G

Gold Sector Sensitivities

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Rolling with the punches

13 January 2009

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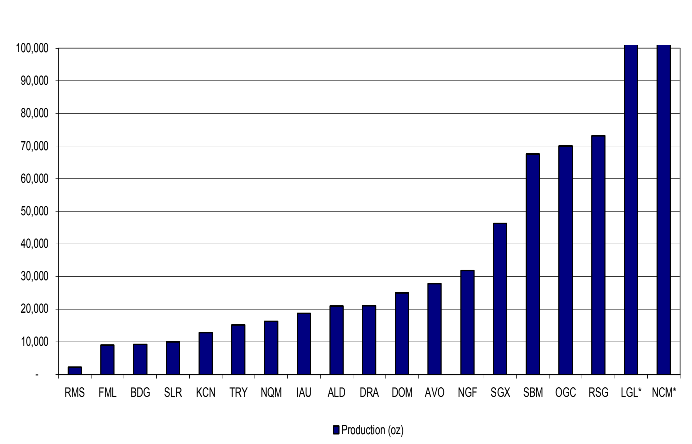
Investment Highlights

- **Macro developments to drive share prices from here**. Following on from our January sector note, the US bailout package failed to target unwinding of the over-the-counter (OTC) derivative market which we view as central to any recovery. Accordingly, our positive investment thesis for the gold sector is maintained however, in our view valuations are now under pressure on our long-term pricing assumptions and we have incorporated sensitivity modelling in our fundamental peer comparison.
- **Let the profits run**. Given the extent of global uncertainty we are prepared to let profits run in our favoured gold exposures.
- **Month-end upgrade on the way**. Assuming recent gains are consolidated, we anticipate significant upward revision to our gold and silver price assumptions, and likely downward revision to our FX assumptions when we update our pricing forecasts at months' end.
- **Domestic leverage back in focus**. While we remain cautious on low quality leverage, we do acknowledge increased market appetite for higher-cost exposure in the current environment. In particular, several of the domestic's loom as major beneficiaries of a record A$ gold price including:
    - **St Barbara Limited (SBM) A$0.46 – BUY** (price target A$0.60)
    - **Newmont Mining Limited (NEM) A$6.63 – not rated**
    - **Norton Goldfields (NGF) A$0.17 – not rated**
    - **Silver Lake Resources (SLR) – BUY**. (price target A$0.47/sh)
- **Lihir Gold Limited (LGL) A$3.56 - BUY**. LGL remains our preferred large-cap gold exposure given relative discount to NCM (LGL trades at 2x NPV vs NCM at >3x), bolt-on corporate appeal afforded by 23moz of reserves at Lihir Island, workman like production from Mt Rawdon, and what we continue to rate as exceptional exploration potential in Ivory Coast. Price Target A$3.75/sh.
- **Independence Group (IGO) A$2.76 - BUY**. IGO holds a (30%) interest in the +5moz Tropicana Gold JV (AngloGold Ashanti 70%), and is underpinned by A$0.95/sh in cash and 8ktpa of low cost nickel production at Long Shaft. Tropicana looks to be a materially different proposition in the current environment with a 55% fall in the A$ oil price yoy, deflating labour market in WA, and A$1500/oz gold price making development increasingly more certain. Price target A$3.59/sh.
- **Andean Resources Limited (AND) A$1.38 - BUY**. Undeniably the most significant gold discovery in our coverage universe. Recent drilling has opened up Eureka West at depth and results from the ongoing 40,000m Phase 5 program could deliver transformation discovery at any time. Election to pursue a trimmed down development scenario better aligns pre-production capital costs with prevailing credit markets. In our view, perceived funding risk leaves AND vulnerable to predation in CY09 with Eureka West cash cost estimates of c.US$100/oz adequate to move any producer down the cost curve. BUY maintained, price target A$1.56/sh.
- **Allied Gold Limited (ALD) A$0.47 – BUY**. ALD delivered strong December Q improvement and with operational control being established, we identify exceptional low-grade leverage courtesy of a bulk mining strategy at Simberi Island in PNG. ALD trades at a significant discount to its peer group and should benefit from a lower cost environment and likely growth catalysts (brownfields expansion?). Price target A$0.54/sh.

