



Sumatra SPECULATIVE BUY

Current Price: **\$0.17**

Ticker: **SUM**
Sector: **Materials**

Shares on Issue (m): **183.9**
Market Cap (\$m): **31.3**
Cash (\$m): **5.5**
Enterprise Value (\$m): **25.8**

52 wk High/Low: **\$0.18** **\$0.40**
12m Av Daily Vol (m): **0.42**

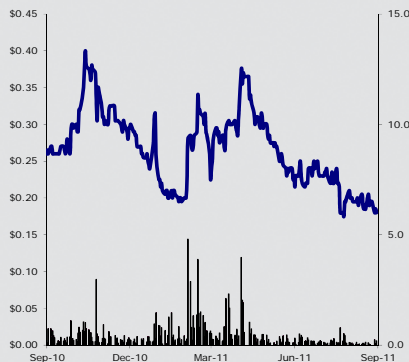
Directors and management

Warwick Morris Non-Executive Chairman
Julian Ford Chief Executive Officer
Adi Adriansyah Sjoekri Director
Jocelyn Waller Non-Executive Director
Dr Michael Price Non-Executive Director
Peter Nightingale Non-Executive Director

Substantial shareholders

Macquarie Bank 9.5%
Newcrest 7.0%

Share Price Graph



Analysts:
Troy Irvin
Tim Serjeant

16 September 2011

Doing the sums

Focused on production:

Sumatra (SUM) is targeting production from its 100% owned Tembang project in Southern Sumatra, Indonesia by 2014. Two stages of development are planned.

Stage 1 comprises a 200-400ktpa plant delivering 40-45kozpa Au and 350-400kozpa Ag over a 4 year mine life. Head grades are 7.0g/t Au and 64g/t Ag, with cash costs of US\$340/oz (after silver credits).

Stage 2 offers an additional 6 years of mine life. The production concept is a 750ktpa plant delivering 40-45kozpa Au and 650-800kozpa Ag, 2.0g/t Au and 31g/t Ag head grades, and US\$450/oz cash costs (after silver credits).

SUM recently raised \$3.8m (before expenses) via a placement (23.98m CDIs at \$0.16 per CDI). The funds will primarily be used to further advance feasibility studies. SUM also received a firm undertaking from an institution to take up an additional 6.25m CDIs on the same terms to raise a further \$1.0m (subject to shareholder approval).

Impact:

Positive

Argonaut values Stage 1 at \$0.18 based on SUM's slated production rates, commissioning in June Q 2014, and a 15% discount rate. Price and cost assumptions are US\$1,100/oz long term gold, US\$66m capex, and US\$400/oz cash costs (after silver credits). This valuation exceeds the current share price, implying the market is attributing nil value to Stage 2 development and the exploration upside.

View:

Positive

SUM's aggressive push towards production doesn't come without risk, in particular timely permitting in a jurisdiction with a mixed track record. However the upside is substantial. The success of Kingsrose (KRM) demonstrates the potential re-rate if SUM can successfully take Tembang into production. In FY11 KRM delivered 27koz from the Way Linggo mine in Sumatra and is targeting 45kozpa at US\$185/oz cash costs. Resource grades are 8.4g/t Au and 129g/t Ag, with mining to date achieving 14.8g/t and 174g/t Ag. KRM has an EV of ~\$330m.

SUM has an undemanding EV of \$20/Resource oz (Au eq) v a peer average of US\$59/oz.

Recommendation:

Spec Buy

SPECULATIVE BUY maintained.

Important Disclosures

In December 2010 Argonaut acted as broker to a placement to raise \$1.1m and in September 2011 Argonaut acted as co-lead manager to a placement to raise \$3.8m.



Gold production by 2014

Focused on becoming an Indonesian precious metals producer...

SUM is targeting gold and silver production by 2014 from its 100% owned Tembang project in Southern Sumatra, Indonesia.

