Northern Energy Corporation (NEC)

Opinion Data

Recommendation	**Hold** *(from Spec Buy)*
Risk Rating	**High**
Current share price	**$0.47**
DCF Valuation	**$0.84 (risked)**
Market capitalisation	**$31m**

Company Background

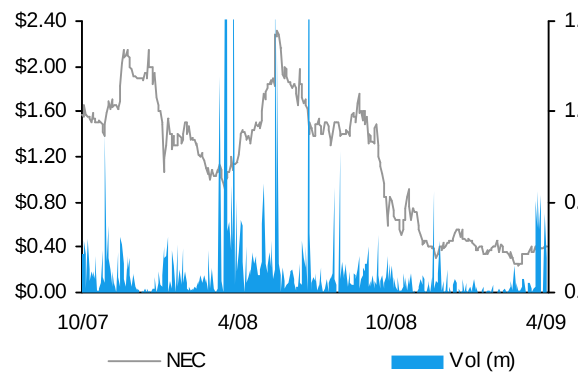
Northern Energy Corporation (NEC) is a Queensland based pure coal company. In 2005, NEC listed on the ASX as a single project explorer, and has since developed a portfolio of active projects, three of which are at the early project development stages.

The company's key projects are:

- Elimatta (NEC 100%): 69mt thermal coal reserve (244mt resource, 129mt measured, 75mt indicated, inferred 40mt) in the Surat Basin, Queensland. Targeting a 4-5mtpa, 20yr open cut operation.
- Yamala: JV with Sojitz Corporation (Sojitz earning 30%, with option to acquire a further 19%), developing a 220mt thermal/PCI coal resource at Emerald, to support a 3.0-3.5mtpa underground operation (additional 190-220mt exploration target exists).
- Colton (Maryborough) (NEC 100%): hard coking coal resource near Bundaberg. Targeting a 0.2- 0.5mtpa open cut operation.

NEC's development timeline is intended to coincide with the commissioning of upgraded rail and port infrastructure in Queensland, including the Southern missing rail link (possibly mid-2012) and the Wiggins island port development at Gladstone.

NEC Share Price / Volume



Highlights

NEC has completed drilling and associated geotechnical studies at Elimatta and is now focussed on developing further iterations of the Elimatta mine plan that are expected to lead to increases in the marketable reserve.

At the Colton Project (Maryborough), NEC has recently obtained historical exploration records from ~350 drill holes with an initial JORC resource expected shortly. Now that Queensland Rail has agreed it is practicable to haul coal to Gladstone port, NEC is receiving interest from Japanese parties, in addition to earlier interest that was mainly from Indian parties (comfortable with the smaller vessel sizes dictated by Bundaberg port). Interestingly, some parties that abandoned discussions last year are once again showing interest now that their own industries are stabilising.

Outlook / Investment View

On an EV/t of reserve (based solely on Elimatta) NEC is trading at just 0.4 compared to the next lowest in our coverage universe, CEY at 2.9. In our risked valuation we now apply only 10% of the value of the Yamala and Elimatta projects and 50% of the Colton project value. Despite this, our risked NPV of $0.84/share remains well above the current share price. However, to capture the project value NEC must fund modest capex ($30-40m) for Colton and substantial capex for Elimatta (~$600m).

We had assumed that NEC would fund the majority of this through the sale of JV shares in the projects. NEC has ~$5m in cash, and is likely to require further funding during 2009 if it is to continue to progress its suite of projects at the desired rate.

Unfortunately, the deterioration in global markets has made NEC 3-6 months too late in its search for JV partners. Potential partners have either been unsettled by turmoil in the steel industry, unable to get finance, or of the opinion that assets will be cheaper in the future. NEC's market cap of just $31m does not make the task of arguing the case for far higher values for its projects any easier. However, it also means that any JV outcomes might see the stock rally quite hard.

We have no doubt that the inherent value of NEC's project suite will, in the long term, prove to be multiples of the current market cap. However, JV negotiations show no signs of imminent conclusion and the prospect of a windfall deal is much diminished. With financial close on the Wiggins Island expansion delayed, project timing risk is also increased, and we are reducing our twelve month recommendation to a Hold.

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Recommendation Criteria

Investment View

Austock Securities Investment View is based on an absolute 1-year total return equal to capital appreciation plus yield.

Buy	Hold	Sell
> 20%	20% - 5%	< 5%

A Speculative recommendation is when a company has limited experience from which to derive a fundamental investment view.

Risk Rating

Austock Securities Limited has a four tier Risk Rating System consisting of: Very High, High, Medium and Low. The Risk Rating is a subjective rating based on: Management Track Record, Forecasting Risk, Industry Risk and Financial Risk including cash flow analysis.

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