

# Stock Analysis

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By Peter Strachan

This Week

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## Market Moves

### Texon Capital Structure

Shares	135
Options	5.3 50 cts 5/11 & later 5.7 75 cts 5/10 & later 8.3 \$1 5/11 & 5/12
Fully Diluted	153.8
Price	\$ 0.43
Market Cap	\$ 58 m.
Cash (est)	\$ 5 m. post current well

**TEXON POWERS AHEAD:** *Texon (TXN) remains a buy for the emerging value of its Eagle Ford and Olmos oil and gas interests in Texas. The stock has little downside risk and should continue to perform strongly for several months. It offers both a trading position as production rises short term and farm-out deals are negotiated and also a long term (12-24 month) buying proposition.*

Logging results from Texon's latest well, located south of its producing Leighton oilfield area at the Rockhampton and Mosman project area in McMullen County Texas, recorded intersections totalling 150 metres of combined Olmos and Eagle Ford Reservoirs. Texon will complete this latest well for production from the Olmos, after collecting data from the Eagle Ford and fracture stimulation of the Olmos.

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### Indices & Prices

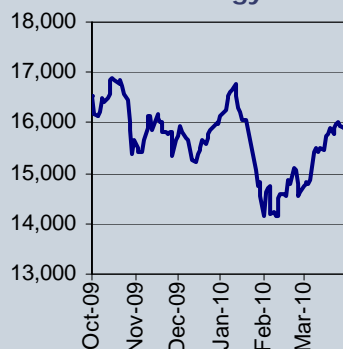
All Ordinaries	4,974.10
Energy Index	16,319.20
Brent AU\$/bbl	93.32
AUS\$/US\$	0.9279

As at Close April 6th

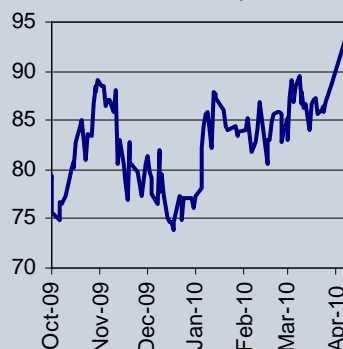
All Ordinaries



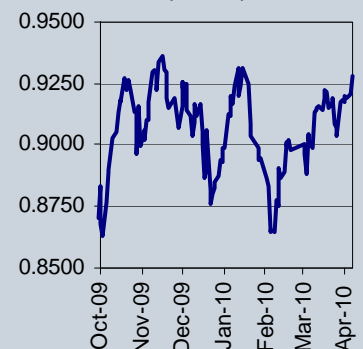
S&P ASX 200 Energy Index



Brent Crude Oil \$A/barrel



A\$/US\$



This well should add an initial 400 BOPD to Texon's production capability, once it is tied back to facilities and linked into transport to market. The company calculates that the combined potential of both its Olmos oilfield and its Eagle Ford shale prospects in both project areas amounts to a net working interest totalling 42 million barrels of oil equivalent, to the company's account. StockAnalysis believes that the risks going forward are low to moderate.

StockAnalysis calculates that gas and oil at Antares Energy's nearby Eagle Ford area has a value of US\$2.60 to US\$3.20 per Mcfe, which equates to about US\$16 per BOE, at the lower end. On this basis, hydrocarbons within Texon's McMullen County permits should have an NPV of US\$670 million. The problem for Texon is that it only has about \$5 million of cash, which is insufficient to develop this field on its own, where horizontal Eagle Ford wells cost about US\$5-6 million each to drill and complete and an additional \$20 million may be necessary to establish oil and gas processing and gathering facilities.

Assuming that Texon had to sell say 40% of its permit interests to fund development of the remaining 60%, this would still leave a value of about \$2.80 per share from this interest alone, prior to allocating value to other exploration and production assets. Alternatively, Texon could bootstrap itself into production with the help of debt from Australia's Commonwealth Bank, operating out of New York. Deducting say \$100 million in value to account for debt obligations leaves an NPV of \$4 per share in the case of total success.