December Q Wrap

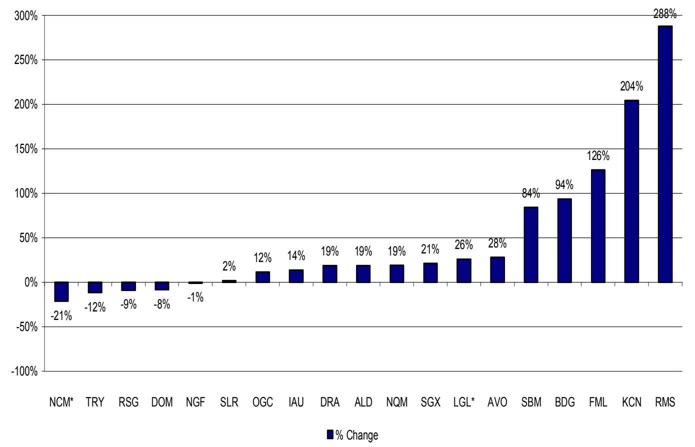
Figure 1: December Q Production



***LGL production 315koz, NCM production 382koz**

Source: PSL estimates

Figure 2: QOQ Change

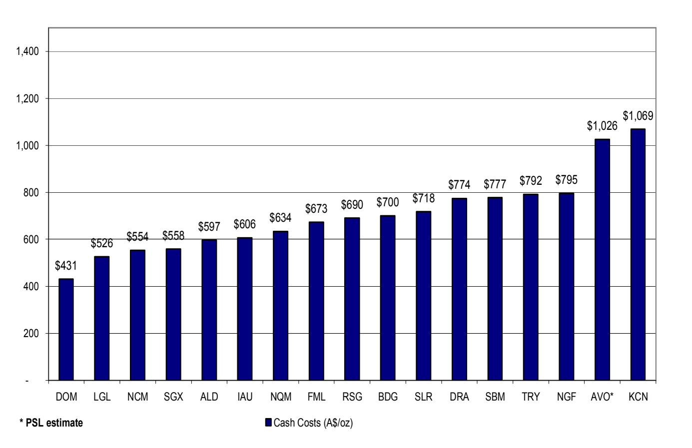


Source: PSL estimates

December Q broadly stronger. The majority of producers in our mid-cap universe increased production in the December Q, with the domestic's benefitting from record A$ gold prices.

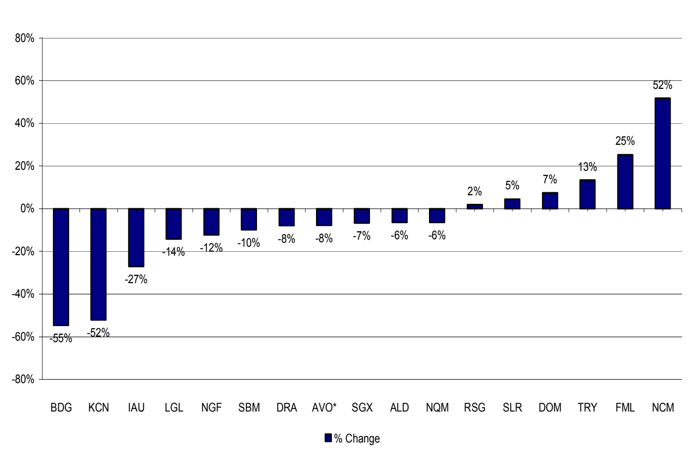
We highlight KCN (accelerated ramp-up at Chatree North), SBM (overcall at Gwalia Deeps), LGL (Dec Q production was 65koz higher qoq) and NCM (lower grades return at Cadia) as the most significant developments during the period.

Figure 3: Cash Costs (A$/oz)