Figure 1: Sumatra – Prolific mineralisation



...at the Tembang project in Southern Sumatra

Source: All figures and tables are source from SUM unless stated otherwise

Staged development

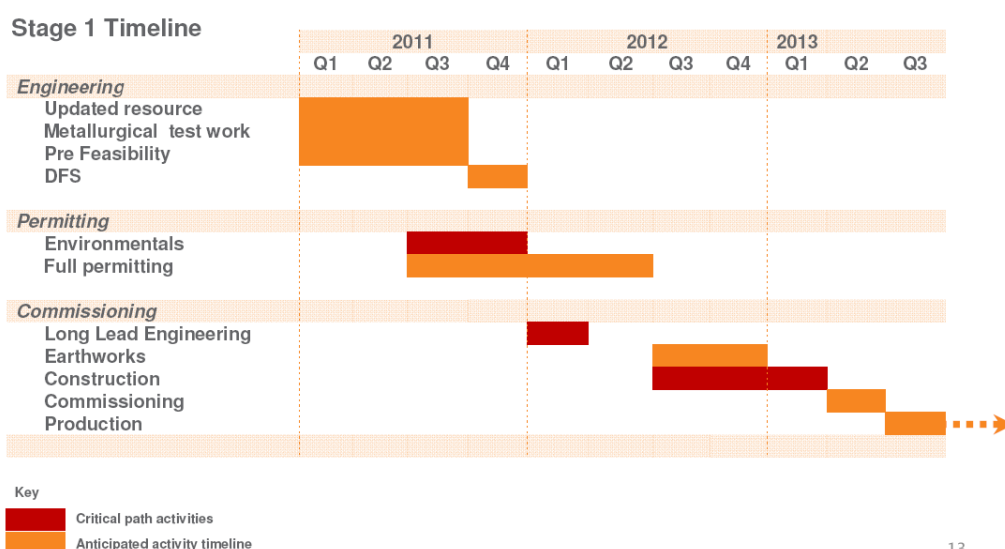
Two stages of development are planned...

The Company is planning two stages of development:

- Stage 1 - 200-400ktpa plant delivering 40-45kozpa Au and 350-400kozpa Ag over a 4 year mine life, 7.0g/t Au and 64g/t Ag head grades, US\$340/oz cash costs (after silver credits)
- Stage 2 - Offers an additional 6 years of mine life, 750ktpa plant delivering 40-45kozpa Au and 650-800kozpa Ag, 2.0g/t Au and 31g/t Ag head grades, US\$450/oz cash costs (after silver credits)

Table 1: Tembang project timeline

...with first production by 2014





Tembang was previously mined from 1997 to 2000

Tembang (formerly Rawas) is a large low-sulphidation epithermal system that produced 155koz by open pit mining from 1997 to 2000 (operated by Laverton Gold).

Figure 2: Tembang – Aerial view



Stage 1 is valued at \$0.18 per share...

Valuation

Argonaut values Stage 1 of Tembang at \$33m (or \$0.18 per share) using the gold and silver price assumptions presented in Table 2, and the project parameters presented in Table 3.

Table 2: Argonaut's price assumptions

Assumptions		FY12	FY13	FY14	LT
Gold	US\$/oz	1,550	1,550	1,550	1,100
Silver	US\$/oz	25	25	25	20
fx	A\$:US\$	1.00	1.00	1.00	0.80

Source: Argonaut

Table 3: Argonaut's project parameters

Tembang		
Key Project Assumptions		Stage 1
Ore mined	ktpa	200
Gold grade	g/t Au	7.0
Gold recovery	%	91
Gold production	koz	45
Silver grade	g/t Au	64
Silver recovery	%	82
Silver production	koz	326
Mine Life	yrs	4
Capex	US\$m	66
Sustaining capex	US\$m pa	5
Cash Costs - uninflated	US\$/oz	400
Fiscal		
Government royalty	%	3.75
Tax Rate	%	30
Discount Rate	%	13

*Denotes average over life of mine

Source: Argonaut

...exceeding the current share price

Argonaut's Stage 1 valuation exceeds the current share price, implying the market is attributing nil value to Stage 2 development and the exploration upside.



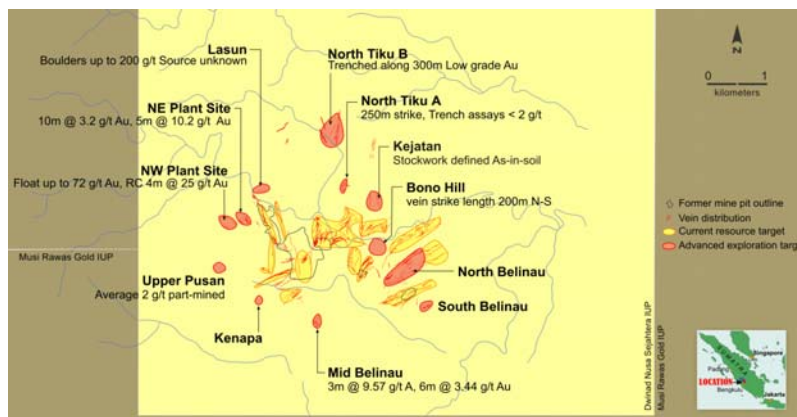
Exploration upside

Tembang near mine

SUM has multiple near mine exploration targets at Tembang...