TXN - Valuation	A\$m	\$/share
Discovered Gas	13	0.09
Leighton	40	0.27
Exp'n Programme	251	1.63
Data Value	3	0.02
Un-issued Equity	15	0.10
Cash (est)	5	0.03
Corporate	(9)	(0.06)
<b>Total</b>	<b>318</b>	<b>\$ 2.09</b>

**Conservatively, StockAnalysis calculates a risked value of \$1.75 per share for Texon's McMullen County interests and upgrade's total risk adjusted target value to \$2 per share.**

Subscribers are referred to the 17<sup>th</sup> of March StockAnalysis edition for a recent update on Texon.

**NEWCREST'S BID ON LIHIR INCREASES INTEREST IN SECOND LINERS:** A bid by **Newcrest** for **Lihir Gold** will increase interest in the second rank players. Funds released by this bid, either as sellers take profits or ultimately as Lihir shareholders accept Newcrest's bid and walk, will no doubt seek to regain gold exposure through stocks such as Avoca, Independence, Oceanagold, Focus, Perseus, Azumah, Catalpa and Integra. Further consolidation in the local gold mining scene is highly likely. A short term consolidation in the gold price and a shake out of the weak players is a possibility. Recent strong exploration results from **Integra** and **Catalpa**, both of which have been assisted during 2009 by commissioned Strachan Corporate reports, hold promise for expanded production from projects now under construction.

Source: Strachan Corp. Pty Ltd.

Amongst the explorers, several companies are actively drilling, including **Sipa Resources**, **Eleckra** and **Tectonic Resources**, whose commissioned Strachan Corporate report can be found here:

<http://www.tectonic.com.au/pdf/TTR%20final%2003%2010.pdf>

**Recommendations: Tectonic is a trading speculative buy ahead of first RAB drill results from its Railway prospect at the Phillips River project. Integra and Catalpa are long term buys for exposure to exploration upside and a re-rating in Q3 and Q4 2010, following the commissioning of gold production.**

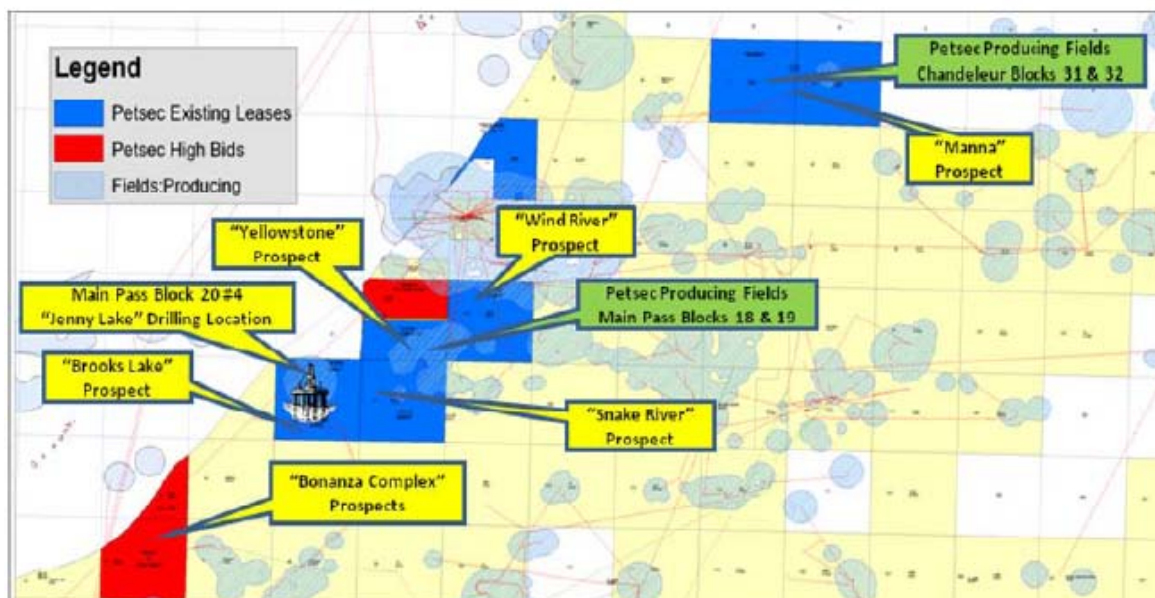
**PETSEC RE-ENTERS THE GAS EXPLORATION GAME:** Petsec (PSA) has not approached the surface of the earth with drill bit for such a long time that StockAnalysis wonders if it still remembers how! The company has been biding its time during the GFC, controlling costs, repaying debt, studying prospects, bidding for new permits and waiting until drill rig rates subsided sufficiently to warrant drilling some of its prospects. With the help of farm-out funding, the company is embarking on 3 exploration wells at a combined cost of about \$8 million, which have a combined potential to yield between 33 and 48 Bcfe of gas to the company's account.

