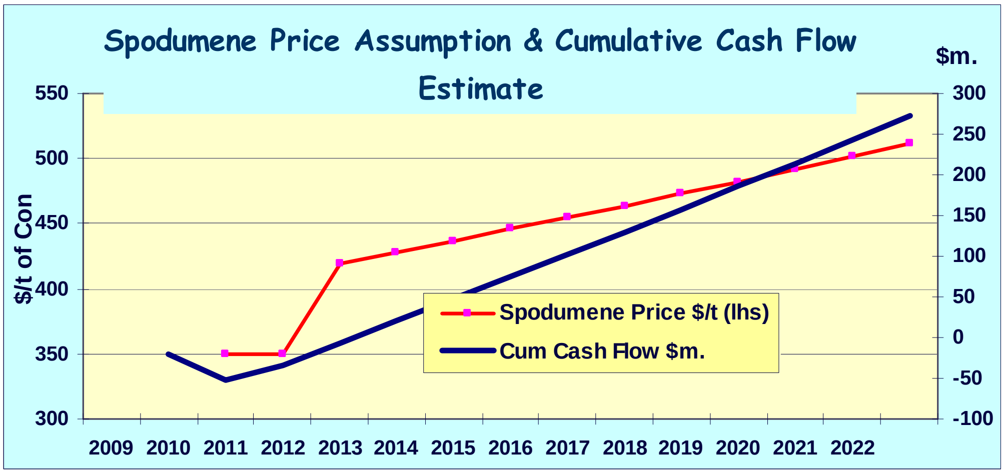
StockAnalysis estimates that a funded project to sell spodumene and tantalum concentrates, generates an NPV of $104 million. Gearing the project would reduce its NPV, but improve the return to shareholders. Total cash flow is estimated to amount to over $250 million over a 12 year project life.

NPV of over $100 m for concentrate phase alone



Source: Strachan Corp. Pty Ltd.

A project, designed to add lithium carbonate production in year 2 of operation, delivers an estimated NPV of $189 million, with cash flow exceeding $550 million, producing an internal rate of return of 31%. Gearing the project should deliver a higher IRR but lower NPV.

NPV estimated at $189 million

Mt Cattlin Li Carbonate Option			2009	2010	2011	2012	2013-22
					$m.		
Revenue	Spodumene/carbonate			24.9	87.4	134.6	1,710
	Tantalite			4.8	9.9	11.2	125
	Other (Gravel)			1.0	2.0	2.0	20
	Total			30.7	99.3	147.8	1,854
Operating costs	Mine/Con			(17.5)	(35.0)	(36.1)	(426)
	Carbonate			-	(20.4)	(42.1)	(497)
	Royalties		5%	(1.5)	(5.0)	(7.4)	(93)
Combined op	Savings				0.3	0.7	7
	Total Costs			(19.0)	(60.1)	(84.8)	(1,008)
Operating Margin				11.7	39.3	63.0	846.5
Capex			(20)	(122)	(30)	-	
Depn			-	(4.0)	(10.7)	(15.7)	(157)
PBT				7.7	28.6	47.3	689
Tax		30%		(2.3)	(8.6)	(14.2)	(207)
Net Profit				5.4	20.0	33.1	482.6
Cash Flow			(20)	(113)	1	49	640
Cum Cash Flow			(20)	(133)	(133)	(84)	
NPV		10%	$ 189	million			
IRR			31%				

Source: Strachan Corp. Pty Ltd.

Conservative commodity prices used

Discussion with potential off-take partners indicate that a 6% Li_2O concentrate should sell for over US$400/t. StockAnalysis assumes a price of US$350/t for the first two years and thereafter US$420/t and then rising at 2% pa. Tantalite concentrate is presently traded for over US$45 per pound of contained Ta_2O_5, but StockAnalysis applies an initial price of US$40 per pound, rising to US$45/lb in year three and then rising at 2% pa.

While the current price indication for high quality lithium carbonate is US$6,500 per tonne, StockAnalysis applies an initial price of US$4,500/t, to take account of a possible weaker market environment during 2010 and 2011, along with product acceptance trials, but lifts the estimated price to US$5,800/t in 2013, with subsequent price rises of 3% pa.

