

11 December 2007

Lion Selection (LST)

Transformational transaction brewing!

- **Newcrest has put its 70% interest in the Cracow gold mine out to tender; LST, which directly owns 30% (present value \$58m), has a pre-emptive right.** LST has said 100% ownership of Cracow would be a major strategic step in
 - transforming the company from a NTA related basis to one based on earnings multiples. **It is here we see a significant lift in value (mkt cap.) if LST is successful in obtaining 100%.** The process is expected to start for LST in early February with a final investment decision around mid-2008.

Presently, LST's 30% of Cracow is valued at \$58m which places a run-through value of \$193m on Cracow. But, Dominion Mining, for a similar level of gold production/comparable costs and mine life, has a market capitalisation is \$498m. We value DOM at \$250m (\$2.50 per share) and 100% of Cracow at \$190m but attribute another \$55m to exploration (see summary sheets attached – DOM, Cracow).
 - LST says it's serious about owning 100% of the mine. The value lies somewhere between –
 - a) **\$156m** (70% of \$215m, a function of grossing up LST's \$58m value and inflating by 15% for a control premium).
 - b) Our own valuation, including exploration upside, is \$245m with 70% worth **\$171m plus a premium for operatorship, say \$185m.**
 - Well, LST is now an "operating" investment company which trades at a discount to its NTA, like most such companies. The present share price is \$1.79 versus the most recent NTA of \$2.03, ie a discount of 13%. It has \$67m in cash, boosted by \$30m coming from the sale of its interest in Platmin and residual investments totalling \$249m.

LST has been liquidating some non-performing investments within the portfolio, eg Intrepid Gold. We understand it is selling other interests but is reluctant to nominate given market sensitivities. Should it sell all of its AGM shareholding (it has sold some) it would realise around \$30m.

So potentially, LST could, by the time it is required to make a pre-emption on the 70%, have over \$100m in cash.
 - **Based on a pre-emptive price of \$175m to \$200m, this could/would leave a funding shortfall of \$75m to \$100m** (at a mid point). **LST has had numerous approaches about various alternative forms of financing in the event of a purchase.** And there are those content to take a minority position (25% to 30%) in the total asset; paying a premium to get in.
 - The Lion Selection Group has in its history been very frugal when it comes to issuing shares; we would only see the issue of shares as a last resort although not out of the question. It's likely the shortfall in funding will be a mix of debt (say 70%) and equity.
 - **The attraction of owning Cracow in its entirety is that the market has only limited choices in this category of gold mining, ie +100,000 oz pa, cash cost of below A\$375/oz, unhedged with exploration upside.** We have referred to DOM and point out that at its present share price of \$4.87 it's selling on a prospective PER of **19 times** for 2007/2008 earnings.

In Brief

Recommendations

Short Term: Speculative Buy
 Risk: Medium to High
 Price: **\$1.79**
 Valuation Range: \$2.54 to \$3.08

Snapshot

Monthly Turnover (m) 6.6
 Market Cap (m) **\$340.9**
 Shares Issued (m) 191.0
 52 Week High \$1.90
 52 Week Low \$1.34
 Sector Div. Metals & Mining

Business Description

Lion Selection Limited, is a resource investment company. LST invests in Australian mining and exploration companies with gold and base metal activities in Australia, Africa and South East Asia. It owns a direct 30% interest in the Cracow underground gold mine in Queensland.

Investment Fundamentals

Year end July	FY07	FY08	FY09	FY10
Reported NPAT (\$m)	64.3		46.1	40.3
EPS (¢)	32.4		19.5	17.1
PE Ratio (x)	5.5		9.1	10.5
DPS (¢)	10.5		5.9	5.1
Dividend Yield (%)	5.9		3.3	2.9
Spot Gold (US\$/oz)	647		750	750
Exchange Rate (A\$/US\$)	0.80		0.90	0.89

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We estimate that LST could generate earnings of 7.6 cps (\$16m) from 100% of Cracow in the 2008/09 year. Capitalised at a PER of 15 times (mid point between forward PERs of DOM and EQI) translates to \$240m or \$1.15 per share.

Then there's the investment portfolio which LST intends to still aggressively pursue and after further rationalisation could still approximate \$1.65 per share.

So, base case, the LST share price moves up through \$2.80 per share . . . that's if it all goes to plan!

We see negligible downside risk for LST given the strategic nature of its shareholdings in IRN and ALB and its other investment opportunities.