StockAnalysis guesses that the first well, Main Pass 20#4 holds potential for up to 80 Bcfe at a depth of 4,000 metres. Petsec will retain a 30% interest, so discovery would be worth about 22 cps, and underwrite the company's current market capitalisation. This 3 well programme has a risked valuation of about 12 cps, with total upside of about 37 cps, adding to the value of its existing producing reserves in the GoM, worth about 22 cps and development assets in the Beibu Gulf, worth an additional 17 cps.

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While it is easy to come up with a risk adjusted target value of 50 cps for Petsec, the stock will continue to underperform because it has no clear path to deliver that value to shareholders. Petsec, in common with others in the sector such as Amadeus, never generates sufficient free cash flow to be able to grow its business for shareholders. All operating cash surpluses are inevitably reapplied to sustaining operations and paying wages.

## Petsec Main Pass Focus Area Prospects and Production



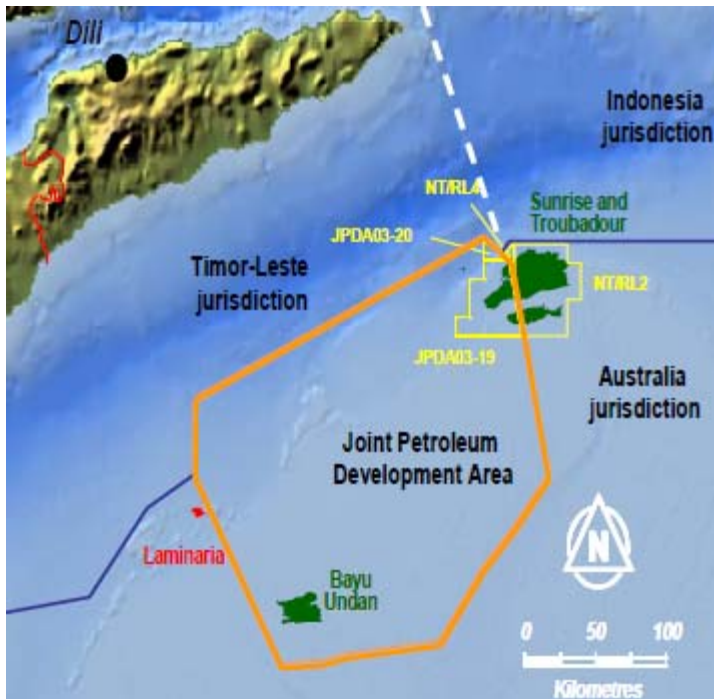
Source: Petsec

**Recommendation:** *Petsec is a trading buy for a two to four month time frame, during its GoM drilling campaign. Early success could see the stock initially regain recent highs around 34 cents.*