SUM has multiple near mine exploration targets at Tembang, divided into current Resource targets and advanced exploration targets.

Figure 3: Tembang – Near mine targets

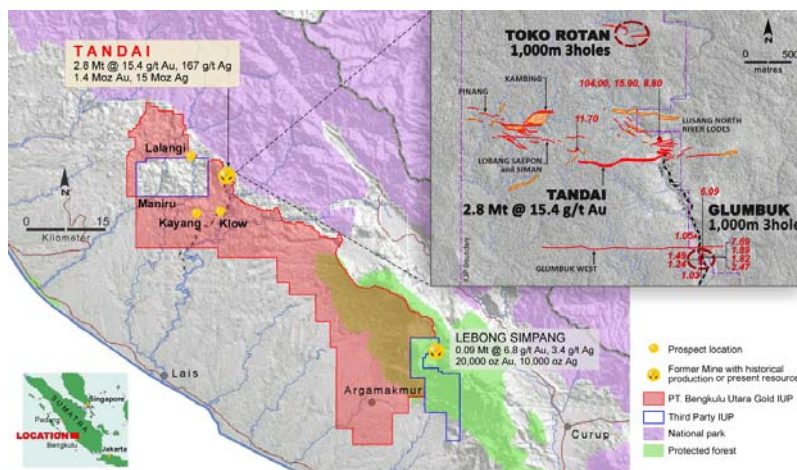


Tandai JV

...a JV with gold major Newcrest at Tandai...

At the Tandai JV historic Dutch underground production totalled 1.4Moz Au and 15Moz Ag at a grade of 15.4 g/t Au and 167 g/t Ag. A further 150koz Au was produced by CSR/Billiton during 6 years of mining following the mine's reopening in 1986.

Figure 4: Tandai JV – NCM earning in



Newcrest (NCM) is spending US\$12m over 5 years to earn 70%. NCM plans to grow by acquisition and exploration in the Asia-Pacific region and Africa, and is a connoisseur of high grade Indonesian epithermal deposits. NCM successfully mined >2Moz from three ore bodies (Gosowong, Toguraci and Kencana) on Halmahera Island since 1999.

Sontang

...a polymetallic discovery at Sontang...

SUM discovered this new high-grade polymetallic manto in ground previously explored by other companies. The best intersection to date is 11.9m @ 6.5g/t Au, 33g/t Ag and 8.0% Zn.

Other

...and other greenfields IUPs covering >1370km²

Other 100% owned greenfields IUPs cover >1370km².



Key risks

Permitting

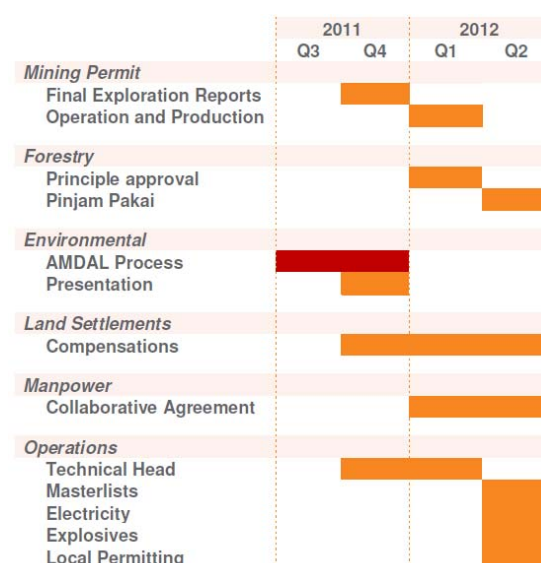
Risks include timely permitting...

Timely permitting is critical for SUM to meet its development target.

Director Adi Sjoekri is a key mitigating factor, with a track record navigating the permitting process in Indonesia (at North Lanut, North Sulawesi and Martabe, Sumatra). Mr Sjoekri has over years 17 corporate experience, working for major companies such as CSR and Newmont, and is focused on Government liaison, permitting, and forestry for SUM.

Importantly, the Tembang environmental impact assessment (AMDAL) is underway given it is the critical path activity.

Table 4: Tembang project permitting



Sumatra Performance

Historical

- New Mining Law passed in Dec 2008
- Further regulations in 2010
- All SUM IUPs converted to new IUP's by Jan 2010
- All subsidiaries are 100% owned PMA companies with corporate structure approved by BKPM in March 2011

Key Issues

- AMDAL process is critical path
- Both Land and Forestry have previously been compensated
- Forestry is lowest level of Production Forest and has previously been harvested or clear felled

...with AMDAL on the critical path...