Lion Selection						
Share Price	<i>LST</i>		\$ 1.79	\$ 1.79	\$ 1.79	
Year Ending .	<i>31-Jul</i>	2005/06	2006/07	2007/08	2008/09	2009/10
Market Capitalisation	\$m	189.4	340.9	340.9	376.3	0.0
Valuation	\$m	477.7		559.2	635.0	686.9
Valuation per share				\$ 2.65	\$ 3.01	\$ 3.26
Issued Ordinary Shares	m	106.1	191.0	191.0	210.8	210.8
New Issue	"			14		
Options	"	7.600	7.600	5.800		
Fully diluted		113.7	198.6	210.8	210.8	210.8
ASSUMPTIONS						
Spot Gold	\$US/oz	527	647	720	750	750
Spot Exchange Rate	\$A/\$US	0.755	0.800	0.878	0.898	0.892
Gold production	000oz	32	36	33	110	112
Gold Resource	m.oz	1.1	0.9			
Mkt Cap per resource oz		310	401			
Cash Cost		281	327	356	367	356
Number of Shares	m	113.7	198.6	210.8	210.8	210.8
FINANCIALS						
Sales Revenue		22.6	26.1	28.2	95.8	97.4
Other Revenue		56.4	51.6	52.1	40.6	30.2
- Operating Costs		9.0	12.4	12.7	44.5	44.5
EBITDA		13.6	13.7	15.5	51.3	52.9
- Depreciation/Amortisation		2.6	2.6	2.5	8.4	8.4
-Other		3.5	7.5	10.1	15.6	15.2
EBIT		7.5	3.6	2.9	27.3	29.3
Pre Tax		62.1	53.8	52.1	66.3	58.0
Net Profit (pre Abnormals)	\$m	41.0	64.4	36.5	46.4	40.6
-Half year result		1.2				
EPS	cents	36.1	32.4	17.3	22.0	19.3
EPS Growth	%	4618%	-10%	-47%	27%	-13%
P/E ratio	x	5.0	5.5	10.3	8.1	9.3
Gross Cash Flow	\$m	16.2	37.4	28.6	44.0	41.4
GCFPS	cents	14.2	18.8	13.6	20.9	19.7
P/GCF	times	12.5	9.5	13.1	8.5	9.1
Dividend	\$m	10.0	20.0	15.0	13.9	12.2
DPS	cents	9.4	10.5	7.9	6.6	5.8
Dividend Yield	%		5.9	4.4	3.7	3.2
Net Cash Flow	\$m	9.0	32.4	23.6	39.0	40.4
Discount rate	%	8.5%	8.5%	8.5%	8.5%	8.5%
Net Present Value Cracow	\$m	156.6	344.4	346.4	357.5	354.2
Exploration/other		(8.3)	(14.0)	(12.6)	(12.6)	(9.5)
H/Office		4.4	4.5	4.5	11.0	11.0
Debt		(9.0)	(13.0)	(68.5)	(56.6)	(44.7)
Cash		73.0	102.7	28.5	74.8	115.0
Investments		261.0	261.0	261.0	261.0	261.0
Total Valuation	\$m	477.7	685.6	559.2	635.0	686.9
NPVPS	\$	2.50	3.25	2.65	3.01	3.26

Dominion Mining		dom	\$ 5.37	\$ 5.37	\$ 5.37	\$ 5.37		
Market Capitalisation	\$m		\$ 543.3	\$ 553.6	\$ 553.6			
Valuation	\$m		\$ 233.4	\$ 281.2	\$ 268.3			
Valuation			\$ 2.37	\$ 2.80	\$ 2.67			
Year Ending .	30/june	2004	2005	2006	2007E	2008E	2009E	2010E
Issued Ordinary Shares	m	80.7	98.5	98.5	100.4	100.4	100.4	100.4
Options	"	2.150	0.300	0.000				
Unlisted Options	"	2.000	2.100	2.700	2.700	2.700	1.500	1.500
Fully diluted		84.810	100.870	101.170	103.100	103.100	101.900	101.900
ASSUMPTIONS								
Spot Gold	\$US/oz	409	450	556	666	750	750	750
Spot Gold	A\$/oz	626	616	736	832	855	835	841
Hedged Price	A\$/oz	562	580	580	710	729	0	0
Realised Price	A\$/oz	594	593	635	790	811	835	841
Hedging as a prop. of production		50%	65%	65%	35%	35%	0%	0%
Silver	\$US/oz	6.10	8.00	12.25	13.43	14.60	14.60	14.60
Spot Exchange Rate	\$A/\$US	0.653	0.730	0.755	0.800	0.878	0.898	0.892
Gold production	oz	60,813	43,477	108,017	108,329	111,257	110,938	109,829
Silver Production		0	0	0	0	0	0	0
Gold Reserve	000oz		298	293	293			
Gold Resorce	000oz	0.37	328	686	686			
Mkt Cap per oz OF RESOURCE		0	0	0				
FINANCIALS								
		2004	2005	2006	2007E	2008E	2009E	2010E
Sales Revenue		36.1	25.8	68.5	85.5	90.2	92.6	92.4
EBITDA		12.2	-1.6	15.5	61.6	51.9	42.6	45.8
EBIT		6.7	-8.6	1.3	47.9	37.7	27.0	30.3
Pre Tax		5.7	-9.1	0.9	47.9	37.7	27.0	30.3
Reported Net Profit	\$m	5.7	-9.1	9.7	54.2	26.4	18.9	21.2
NRI (included above)				-8.8	-21.0			
Sust. Profit				18.5	33.2	26.4	18.9	21.2
Half Yr	\$m	0.6	(3.6)	4.4				
EPS	cents	6.7	-9.1	9.6	32.2	25.6	18.5	20.8
EPS Growth	%		-235%	-206%	235%	-21%	-28%	12%
P/E ratio	x		-59.2	55.9	16.7	21.0	29.0	25.8
Gross Cash Flow	\$m	14.2	0.8	28.9	75.9	48.6	42.5	38.7
GCFPS	cents	17	1	29	74	47	42	38
P/GCF		32.18	699.42	18.80	7.30	11.39	12.87	14.13
Dividend	\$m	0.0	0.0	0.0	16.1	12.8	9.3	10.4
DPS	c	0.0	0.0	4.0	8.0	27.0	13.1	9.4
Dividend Yield	%	0.0	0.0	0.7	1.5	5.0	2.4	1.8
Franking	%	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Net Cash Flow	\$m	-4.8	-12.2	16.9	50.9	34.5	29.4	26.4
NCFPS	c	-5.7	-12.1	16.7	49.3	33.5	28.8	25.9
Net Present Value (8.5%)	\$m	91.0	118.5	215.4	216.8	184.3	165.5	150.2
Cash		4.2	6.4	16.8	62.8	80.0		
Debt		-	(6.5)	-	-	-		
Exploration investments			6.0	10.0	16.0	16.0		
HO		(12.0)	(6.0)	(8.8)	(14.4)	(12.0)		
Total Valuation	\$m	83.1	118.4	233.4	281.2	268.3		
NPVPS	\$	1.03	1.20	2.37	2.80	2.67		