**IRON ORE SHENANIGANS IN CHINA:** Calls by China Iron and Steel Association for steel mills to boycott iron ore purchases from Brazil's Vale, Australia's Rio Tinto and BHP are not going to create more iron ore supply and will not alter the medium term outlook for the price of that bulk commodity. If this type of market manipulation was tried on the ASX, the perpetrators would be thrown in jail for 10 years! (just kidding, they would probably be offered top jobs with ASIC)

Global seaborne trade in iron ore presently runs at about 1,000 million tonnes per year. China currently imports about 650 to 700 million tonnes pa or about 55 mt per month, with some recent months seeing import levels of over 65 mt. Coincidentally, the three major iron ore suppliers deliver about 650 million tonnes pa into the seaborne iron ore trade, of which StockAnalysis estimates about 75% is destined for China.

Chinese steel mills have recently increased their inventory levels. There is currently about 90 million tonnes of iron ore on hand, sufficient for 50 days of consumption. During the past 12 months, when contract iron ore has been available for an FOB price of less than US\$62 per tonne, China's high cost domestic suppliers cut back production. In the current high price environment, Chinese domestic iron ore production could ramp up by about 10 million tonnes per month and steel mills might try to reduce production while sourcing ore from other Australian producers, along with suppliers in South Africa and India, while running down inventories. In this way, the Chinese steel industry could survive a 60 day boycott on buying from the big three iron ore miners. Inevitably, the Chinese steel industry would then face a massive restocking task, which would be negatively impacted by infrastructure bottlenecks and broken goodwill between customer and suppliers.



**SUNRISE DELAYED:** Yet again, the Woodside operated Sunrise LNG project looks set to be delayed, however the company is not going to be hugely upset. Woodside and its partners on the Browse project have just commenced a 22 month, \$1.3 billion investment process to study development of a project at James Price Point. In addition, Woodside is getting towards the sharp end at its Pluto LNG project, which is due to deliver first gas in Q1 2011 and will be looking at delivering an FID for Pluto II late in 2011, so the company will be fairly busy on the project development front, not to mention ongoing drilling to find enough gas to fill Pluto II.

Sunrise was discovered in 1974 and was on Woodside's 'to do' list in 2004, with a start date pencilled in by 2010. If it had proceeded, the people of Timor Leste would now be receiving some handsome royalty cheques. But that has not eventuated. Instead, a new treaty was negotiated, splitting royalties from the project 50/50, despite the fact that only 20% of the field is situated in the joint petroleum development area, where 90% of royalties accrue to Timor Leste and 10% to Australia and the bulk of the resources are in undisputed, 100% Australian jurisdiction. The Australian and Timor Leste governments have however agreed to fiscal and administrative terms so that the

underlying issue of sovereignty along the border can be resolved in 50 years time. This should have been sufficient to provide certainty for Woodside to take Shell, ConocoPhillips and Osaka Gas down the development path. But no! Timor Leste thinks that it would be a good idea to bring the gas to shore in East Timor! What bank is going to fund that? What engineer is going to lay a 40 cm diameter steel pipe down a 2,000 metre deep undersea ravine and up the other side, across a seismically active region?

StockAnalysis observes that the government of Timor Leste appears to have taken up a mendicant personality. This cargo cult style of approach to its own development, relying on others to deliver goods and services, is truly unhealthy. A more mature approach for the East Timorese would be to take control of their own destiny in an achievable fashion and become self reliant. Secularising their economy, educating children, reducing their huge population growth by educating and empowering women while putting the church where it belongs, away from government and social policy issues. In so many poor nations, religion is the last refuge for the destitute. Timor Leste needs to gear up to feed itself and control its destiny without relying on foreign companies or governments to provide aid or build pie-in-the-sky projects where there is no commercial rationale.

Continued delay in progressing resource projects which stand to deliver much needed funding for government sponsored social infrastructure development, is not in the best interests of the country, where about 50% of the population is under the age of 25 years.

