

Sumatra Copper & Gold (SUM)

PFS Stage 2 : confirm base case valuation

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Three Key Points

- On 7 September, 2012, SUM announced the results of the Definitive Feasibility Study on Stage 1 of the re-development of Stage 1, processing 1,800kt, at 400kt/yr, producing . On 24 September, 2012, SUM announced the results of the Pre-Feasibility Study on Stage 2 to process a further 4.2Mt, at an increased rate of 900kt/yr.
- Incremental capital is \$1.5m and gold production increases from 146koz over 5 years to 385koz over 8 years at a cash cost of \$431/oz.
- SUM is now working on upgrading some of the PFS work to DFS standard to enhance the debt funding and reduce the amount of equity to be raised.

SUM : PFS Stage 2; 36c valuation confirmed

DFS Stage 1 : 146koz gold, cash cost \$487/oz

SUM announced the DFS results on 7 September. Pre-production cap.ex is \$38.5m.

PFS Stage 2 : total 249koz gold, cash cost \$431/oz

SUM have just announced the results of the Pre-Feasibility Study on Stage 2 of the development of Tembang. The incremental capital is \$1.5m.

Next Steps

Tembang has been mined previously and SUM has developed, though flooded, open pits when can be quickly brought into production.

There has been a mill previously, so a site has been prepared and mill foundations are in place,

SUM will do more work on some of the Stage 2 components to upgrade the quality of the work to DFS status. This will enhance the debt funding for the project.

Environmental approval was given in March and the Mining Lease was granted in April 2012.

Tembang has been previously mined an the South Sumatra regency has an approved regional forestry plan in place. SUM expects that the Forestry Approval will be granted during the December quarter.

Investment View

The results of the PFS confirm Octa Philip's valuation of SUM of 36c a share, after allowing for an equity raising (see our note of 7 September, 2012).

Octa Phillip confirms a Strong Buy recommendation.

Recommendation

Strong Buy

Previous Recommendation	Strong Buy
Risk Rating	High
Current Share Price	\$0.15
12 Month Price Target	\$0.36
Price Target Methodology	DCF
Total Return (Capital + Yield)	139%
NAV / Share	\$0.35
Market capitalisation	\$33m
Liquidity – Daily Value	\$0.1m

EPS Changes & Octa Phillip vs. Consensus

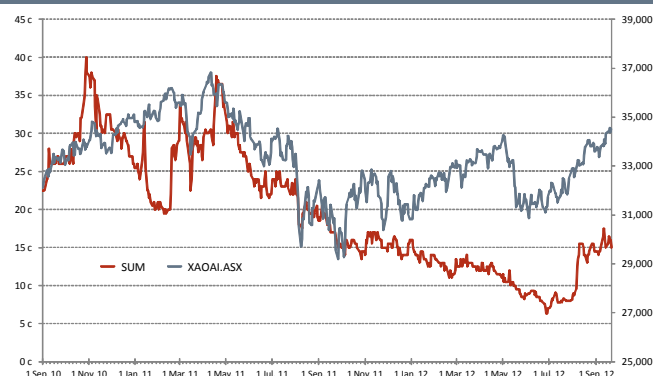
Y/e (\$m)	2012F	2013F	2014F
Previous EPS (cps)	-0.3c	2.2c	3.6c
Change in EPS (%)	-2%	-52%	78%

Financial Forecasts & Valuation Metrics

Year ended December	2012	2013	2014	2015
Revenue	SA 0m	SA 4m	SA 45m	SA 75m
NPAT (reported)	(SA 4m)	(SA 2m)	(SA 2m)	SA 14m
Adjusted EPS (cps)	(1.7c)	(0.6c)	(0.7c)	4.3 c
EPS Growth (%)	49 %	64 %	(20%)	678 %
DPS (c)	0.0 c	0.0 c	0.0 c	0.0 c
EV / EBITDA (x)	(7.8 x)	(90 x)	4.1 x	1.2 x
PE adj. (x)	(9 x)	(24.3 x)	(20.2 x)	3.5 x
Dividend Yield (%)	0 %	0 %	0 %	0 %
Gearing (%)	0 %	39 %	36 %	30 %
Interest Cover (x)	n/a	(2.5 x)	0.4 x	6.4 x

Source: Octa Phillip Securities estimates

Sumatra Copper & Gold : share price v. market



Source: Octa Phillip Securities estimates

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SUM : PFS for Stage 2

Figure 1 shows the key results from the announcement of the PFS.