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Power

...and power costs (especially for Stage 2)

A pre-condition to implementing Stage 2 will be lower power costs. While grid power is relatively cheap, it is unreliable and currently unavailable at Tembang. The current plan is to use contract diesel power.

Recent additions to management

SUM recently boosted the management team...

Given the development focus SUM has appropriately boosted management, adding substantial project experience with two recent key appointments:

- Julian Ford – Chief Executive Officer (Chemical Engineer) - 25 years industry experience with major resource companies including Alcoa, British Gas, Western Metals and Rustenburg Platinum, co-founded Zambezi Resources in 2004
- Grant Harding - Project Manager (Metallurgist) - >25 years in the resources industry, Indonesian experience includes Way Linggo (KRM), Gosowong (NCM), Wetar (FND) and Bakan (AVM.L)

...adding substantial project experience

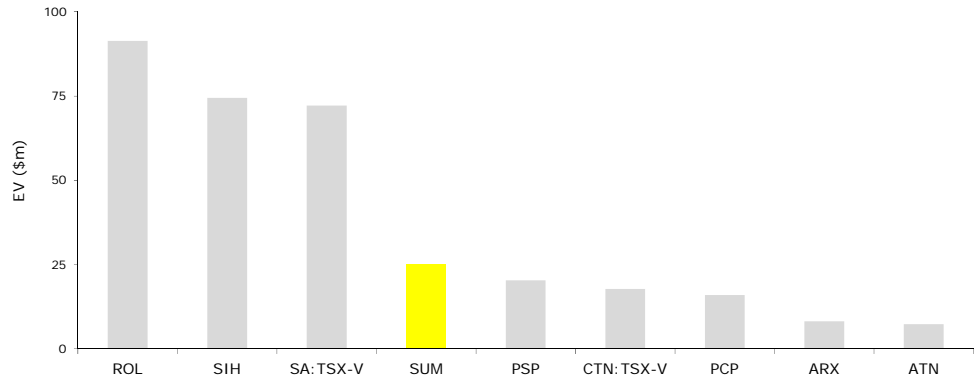


Peer comparison

Argonaut presents a peer group of 10 pre-production stocks...

A peer group of Indonesian pre-production stocks is presented below.

Figure 5: Indonesian explorer peers - EV



Source: Argonaut

G Resources (HK1051) has been omitted from Figure 5 given the EV is an outlier at ~\$830m.

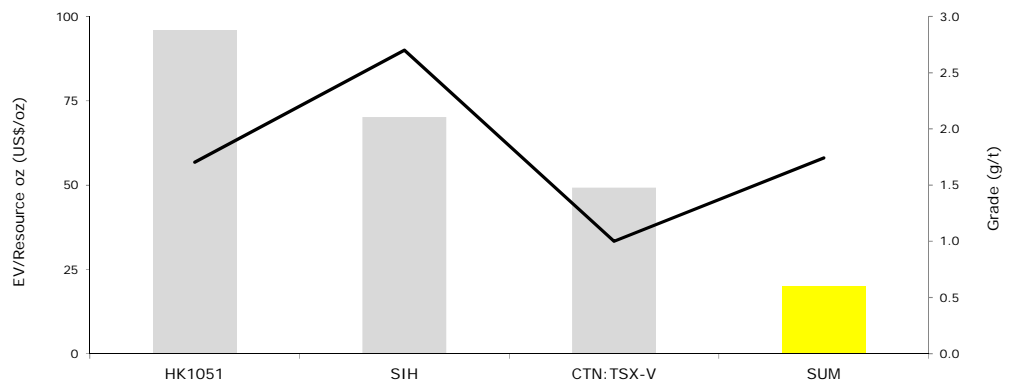
...with 4 currently offering established Resources...

Within the pre-production group only 4 stocks have established Resource estimates – G Resources, Sihayo (SIH), Centurion (CTN:TSX-V) and SUM. The next likely addition is Southern Arc (SA:TSX-V) in the first half of 2012.

SUM's current Tembang Resource (August 2011) is 22.6Mt @ 1.35g/t Au and 17.6g/t Ag for 976koz Au and 12.8Moz Ag.

The stock is trading at an EV of US\$20/oz (Au eq) v an Indonesian peer average of US\$59/oz.

Figure 6: Indonesian explorer peers - EV / Resource oz and grade



...including SUM with 976koz Au and 12.8Moz Ag...

...putting the stock on an EV / Resource oz of \$20

Source: Argonaut

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