Source: PSL estimates

Figure 4: QOQ Change



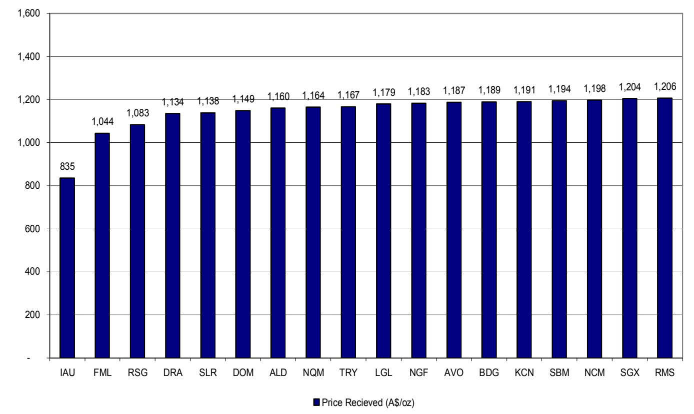
Source: PSL estimates

Normalised to Sep Q FX for companies reporting in US$

A mixed bag. Mitigating fixed costs with increased production was a feature for many (BDG, KCN, LGL, SBM) while FX translation gains helped IAU headline numbers (A$ operation, US$ reporting currency). NCM was exposed by lower copper prices, while lower production impacted TRY, RSG and DOM.

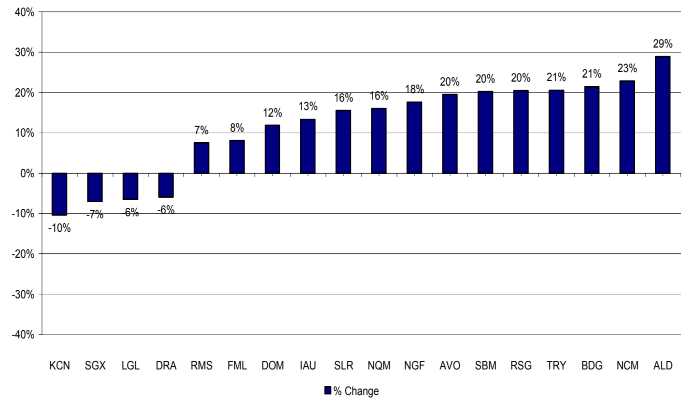
Cost outlook benign. With sustained deterioration in the global economy, we consider cost pressures remain firmly to the downside. As anticipated, major savings failed to crystallize in the December Q as higher cost inventories (reagents and consumables etc) continue to run down. However, a major power shift in the contracting and labour markets coupled with sharply lower fuel and reagent costs we anticipate savings to increasingly flow through in the current Q.

Figure 5: Average Price Received (A$/oz)



Source: PSL estimates

Figure 6: QOQ Change



Source: PSL estimates

Normalised to Sep Q FX for companies reporting in US$

What hedging? The extent of producer de-hedging in recent years is evident in Figure 5 above. The majority of our coverage universe is now either unhedged or employing alternative instruments (i.e. put options) to mitigate downside pricing risk.

Most notable movers qoq were ALD (more ounces delivered into spot), the domestics (A$ gold price increased 20% qoq), and KCN, LGL, SGX, DRA which reported lower price received on weaker US$ gold price during the period.

Positive investment thesis maintained

Uncertainty rules. Despite best endeavours of regulators, an unwavering tsunami of negative news continues to undermine US pump priming efforts, while dismal news flow emanating from the Eurozone, Japan and emerging economies has upped the treasury anxiety levels worldwide. While the ultimate depths of this crisis remains uncertain, it is highly likely that additional, and as yet intangible, funds are required to achieve stated policy aims.

How deep is the well? We see demand for US treasuries remaining sound for now (albeit for less than altruistic motives) however, a look at the top 5 holders of US$ treasuries (in order China, Japan, UK, Oil Exporters, Brazil) raises questions over the longer-term appetite given the market is already required to fund a US$2 trillion US deficit over the coming two years. While US treasuries are arguably one of the safest places to be right now, we reiterate our view that there remains downside risk in the US$ moving forward.

Best case remains supportive for gold. Given the magnitude of pump priming efforts and assuming a best case recovery outcome, there will certainly be a back-end inflationary legacy to address. While inflation will be regarded by some as an unavoidable evil, we argue that scattergun funds allocation (under the 'too big to fail' mantra) will ultimately deliver a diluted and less potent recovery, albeit with few alternatives to policy makers.

Skeletons in the OTC closet? Unwinding the global over-the-counter market looms as a critical component in resolving the financial crisis and we were disappointed this was not addressed by the current stimulus package. Unwinding the OTC market has the potential to shake, as yet unknown skeletons, out of the closet with significant implications for the gold price. Recent failure to act on OTC failings has in our view, raised more questions than answers.