Figure 1 : Key Results from SUM's PFS on Tembang

	Units	Stage 1 DFS	Stage 2 (incremental impacts)	Total Tembang Project after Stage 2
Gold production	Oz	146,000	249,000	395,000
Silver production	Oz	1,388,000	3,446,000	4,834,000
Processing Rate	tpa	400,000	500,000	900,000
Mine Life		5 years	3 years	8 years
Pre-production capital	US\$ M	\$38.50	\$1.50	\$40.0
Total Capital	US\$ M	\$68.0	\$37.5	\$105.5
Revenue	US\$ M	\$261	\$477	\$738
Net cashflow ⁽¹⁾	US\$ M	\$71	\$151	\$222
Cash operating Cash Cost C1 ⁽¹⁾	US\$/Oz	\$487	(\$56)	\$431

NOTE 1) C1 Costs are as defined by Brook Hunt and are cash costs before tax and royalties and after silver credits using a silver price of US\$30 per ounce and a recovery of 80%.

Source : SUM ASX announcement, 23 September 2012

On 7 September, 2012, SUM announced the results of its DFS on Stage 1 of the re-development of Tembang, in southern Sumatra.

On 24 September, 2012, SUM announced the results of PFS on Stage 2 of the re-development of Tembang.

Incremental pre-production capital cost is an extra \$1.5m, which will be paid out of cashflows.

Combined, Stages 1 & 2 are expected to produce 395koz of gold at a cash costs of about \$431/oz.

The key outcomes are

- A further 249koz of gold is produced;
- Throughput is increased from 400kt/yr by 500kt/yr, through the addition of a ball mill, a gravity concentrator, a cyanide detoxification tank, and tails thickener, while the elution circuit is operated for a second shift;
- The pre-production project capital for Stage 2 is an incremental \$1.5m, as shown in Figure 2, while further capital is paid out of project cashflows; and
- Projected cash costs are \$431/oz.

Figure 2 : Total Capital, Tembang project

	Stage 1 (DFS)	Stage 2 expansion	Total Project
Pre-production capital	US\$ 38.5m	US\$ 1.5m	US\$ 40.0m
Sustaining capital	US\$ 29.6m	US\$ 35.9m	US\$ 65.5m
	US\$ 68.1m	US\$ 37.4m	US\$ 105.5m

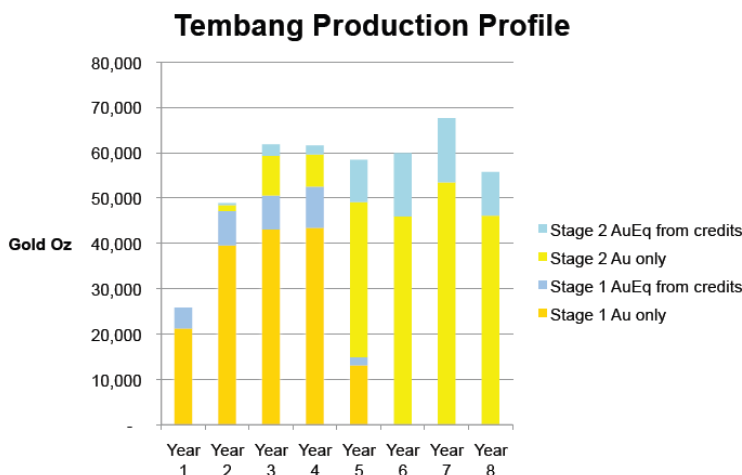
Source : SUM ASX announcement, 23 September 2012, Octa Phillip

As shown in Figure 3, gold production from Tembang is expected to be about 40koz/yr in Stage 1, rising to 50koz/yr for Stage 2, though the pattern of production will be determined by mining and the mining plan.