**CHINA IN OTHER MARKETS:** China was apparently an active importer of base metals during 2009, when prices fell during the GFC. Low copper (<\$2/lb) and nickel (<\$7/lb) prices provided Chinese manufacturers and consumers with a golden opportunity to restock and build inventories of strategic metals which had previously posed a bottleneck for industry as a result of high prices and a lack of availability in 2006/7. Prices for nickel, copper and iron ore have now recovered as a result of China's aggressive buying. Commodity funds have most likely piggybacked on this phenomenon to trade metals higher, leaving a volatile market in the short term, with the potential for a short but sharp pullback as was seen in late March, when Greek sovereign debt became an issue. If China were to begin to sell into the current high commodity prices, a rapid fall would be seen as traders head for the door.

China's high cost domestic base metal and iron ore producers will again be competitive at current prices. StockAnalysis expects that imports will generally be lower during the June quarter, resulting in moderation or falls in prices for base metals and spot prices for bulk commodities, even as OECD nations continue a patchy recovery. Supporting this theory, the Baltic dry Index of shipping costs for bulks, has weakened since early March, though this may be more to do with increase shipping tonnage than lack of cargo, but only time will tell.

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Sovereign debt and current account deficits in many European nations as well as in Japan will continue to play a negative hand in global economic recovery. There can be little doubt that taxation rates will rise during 2010 in an effort to repay national debts, while government spending levels will retreat from post Lehman Brothers stimulus levels, resulting in a reversal of the financial stimulus seen during 2009.

Meanwhile, an expected surplus of copper during 2010 has most likely been turned into a balanced market as a result of production problems in Chile following its massive earthquake and ongoing issues at Olympic Dam, which combined may have cut as much as 110Kt of copper supply from this year's market.

**HOKI RESTARTS:** Can I refer subscribers to StockAnalysis for 10<sup>th</sup> of March. Rig repairs are complete and all partners in the Taranaki triathlon took a big jump on news that the rig is now up an' at 'em.

**GOLDEN STATE:** Logging looks OK on its Paradox Basin well, but having previously seen plenty of hype about gas with not much in the way of real and sustainable gas flows, the market is saying lets see the gas. While logging can give estimated reservoir porosity it has a limit when determining permeability and thus gas flow potential.

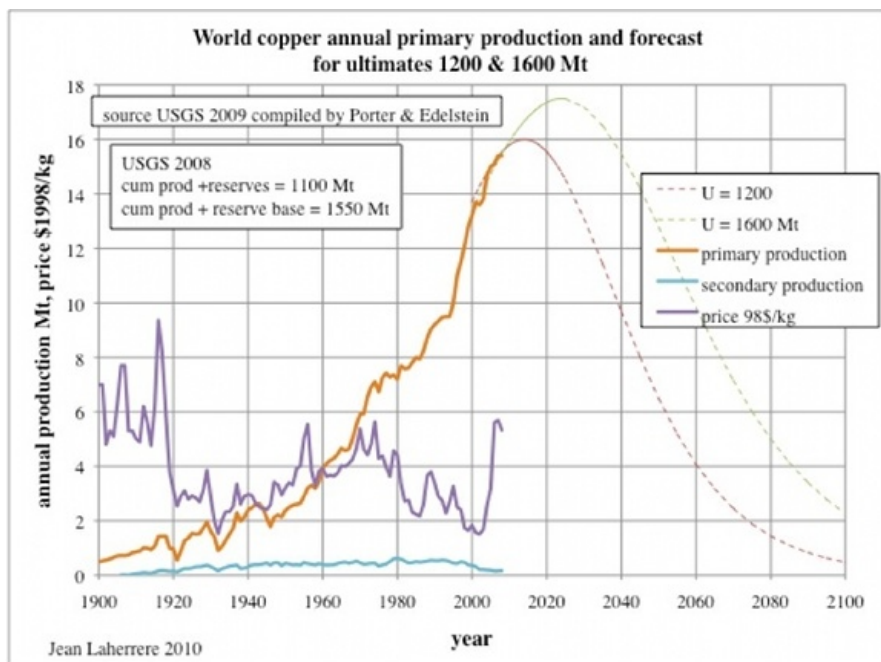
**JUPITER ENERGY:** The company's J-50 well in Kazakhstan has so far drilled 91 metres of Triassic Reservoir and is looking the goods to prove up a 2P Triassic target of 8.6 mmbbls, with upside to 20 mmbbls, plus a further 20 mmbbls of overlying Jurassic. With roughly 1,087 million shares, assuming 8 cent options are exercised; JPR would have \$25 million in the bank and 17 cps of oil in the ground, with an ability to ramp up to 1,000 BOPD from its discovery later this year. *Jupiter rates a speculative buy ahead of production testing.*