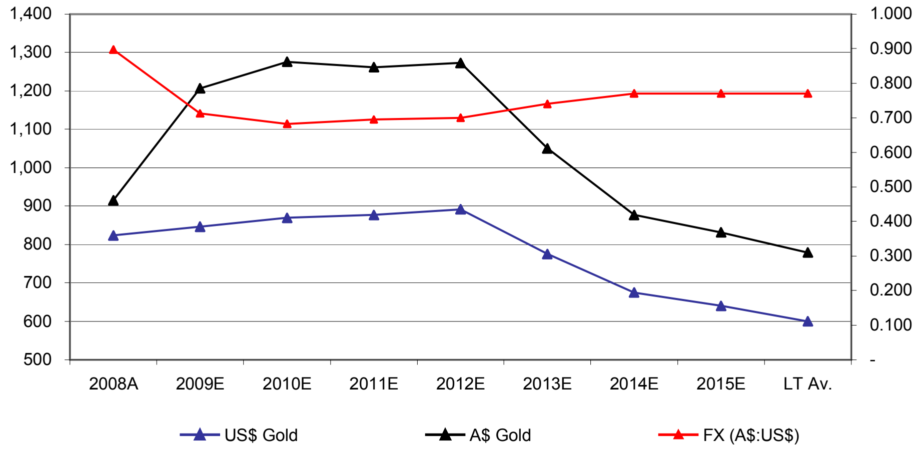
ETF's an unknown quantity. Exchange traded gold funds remain an underappreciated component of the gold market and importantly, one sub-sector where there is the potential for explosive and self-fulfilling demand growth. For example, the US$27b StreetTracks ETF (GLD.US) was incorporated in 2005 and this week surpassed 1,000t (32moz), making it the twelfth largest holder of bullion globally, and bigger than the central bank holdings of India, Russia, Saudi Arabia or the UK. The gold market is small (official global bullion holdings total just ~30,000t) and recent upward pressure on bullion price can in part be attributed to ETF purchases (we note GLD holdings increased 7% (73t) over the last week).

Figure 6: Patersons Gold price Assumptions

		2007A	2008A	2009E	2010E	2011E	2012E	2013E	2014E	2015E	LT Av.
Gold	(US$/oz)	639	824	846	870	877	891	775	675	640	600
Silver	(US$/oz)	12.74	15.49	11.92	11.45	11.51	11.63	10.68	11.50	12.00	12.00
Gold	(A$/oz)	812	915	1207	1276	1262	1273	1050	877	832	779
Silver	(A$/oz)	16.18	17.26	16.72	16.78	16.57	16.62	14.43	14.94	15.58	15.58
FX		0.787	0.898	0.713	0.683	0.695	0.700	0.740	0.770	0.770	0.770