As shown in our research note of 7 September, SUM has 550koz in Measured and Indicated Resources, of a total of 976koz gold plus 12Moz silver in Resources, compared with total expected production of 385koz.

SUM has 550koz of gold in Measured and Indicated Resources, of a total of 976koz gold and nearly 13 Moz of silver

Figure 3 : Tembang project, gold and silver production



Source : SUM ASX announcement, 23 September 2012

Valuation

Figure 4 shows Octa Phillip's projected financial outcomes for SUM's share of the Tembang project.

Figure 4 : Octa Phillip's projected outcomes, SUM share of Tembang

	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
AUD/USD	1.014	1.000	1.000	1.000	1.000	1.000	1.000	1.000	1.000	1.000	1.000
Gold	\$ 1,636/oz	\$ 1,650/oz	\$ 1,650/oz	\$ 1,650/oz	\$ 1,650/oz	\$ 1,650/oz	\$ 1,650/oz	\$ 1,650/oz	\$ 1,650/oz	\$ 1,650/oz	\$ 1,650/oz
Silver	\$ 31.7/oz	\$ 30.0/oz	\$ 30.0/oz	\$ 30.0/oz	\$ 30.0/oz	\$ 30.0/oz	\$ 30.0/oz	\$ 30.0/oz	\$ 30.0/oz	\$ 30.0/oz	\$ 30.0/oz
TEMBANG, SUM share	100 %	100 %	100 %	100 %	100 %	100 %	95 %	79 %	73 %	67 %	61 %
Gold sold	0 oz	1,904 oz	22,900 oz	38,350 oz	62,307 oz	64,212 oz	57,157 oz	35,979 oz	32,615 oz	28,567 oz	1,130 oz
Silver sold	0 koz	21 koz	229 koz	381 koz	801 koz	892 koz	788 koz	460 koz	407 koz	376 koz	16 koz
Gross Revenue	\$A 0.0m	\$A 3.8m	\$A 45m	\$A 75m	\$A 127m	\$A 131m	\$A 118m	\$A 73m	\$A 66m	\$A 58m	\$A 2m
Mine site cash costs	\$A 0.0m	\$A 2.4m	\$A 19m	\$A 27m	\$A 38m	\$A 41m	\$A 38m	\$A 29m	\$A 27m	\$A 23m	\$A 1m
Realisation costs	\$A 0.0m	\$A 0.4m	\$A 0.4m	\$A 0.6m	\$A 1.2m	\$A 1.2m	\$A 1.1m	\$A 0.7m	\$A 0.6m	\$A 0.5m	\$A 0.0m
Royalties	\$A 0.0m	\$A 0.1m	\$A 1.6m	\$A 2.7m	\$A 4.6m	\$A 4.7m	\$A 4.3m	\$A 2.7m	\$A 2.4m	\$A 2.1m	\$A 0.1m
E B I T D A	\$A 0m	\$A 1m	\$A 24m	\$A 44m	\$A 83m	\$A 84m	\$A 75m	\$A 41m	\$A 36m	\$A 32m	\$A 1m
Dep'n & Amort'sn	\$A 0.0m	\$A 0.6m	\$A 14.5m	\$A 18.7m	\$A 21.4m	\$A 19.5m	\$A 0.0m	\$A 0.0m	\$A 0.0m	\$A 0.0m	\$A 0.0m
Interest	\$A 0.0m	\$A 0.6m	\$A 2.7m	\$A 2.7m	\$A 2.6m	\$A 0.0m	\$A 0.0m	\$A 0.0m	\$A 0.0m	\$A 0.0m	\$A 0.0m
Tax	\$A 0.0m	\$A 0.0m	\$A 1.6m	\$A 5.7m	\$A 14.7m	\$A 16.2m	\$A 0.0m	\$A 0.0m	\$A 0.0m	\$A 0.0m	\$A 0.0m
N P A T	\$A 0m	\$A 0m	\$A 5m	\$A 17m	\$A 44m	\$A 49m	\$A 59m	\$A 31m	\$A 27m	\$A 24m	\$A 1m
Net Cashflow to SUM	(\$A 4m)	(\$A 11m)	\$A 18m	\$A 27m	\$A 48m	\$A 57m	\$A 50m	\$A 25m	\$A 22m	\$A 20m	\$A 1m
Asset sales	\$A 0.0m	\$A 0.0m	\$A 0.0m	\$A 0.0m	\$A 0.0m	\$A 0.0m	\$A 8.8m	\$A 1.8m	\$A 1.0m	\$A 0.1m	\$A 0.0m