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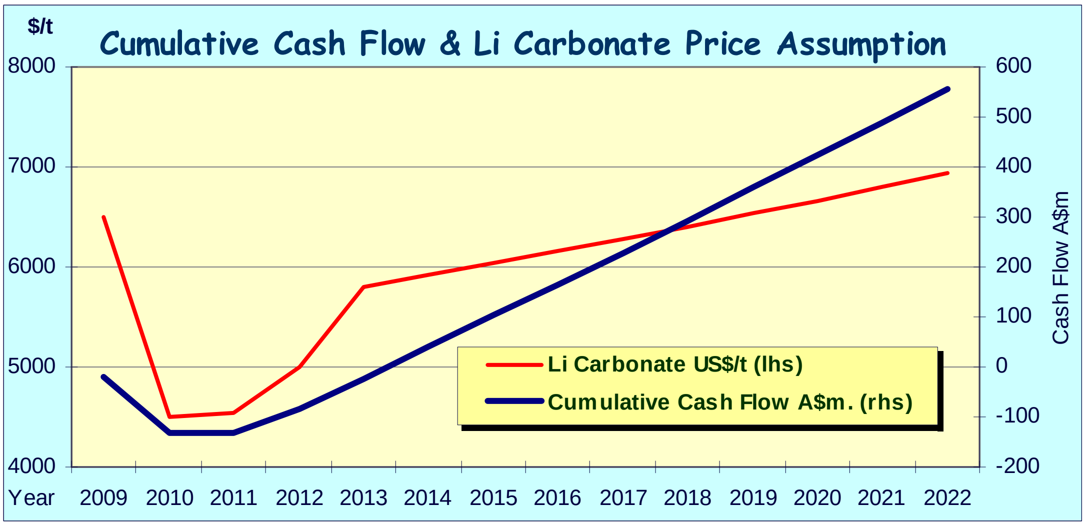

Source: Strachan Corp. Pty Ltd.

Financial Position

Seeking customer support for project finance

Galaxy is currently estimated to hold about $1.9 million of cash, which it is applying to the completion of a BFS for Mt Cattlin. Development of a project at Mt Cattlin will rely on positive results from this study and the company's ability to attract debt and equity support for the project.

The company is in discussions with potential off-take customers with a view to attracting funding support in the form of a marketing contract for lithium products and a possible up-front payment for marketing rights plus an agreement to provide funding support for project financing required. Despite current financial market weakness, such an agreement would leave Galaxy in a strong position to raise the additional equity required to support project development.

S.W.O.T Analysis

Strengths

Rising Demand for Lithium: Several auto manufacturers have initiated programmes to develop fully electrical or hybrid electric vehicles, using lithium ion batteries. Chinese battery makers are gearing up to expand capacity by 2011/12. Warren Buffett has invested in the industry.

Skilled Technical Consultants: Galaxy has appointed well regarded expert advisors in every aspect of plant design and service provision.

Known Mineralisation: Mt Cattlin resources are well understood and the project does not appear to be resource constrained.

Location: Mt Cattlin is well located to transport, services, labour, etc and has the potential to access low cost gas to fuel energy intensive parts of its process.

Opportunities

Exploration: Galaxy has the opportunity to find more mineralisation at Mt Cattlin and on its other project areas.

Corporate Activity: Companies with sound projects will marry those with cash and poor project opportunities.

Weaknesses

Funding: The company has an estimated $1.9 million of cash and will most likely require at least $10m of equity, plus debt to move forward.

Small Company: Weak equity markets expected into 2009 and possibly beyond will challenge Galaxy's ability to maintain progress on its projects.

Start-up Project: Galaxy will need the support of a customer to set off-take contracts and provide certainty for funding.

Threats

Funding: Until a BFS is completed, with all technical and commercial parameters nailed down and financial estimates firmly in place, final funding arrangements will remain uncertain.

Competition: High prices for both lithium minerals and tantalum are likely to draw in additional suppliers, potentially leading to lower commodity prices. Galaxy will need to work closely with customers to ensure that it is not in competition. Operating in an environment where Chinese producers and customers are major players presents special marketing risks.

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