Source: PSL estimates

Figure 7: Patersons Gold price Assumptions



Source: PSL estimates

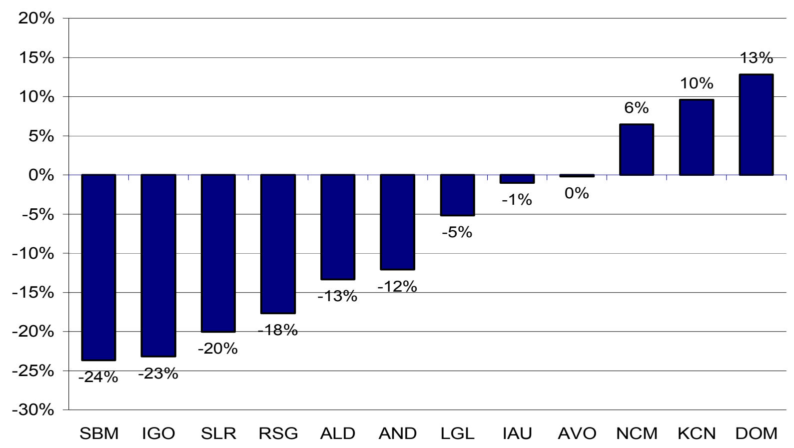
Sector Sweep

Figure 8: Price Target and NPV – selected mid-cap golds

	NPV	Baseline	NPV (spot)			
Code	(A$/sh)	**Price Target**	FX/Au	Last	prem/(disc)	**Rec.**
ALD	$0.42	**$0.54**	$1.17	$0.47	-13%	**BUY**
AND	$1.04	**$1.56**	$2.18	$1.38	-12%	**BUY**
AVO	$1.29	**$1.93**	$2.28	$1.93	0%	**BUY**
IAU	$0.28	**$0.28**	$0.33	$0.28	-1%	**BUY**
KCN	$3.94	**$3.94**	$9.20	$4.32	10%	**HOLD**
LGL	$1.56	**$3.75**	$4.23	$3.56	-5%	**BUY**
NCM	$9.74	**$34.10**	$29.64	$36.30	6%	**HOLD**
RSG	$0.77	**$0.77**	$1.80	$0.63	-18%	**HOLD**
SLR	$0.46	**$0.46**	$0.57	$0.37	-20%	**BUY**
DOM	$3.02	**$4.34**	$5.09	$4.90	13%	**BUY**
SBM	$0.60	**$0.60**	$0.96	$0.46	-24%	**BUY**
IGO	$3.59	**$3.59**	$9.58	$2.76	-23%	**BUY**

Source: PSL estimates

Figure 9: Premium Discount to Price Target



Source: PSL estimates

Sensitivity in focus

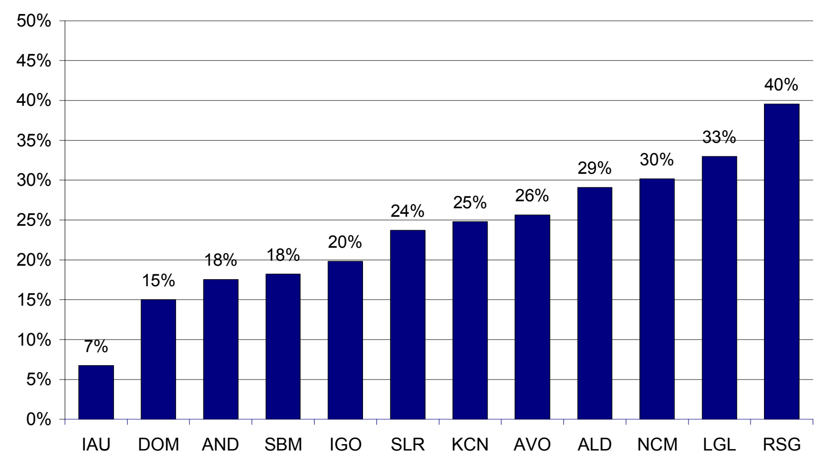
While our positive investment thesis for gold remains intact, equity prices are pushing hard up against our valuations. Accordingly, we increasingly turn to sensitivity analysis to present 'what if' scenarios over and above our gold price assumptions which employ the COMEX forward curve reverting to LT US$600/oz average. We have incorporated spot valuation metrics into our models (gold and FX) as well as individual input sensitivities (costs, grade, gold price, FX) ranked across our coverage universe.

Sensitivity formats. The following graphics illustrate ranked price target sensitivities to every +10% movement in input assumption for gold price, operating costs, FX, and grade considerations.

Gold price Sensitivity.

- RSG the most leveraged courtesy of high costs asset base.
- LGL & NCM benefit from long mine lives and extended tail to our pricing assumptions.
- ALD, AVO (inc royalty), KCN all moderate cost. Year 5 margins decline at Chatree Nth.
- AND & DOM limited leverage on account of low production costs.
- IAU has only c.2 years mine life at Paulsens so no exposure to our LT pricing assumptions.

Figure 10: Gold Price Sensitivity (Delta +10%)

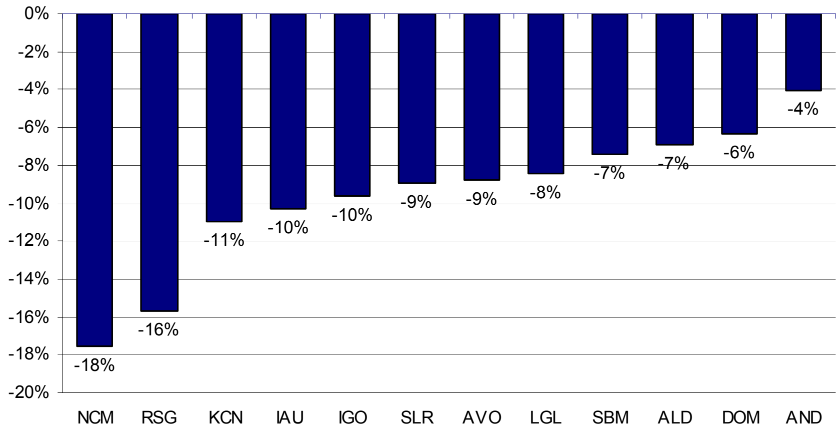


Source: PSL estimates

Operating cost sensitivity.