**HAVILAH ROARS INTO IRON ORE:** First pass drilling on the company's Lilydale magnetite prospect in South Australia has come up with five intersections averaging between 29% and 33% Fe, which is in line with normal magnetite grade expectations over two zones, totalling about 30 metres in thickness. The company has outlined a total target strike zone of 20 kilometres from geophysical data. These 5 holes were located within a 2 km zone of high magnetic signature. StockAnalysis calculates that this small section of the Lilydale prospect could contain 10 million tonnes of magnetite mineralisation to a depth of 50 metres. Metallurgical tests will be undertaken to determine recovery characteristics of this mineralisation. StockAnalysis estimates that Havilah's larger target on this permit could stretch to 50 million tonnes of shallow, open pitable material, which would support a project to produce 2 mt pa of concentrate for 10 years.

## Peak Copper

**Conclusion and Recommendations:** *The copper market remains tight in the short term, though stocks of the metal in Asia remain a wildcard in the short term. At just over 5 weeks of global consumption, visible inventories remain low and are unlikely to expand. In the longer term, Australian copper miners, such as BHP Billiton, PanAust, OZ Minerals and Equinox Minerals, as well as project developers including CuDeco, Exco Resources and Sandfire Resources along with explorers and developers such as Tectonic Resources, all appear to have a bright future, provided management is sound and finance can be found.*

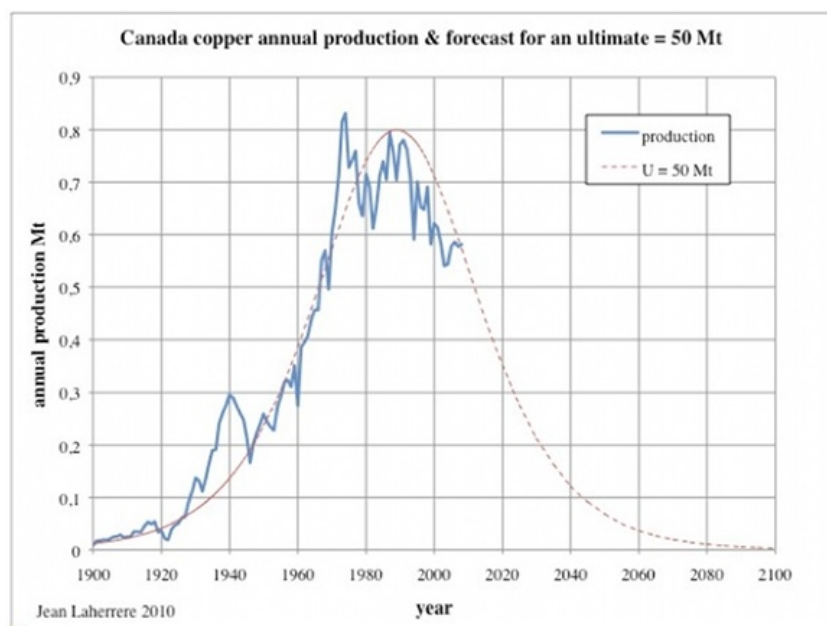
Former TOTAL executive and now author and writer Jean Laherrere, has applied his Peak Oil analysis skills to look at the copper market long term. So far, we have mined about 550 million tonnes of copper globally and on the basis that there will be an ultimate recoverable copper resource on the planet of 1,600 million tonnes, Laherrere predicts peak copper production globally by 2025. If the ultimate Resource is 1,200 mt, then the peak will be prior to 2020.