Cracow		30%	30%	40%	100%	100%
Period Ending		Jun-06	Jun-07	Jun-08	Jun-09	Jun-10
Gold resources	m.oz					
Total Project						
Total Ore Treated	t	314	387	375	375	379
underground		314	387	375	375	379
waste		314	330	353	371	371
Gold price	A\$/oz	795	920	882	829	829
Head Grade	g/t	11.4	10.2	9.8	9.8	9.8
underground		11.4	10.2	9.8	9.8	9.8
open cut		-	-	-	-	-
Recovery	%	93	93	94	94	94
underground		93	93	94	94	94
open cut		93	94	94	94	94
Recovered Grade	g/t	11	10	9	9	9
underground		11	10	9	9	9
open cut		-	-	-	-	-
Gold Produced	ozs	108	118	110	110	112
Silver Produced		95	101	108	113	113
underground		108	115	111	112	112
open cut		-	-	-	-	-
Operating Cost	\$/t	96	100	105	108	110
underground		96	100	105	108	110
open cut						
Operating Cost	\$/oz	281	327	356	367	373
Operating Cost	\$m	30	41	42	41	42
underground		30	39	39	41	42
open cut		0	0	0	0	0
Amortisation & Depreciation	\$/t	39	27	27	54	54
Amortisation & Depreciation	\$/oz	115	75	75	175	175
Amortisation & Depreciation	\$m	13	9	10	20	20
Royalties	\$m	1	2	2	2	2
Total Cost (ex royalties)	\$/t	135	151	144	143	143
Total Cost (ex royalties)	\$/oz	403	438	492	567	574
Total Cost (ex royalties)	\$m	43	50	51	53	53
Total Sales	ozs	32	36	33	110	112
Hedging	ozs	30	30			
Spot sales	ozs	2	6	33	110	112
Spot Gold price	\$/oz	795	920	882	829	829
Gold Price Achieved	\$/oz	664	664			
REALISED Gold PRICE		664	785	882	829	829
Financials						
Sales Revenue	\$m	21.9	25.0	29.2	91.5	92.5
Site Operating Costs		-	-	-	-	-
Mine Operating	\$m	9.0	12.4	12.7	40.5	41.7
Inventory Change/stripping/devel.		-	-	-	-	-
Total Mining		9.0	12.4	12.7	40.5	41.7
Royalties/Other		1.1	1.2	1.5	4.6	4.6
EBITDA		11.7	11.4	15.1	46.5	46.2
Amortisation & Depreciation	\$m	2.6	2.6	3.0	20.3	20.5
Exploration spend		1.1	1.1	1.1	1.1	1.1
Administration	\$m	1.0	1.0	1.5	1.5	1.5
Income from Operations		7.0	6.6	9.4	23.6	23.1
Other Expl.	\$m					
Profit before Tax & Abnormals	\$m	7.0	6.6	9.4	23.6	23.1
Income Tax	\$m	-	0.7	2.8	7.1	6.9
Profit before Abnormals	\$m	7.0	6.0	6.6	16.5	16.2
Period Ending		-	-	-	-	-
Profit before Abnormals	\$m	7.0	6.0	6.6	16.5	16.2

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