

Cash costs still nag as Lihir nears target



Lihir Gold may appear inexpensive on current valuations but the company will no doubt find itself under heightened scrutiny over the coming months.

Lihir is poised to finally silence its detractors as it has highly prospective exploration projects, rising production at its flagship project and the strain of its failed Ballarat aspirations is now removed from the balance sheet.

Wholesale upgrades to most US dollar gold forecasts will also benefit the stock to an extent, providing the basis for much of the market's renewed enthusiasm for gold equities.

But it is unlikely to be all smooth sailing as the gold miner pushes ahead in its quest to hit 1 million ounces of production a year on Lihir Island in Papua New Guinea and in turn reduce its cash operating costs by 2012.

"Cash costs have always been an issue. They've had some mixed results as far as that's concerned in the past. At times they seem to have cash costs under control and other times they don't," Aushli Dextia's head of equities, Paul Xiradis, says.

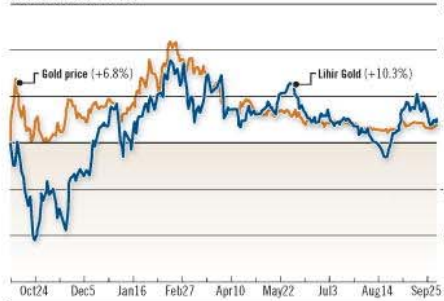
Others are more confident, but are at pains to stress the importance of Lihir meeting production guidance. This year, the company is expected to deliver 770,000 ounces to 840,000 ounces of gold from Lihir Island.

"There's no reason they shouldn't get there, but they need to actually do it," one Melbourne-based analyst says.

"Cash costs should come down with economies of scale but they're never going to be the lowest cash cost producer."

Digging deep

Returns since Oct 08 (%)



Unlike Australia's biggest independent goldminer, Newcrest Mining, Lihir doesn't produce copper as a byproduct.

"Newcrest has the copper credits to offset. We see Lihir's cash costs as decent, they're in the low mid-range on a world scale," the analyst says.

Cost and production issues aside, brokers are pretty much united in their opinion that Lihir is now cheap. Of 20 analysts covering the stock, 13 rate it a "buy", five remain neutral while only one has a sell recommendation.

Royal Bank of Scotland analyst Lyndon Fagan upgraded the stock from "hold" to "buy" last week, pointing to the recent run in the gold price that has gone largely unnoticed by the market.

Spot gold has moved up by over \$US100 an ounce since July to break through \$US1000 an ounce, as the US dollar has taken a clobbering and uncertainty lingers over the amount of run left in the recent equity market rally.

"With the company offering pure gold exposure, no hedging or debt and strong production growth, we believe a share price of 1.45 times is reasonable on a 12-month view," Fagan says. "The stock is currently trading at 1.2 times net present value, which

We have seen the gold price move up a little of late but we haven't seen the share prices recover.

appears cheap from a historical perspective."

Goldman Sachs JBWere prefers Lihir among all gold stocks, with a "buy" rating and \$3.90 price target. The broker says it favours some exposure to gold both as an insurance policy as well as the potential outperformance from gold equities that have a strong volume growth profile.

But not everyone agrees. "In the short term, we're happy not to be exposed to gold. We have seen the gold price move up a little

Lihir Gold's key forecasts Year to Dec, fully diluted

	FY07	FY08	FY09F	FY10F	FY11F	Move
EBITDA (\$USm)	212.3	346.3	550.5	611.0	639.8	▲
Reported net profit (\$USm)	-24.1	109.3	232.0	233.6	282.3	▲
Normalised net profit (\$USm)	111.5	184.9	260.6	296.2	313.3	▲
Normalised EPS (\$US)	0.06	0.08	0.1	0.1	0.1	
Normalised EPS growth (%)	14.2	44.3	30.2	13.7	5.7	
Dividend per share (\$US)	0.0	0.0	0.0	0.0	0.0	
Dividend yield (%)	0.0	0.0	0.0	0.0	0.0	
Normalised P/E (x)	42.1	29.1	22.4	19.7	18.6	
EV/EBITDA (x)	26.7	16.7	9.7	8.9	8.1	
Price/net operating cash flow (x)	43.3	25.0	11.9	9.9	10.9	▼
Return on invested capital (%)	10.8	9.2	8.9	11.6	10.7	

*R last 12M

SOURCE: BLOOMBERG, RBG FORECAST

of late but we haven't seen the share prices recover," Xiradis says. "I guess part of the reason is that no one is convinced that we're going to see the gold price holding at these sort of levels and we do know that those gold companies are very much exposed to the strength or otherwise

of the gold price and also the strength of the Aussie dollar, which has been a counter."