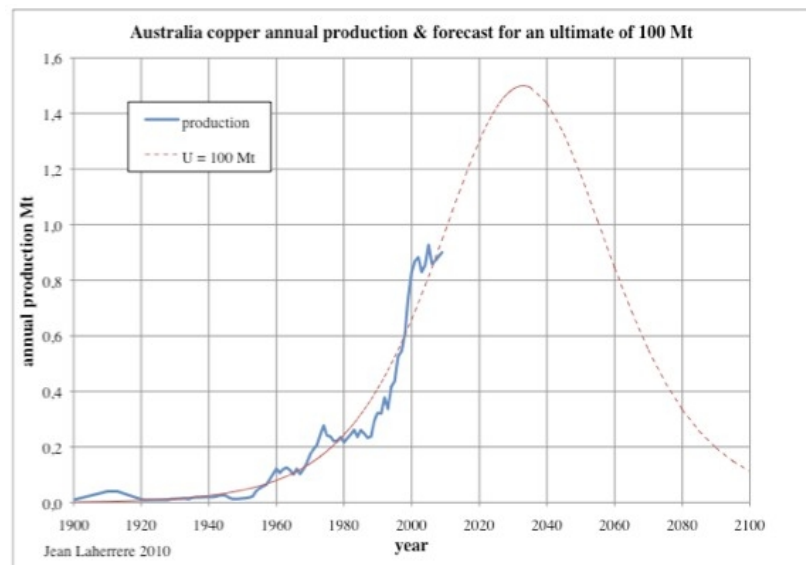
Annual mined copper production currently runs at about 16 million tonnes pa while refined production, which included scrap, is just under 19 million tonnes. The difference between oil and copper is that copper can be recycled after use, whereas oil is burned and can not be reused.

The graph to the left shows the history of copper's annual production rise to the present day, across the past century, along with real copper prices in \$ per kilogram in 1998 price terms. Recent price highs and lows of around \$4.30/lb in 2008 and \$1.40/lb in early 2009, correspond to a price of US\$6.20/kg and US\$2.10/kg, roughly corresponding with the past 90 year's highs and lows, while today's price of US\$3.60/lb is roughly \$5.20/kg in 1998 terms.

While periods of high copper price have some influence on production trends, sharp rises in copper production appear to be more a result of major technology improvements, such as the arrival of solvent extraction and electrowinning (SX-EW) during the late 1970's, combined with increased mechanisation of mining and processing, larger equipment and new discoveries in Chile and Asia during the 1980's and 1990's.



In Canada, copper production peaked in about 1974 at about 820Kt pa and has since declined to 580Kt pa. The USA's copper production peaked in 1998 at 2.2 mt and is now 1.25 mt pa. Total copper production has been 135 mt and an ultimate recoverable target of around 200 mt of copper is estimated. Production in Chile is close to a peak of 5.5 mt pa and after producing 125 mt, an ultimate reserve of 300 mt is postulated.