- NCM and RSG high sensitivity to operating costs courtesy of high cost asset base
- AVO, ALD, KCN, IAU all moderate cost operations (including royalties, and expressed in A$)
- DOM, & AND low cost operations

Figure 11: Operating Cost Sensitivity (Delta +10%)

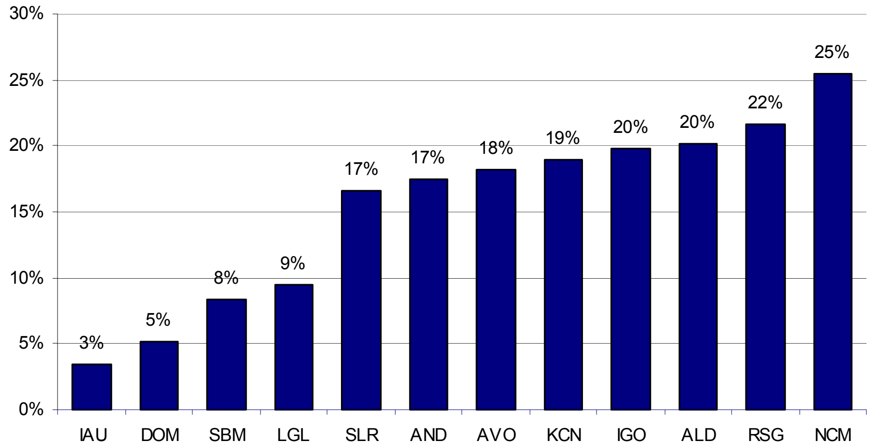


Source: PSL estimates

Grade Sensitivity

- NCM far and away the highest grade sensitivity with largest reserve base
- AVO super leveraged to variation above/below our 5g/t Au LOM mill grade assumption
- IGO & KCN both have long life, moderate grade open pits
- AND & SLR leveraged to high grade upside
- DOM & IAU marginal leverage on shorter mine life

Figure 12: Grade Sensitivity (Delta +10%)

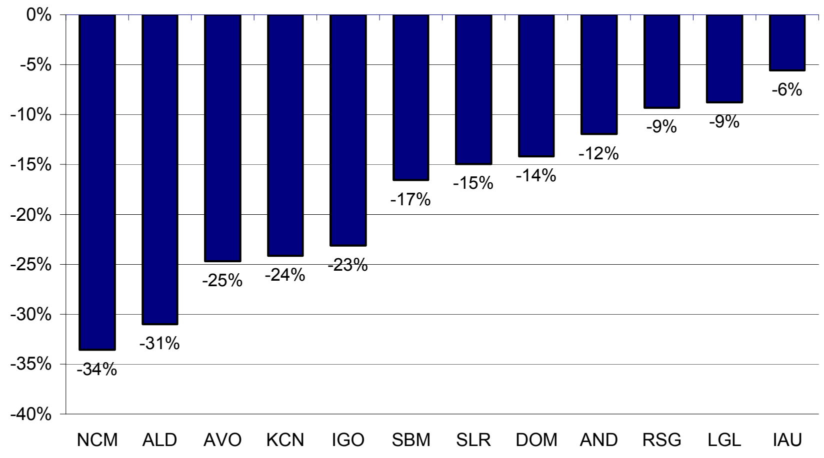


Source: PSL estimates

A$ FX Sensitivity

- IAU, LGL report in US$ so only sensitivity assumed by our conversion FX (currently 0.77)
- RSG being understated – we model Syama in A$ but essentially US$ cost base
- Domestics (NCM, AVO, IGO, SBM) leveraged to assumed FX translation on revenue (A$ costs)

Figure 13: A$ FX Sensitivity (Delta +10%)



Source: PSL estimates

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