Longer term there may be cause for some reconsideration, however. "We are bullish, keeping in mind we have a view that gold probably won't be running too hard in the short term," the Melbourne-based analyst says.

"From a 12-month perspective we're fairly comfortable and we see Lihir as the least expensive of all of the gold stocks, particularly of the big caps. That really is the driver for

our preference there," Xiradis says. The market will also be closely watching as Lihir forges ahead with potential acquisitions in west Africa. But management — which had to write off nearly \$700 million in costs associated with the failure of its Ballarat gold mining project — will be under the microscope this time around.

"It's important that they get future acquisitions right and don't overpay," Xiradis says.

"From an exploration perspective we see west Africa as a very prospective area for Lihir. One of the potential upside scenarios is that they acquire something else in west Africa to complement what they've already got."

A number of junior explorers have nearby projects, including Perseus Mining, Adamus Resources, Mineral Deposits and Appella Mining. The analyst says Lihir could look to target a project with a capacity of around 200,000 to 250,000 ounces a year.

Ayesha de Kretser

Much more to be made on commodities than shares

The Kaleel brothers are basing their predictions on the belief China's need for commodities will keep rising, writes **Justin Bailey**.

Commodity markets have picked up substantially over the past quarter and a boutique fund manager, H3 Global Advisors, is sure to have benefited.

The company, founded by Andrew and Mathew Kaleel in 1995, specialises in commodity investments.

The H3 Global Commodities Fund, which is co-managed by the brothers, has outpaced its benchmark, the Dow Jones-UBS Commodity Index, since its inception in 2005, while returning an annualised 9.9 per cent.

H3 manages more than \$100 million in assets for clients that include Westpac Banking Corp and Mercer Global Investors.

In the September quarter, the Dow Jones-UBS Commodity Index gained 4 per cent and it is up 9 per cent for 2009.

The Kaleels are confident they will beat the index again this year, after their fund returned minus 2.5 per cent after fees last year, compared with a 35.7 per cent plunge in the benchmark.

"This year we're showing double-digit returns and we're currently up over 10 per cent year to date," Andrew Kaleel says.



Mathew Kaleel, left, and Andrew Kaleel of H3 Global Advisors... 'agriculture is probably the biggest growth area'. Photo: MICHELLE MOSSOP

The H3 Global Commodities Fund provides investors with actively managed, long-only exposure to commodity markets such as oil, gold, copper, coffee and wheat.

The Kaleels also use cash as an active asset class, which has helped them outperform the index in the current climate.

Emerging markets, particularly China, have driven prices for most commodities over the year, but fears of a drawn-out recovery have tempered gains. In the past quarter, China's stimulus-fuelled stockpiling showed signs of slowing. Imports of

iron ore, food and fuel products fell in August as the country's central bank began to put the brakes on lending.

Deutsche Bank analysts predict China's economy is going to slow over the second half of the year, which has the potential to hit prices of commodities, unless demand in the US and Europe picks up.

The Kaleels don't agree and believe demand for commodities from Asia is going to continue to grow, particularly in the agricultural sector.

"Agriculture is probably the biggest growth area in the next five

to 10 years," Mathew Kaleel says.

In August sugar prices reached a 28-year high after continued shortages because of falling output from India, the world's biggest sugar consumer, and Brazil. In the third quarter, the sugar price soared 43 per cent and the Kaleels believe this is a sign of things to come, not just in sugar but in most agricultural commodities. A third of the commodity fund is in agriculture.

"Australia's probably going to do as well from its food growth as its metals and gas deposits," Mathew Kaleel says.

Investors can get exposure to this

increased demand in two ways, they can buy futures contracts in commodities or they can buy companies that operate in the space.

The Kaleels favour a balanced approach and advocate a mixture of the two asset classes — not only for agriculture, but also for metals.

"A lot of research we've done shows that it is prudent to have both equities and commodities in your portfolio. Why? Because the two asset classes will do better at different points in time."

"We're not saying people should overload the boat with commodities, it's simply just another asset class people should look at diversifying into," Andrew Kaleel says.

Last quarter gold broke through its 2008 record to hit \$1018.90 an ounce and is still trading above \$1000, but that's nothing compared to what gold stocks have done.

Last month Lihir Gold gained 15.3 per cent, while Newcrest Mining was up 16.4 per cent.

"A lot of research we've done shows that it is prudent to have both equities and commodities in your portfolio," Andrew Kaleel says.

"There are also a lot of markets out there that futures can provide access to that stocks can't, including agricultural markets like coffee, cotton and sugar," Mathew Kaleel says. "You may be able to buy a company like CSR, but that doesn't perfectly track what sugar has done."

In the third quarter sugar was up 43 per cent, while CSR gained only 12 per cent.