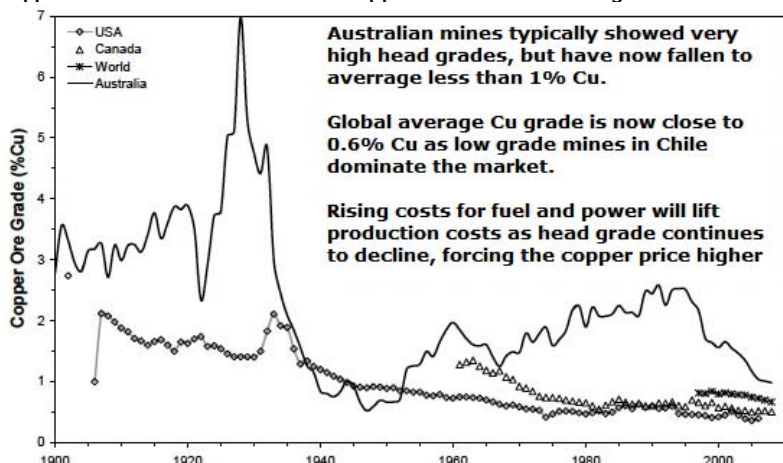


Here in Australia, copper production has so far been 21 mt while annual output runs at 900Kt and could rise to 1.5 mt pa by 2030, once Olympic dam and few other new projects hit their straps. Ultimate reserves are set at 100 mt, with 32 million tonnes at Olympic Dam alone. New discoveries are adding to the national resource. CuDeco's Rocklands project is likely to have an initial Resource of 1 million tonnes of metal, but ultimately 3 to 4 million tonnes, while Sandfire's DeGrussa currently has 372Kt of high grade copper and should ultimately end up with well over 1 million tonnes of metal, all of which puts Australia's yet to be produced 80 mt of copper in perspective.

Mined copper ore head grades have also been on a downward curve. In Australia 100 years ago, a head grade of 3-4% copper was considered normal, but today's miners think that 1% copper is a bonanza, while many mines eke out a living on grades of 0.4% Cu. Clearly when you have to move more waste and more ore to get a tonne of copper, extraction costs will rise. As oil prices rise and energy cost generally take a quantum jump, low cost SX-EW will cease to be the easy and cheap process route for oxide ore once the price of electricity rises to reflect higher coal and gas prices.

(Continued on page 7)

Copper Head Grades Over Time with Approximate Global Average



Copper remains a strategic industrial metal, with uses in construction and transport goods, as well as electronics and heat exchange/power production, though aluminium is by far the largest metal used by tonnage. Substitution by aluminium and PVC in various applications is ongoing, but has slowed and has gone about as far as it can in many applications. Prices are already so high that theft has become a major problem in electrical distribution systems. Some copper based coinage now has a higher intrinsic value than its face value.

## The Hunger Project in Australia

This clip shows a number of Hunger Project investors who travelled with me to Bangladesh last October, including communications specialist Michele Nichol, the head of McKinsey & Co in Australia and former global head based in New York Michael Rennie, a Melbourne based investor Tom King and of course Badiul, the head of THP in Dhaka. <http://www.youtube.com/watch?v=fO-G5CndP1Y> and <http://www.youtube.com/watch?v=5MPpiRjRZQw>

A number of forums are planned in Perth, Melbourne and Sydney for Badiul's visit to Australia next week. If you would like to become an Investor in The Hunger Project to achieve a social return, or even if you are a crusted on believer that poor people deserve to be poor and can not be helped and so have no intention of getting involved, you can contact the organisers to attend an event and meet this amazing man. Badiul will be travelling with his wife Tazima, who is a tireless worker for THP and a village woman from the countryside of Bangladesh, who will be able to tell her story. You will not fail to be moved by what you hear and see.

In Perth there will be a public forum at the Ernst and Young Lecture theatre at the UWA Business School on Crawley Drive at 5:30 pm on Friday the 16<sup>th</sup> of April. For information about other events in following days in Melbourne and Sydney, please contact Cathy Bourke at [cathy@thp.org](mailto:cathy@thp.org) or on 0411699482.

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The author has small holdings in shares of BRU, SRI. Modest holdings in ABC, NMS, OEL, OSH, CWP, NXS, UXC, MGR, COF, PAG, SUN, COE, AGK, HZN, RCR, TAP, AWE, TLS, PTM, WPL, & GLH and larger holdings in ACE, HAV.