Source : Octa Phillip estimates

Assuming SUM processes ONLY its project reserves, Octa Phillip's risked, base case valuation is 36c a share.

We believe there is significant upside potential to our valuation from

- Successful project deliver;
- Higher gold and silver prices than we have assumed, which are \$1,650/oz for gold and \$30/oz for silver;
- Development of Resources not in Reserves at Tembang;
- Further known mineralisation at Tembang; and
- Gold and silver mineralisation at Tandai.

We retain our Strong Buy recommendation on SUM

We expect that SUM shareholders will achieve a better outcome than that shown in Figure 4 :

- We have allowed for divestiture to Indonesian interests, at a discount to the NPV, as required by the new Mining Law of 2009, but the Tembang project is covered by a Contract of Works which stipulates that the required divestiture be done at "fair value";
- SUM currently has a significant local shareholding, but this is at a corporate level, rather than the project level, and SUM has yet to determine how to optimise this outcome, as the first divestment is not required until 5 years after first production.

Figure 5 shows the asset based detail of Octa Phillip's valuation of 36c a share. Note that we have allowed for an equity raising, at a discount to the current share price.

Figure 5 : Octa Phillip's valuation confirmed as 36c a share

discount rate = 12.5 %	risked :	31-December-2011			23 Sep 2012
		100%	Product	per share	
	90 %	\$A 47m	\$A 42m	13 c	14 c
	75 %	\$A 70m	\$A 52m	16 c	17 c
	75 %	\$A 5m	\$A 4m	1 c	1 c
	50 %	\$A 5m	\$A 3m	1 c	1 c
	50 %	\$A 0m	\$A 0m	0 c	0 c
	100 %	(\$A 13m)	(\$A 13m)	(4c)	(4c)
	100 %	\$A 3m	\$A 3m	1 c	4 c
	100 %	\$A 12m	\$A 12m	4 c	1 c
	100 %	\$A 4m	\$A 4m	1 c	1 c
TOTAL		\$A 133m	\$A 107m	33.6 c	36 c
Shares on issue		190.6m	FPO shares	48.6m	options
		101.8m	to be issued	25.5m	exercised

Source : Octa Phillip estimates

Also, we have not given any valuation to resources not included in the current mine plan, as discussed earlier, nor other known mineralisation at Tembang or Tandai.

Our valuation is based on the parameters shown in Figure 4. Figure 6 shows that using current spot prices gives a small uplift in our valuation, while our risking assumption has a significant impact.

Conclusion

We see significant potential beyond our base case valuation. We retain a Strong Buy recommendation.

Figure 6 : Valuation Sensitivity

	Base Case	Spot prices
Base Case	36 c	39 c
Un-risked	44 c	48 c

Source : Octa Phillip estimates

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Recommendation Criteria**Investment View**

Octa Phillip Securities Investment View is based on an absolute 1-year total return equal to capital appreciation plus yield.

Buy	Hold	Sell
>20%	20% – 5%	<5%

A Speculative recommendation is when a company has limited experience from which to derive a fundamental investment view.

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