Rivkin REPORT

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Tarfaya Nominee Pty Ltd T/A The Rivkin Report (ACN 001350634), AFSL: 247373

LION SELECTION LTD (LST)

Key Points

• Buy LST at around $1.80
• Recommended allocation up to 5% of your portfolio
• Medium Risk
• Holding period up to 6 months

We have identified a way of gaining exposure to the hostile bid for Indophil Resources NL (IRN) by Xstrata, without the downside risk that IRN has at current levels. We are quite confident that Xstrata will succeed in its bid for IRN, but with IRN trading at a 12.5% premium to the conditional offer, the downside is just too great for us at the moment.

Having said that, LST is IRN's largest shareholder with a 25.4% stake in the company, thus LST has exposure to any upside in future bids for IRN. LST is actually under hostile takeover from IRN. This was in response to the fear of LST selling its stake in IRN and likely prompting an attack on IRN, but ironically its own hostile bid has been the catalyst for just that. The failure of this bid is the main condition in Xstrata's bid for IRN, so it seems the shareholders of LST have a very important role to play in the takeover battle.

With the knowledge that LST's existence itself is in question, the board has responded by proposing a plan (subject to shareholder approval) that will see a superior return to the offer by IRN. At the time of IRN's bid, its offer (which was two-tiered and all-scrip) was worth $1.65 or $1.78 if the offer receives 90.1% of acceptances. LST's proposed plan looks to be a far superior offer to shareholders, especially if certain things pan out.

Following LST's proposed sale of its 30% interest in the Cracow gold mine (agreed upon but still to be completed), LST has announced its intention to sell its IRN stake to Xstrata at $1.00 through Xstrata's bid (although LST will get the highest price that is offered to shareholders) and has also stated that its subsidiary, African Lion (27.5% owned by LST), will sell its 20.5% investment in Albidon Ltd (ALB), and return to LST its proportion of the proceeds. Following these three transactions, LST will be left with an absolute truckload of cash and very little in the way of remaining investments. At the current expected sale prices of both Cracow and IRN plus the current price for ALB of $3.94, as well as the post-tax NTA of remaining assets as at 16 May, that leaves LST with an NTA (net tangible asset backing) of $2.05 (which is fully diluted for its options).

After disposing of these assets, LST has decided to return a large portion of its cash (at least $1.35 per share) either by capital return, dividend or share buyback, or a combination of the three. This is the event that we feel will see a solid profit returned for subscribers. LST has traditionally traded at quite a large discount to NTA, and returning cash and thus reducing the NTA will increase the return for shareholders, as long as the discount to NTA does not increase enough to erode this gain. So while LST may have traded at a 20% discount to its NTA prior to any of this action, trading at a 20% discount after a cash return will see a gain for shareholders. Take the proposed transaction as case in point. If we were to buy LST at its current price of $1.80, then LST disposes of its assets at the numbers mentioned above and realises an NTA of $2.05, then subsequently returns $1.35 in a capital return, the resultant NTA would be 70c. At a 20% discount to NTA, that suggests a price of 56c per share for the stock. So,

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LION SELECTION LTD (LST) continued...

having bought at $1.80, we would be left with $1.35 in cash as well as our shares trading at 56c, a profit of 11c (or 6%).

Not bad, but LST has also said that if the discount to NTA is still too high, it would then look to wind the company up. We feel that would likely keep a lid on discount to NTA, so we feel a 10% discount is more likely (especially considering such a large portion of its NTA would be in cash). At a 10% discount (therefore 63c), our return would be 18c (or 10%). And with a wind up, our return would be 25c (14%).

Now all of this looks pretty good on its own, but the positive for us is that we get exposure to what we feel will be improved bids for IRN (and an improved price for ALB, which is already up 12% since the announcement on expectation of a bid). LST has released a table (which we have reproduced below) outlining the possible increases to NTA based on improved prices for both IRN and ALB. We have added a column with premium to NTA to show the upside based on a wind up.

Indophil (IRN) Share Price	**$1.10**	**$1.25**	**$1.50**
Albidon (ALB) Share Price	**$4.50**	**$5.00**	**$5.50**
Total NTA per LST	**$2.12**	**$2.20**	**$2.31**
Premium to NTA at $1.80	**17.78%**	**22.22%**	**28.33%**

There are risks to this deal happening, but on the whole they look unlikely to eventuate. One is LST shareholders electing to proceed with the IRN hostile bid (very unlikely) and another is Xstrata failing in its bid. Should Xstrata fail in its bid for IRN, then the original IRN offer for LST may be the best remaining result, and the value of that is no more than 10% below current prices. Additionally, the value of LST’s remaining assets may fall in the interim and reduce the NTA, but these investments make up a small component of the entire portfolio, so the reduction in NTA should not be significant.

The following points characterise this situation:
- Return target of around 10%, with greater upside possibilities should an increased bid for IRN materialise.
- Downside risk is low, but ought to be no more than around 10% if either Xstrata’s bid fails or IRN’s hostile takeover of LST succeeds.
- Timeframe of takeover uncertain, but we expect to hold the stock for no longer than six months, depending on how quickly LST can wind up its remaining portfolio.

In summary, we recommend subscribers buy LST at around $1.80 for a medium risk, short-medium term investment. As a general guide, we suggest subscribers allocate no more than 5% of their portfolios to LST. The stock is not overly liquid, so patience will be required to get set. Having said that, the stock traded 370,000 shares yesterday, so there is stock around, just not sitting in the screens.