

**RECOMMENDATION:**

**Speculative Buy**

**12 MONTH PRICE TARGET:**

N/A

**Capital Structure**

ASX Code	SPI
Current Share Price	\$0.13
Market Cap <sup>1</sup>	\$14.9m
Ordinary shares on issue	115.0m
Options (various) <sup>2</sup>	49.8m

<sup>1</sup> Undiluted  
<sup>2</sup> Listed and Unlisted

**Directors**

James Hamilton	Managing Director
Chris Daws	Non-Exec Director
Russel Hardwick	Non-Exec Director

**Top Shareholders**

Churchill Mining Plc	21.74%
Prosperity Steel United	8.37%
Eralloy Holding AS	7.52%
SK Resources	7.03%

Top 20 69%

**12 Month Price Performance**



Source: IRESS

**Paul Adams**

Head of Research  
+61 08 9263 5200  
padams@djcar michael.com.au

# Spitfire Resources Limited (SPI)

## Chocks Away

SPI is an ASX-listed resource exploration and potential development company focused on the carbon steel and energy sectors, with a suite of manganese and coal projects located in Western Australia and Tasmania. SPI's core asset is the 80%-owned South Woodie Woodie Manganese Project, located 1,200km north of Perth and 230km north east of Newman in the Pilbara Region of Western Australia. SPI is conducting drill programmes to expand the limits of known mineralisation on both the manganese and coal project portfolios and expects to provide an increased level of news flow over the course of the next few months. We don't believe the value proposition has been well elucidated in the market but we agree with the company's measured approach so far. When the results are released and SPI can communicate its strategy going forward, we believe there is potential for a re-rating, especially given the very low enterprise value. We rate SPI as a Speculative Buy.

### Key Points

- SPI's flagship project, the South Woodie Woodie Manganese Project is located north east of Newman and south of Consolidated Minerals' Woodie Woodie Mining Operation. A second drill program, completed in November 2008, resulted in the discovery of significant near-surface Mn mineralisation at the Tally-Ho Prospect.
- After beneficiation, the Tally-Ho deposit is likely, in our view, to yield a final product grading around 40% Mn but SPI will continue to focus on the discovery of Direct Shipping Ore (DSO) which has an in-situ Mn grade of over 40%. SPI is drilling 16 high priority targets outside of Tally-Ho and we expect results over the course of the next few weeks. In addition, SPI expects an updated resource estimate for the Tally-Ho deposit within the next week or two.
- In 2008, SPI announced an agreement to acquire Black Rock Energy Pty Ltd, a privately owned company holding a prospective portfolio of thermal coal exploration projects located in the Derwent Valley, north of Hobart, Tasmania. Although initial exploration occurred during the 1970's and 1980's, no modern exploration has been carried out and SPI's 2010 drilling program is the first for over 30 years.
- The coal projects are located close to road and government owned rail infrastructure that links the project to export quality ports at either Hobart in the south or Burnie and Bell Bay in the north. Initial coal quality analysis suggests the coal could be of an export quality black thermal coal, providing a much better market opportunity than supplying a local industrial market.
- With \$5.6m in cash, two strategic investors registering significant holding notices within the last two weeks, two drilling programs underway in manganese and coal and a very low enterprise value, at just \$9.3m, we take the view that SPI presents an opportunity for investors to take an early position in a potentially undervalued stock. We believe exploration success will result in a re-rating and place a Speculative Buy on Spitfire Resources.

## Introduction

SPI is an ASX-listed resource exploration and potential development company focused on the carbon steel and energy sectors, with a suite of manganese and coal projects located in Western Australia and Tasmania. The company also has projects prospective for base metals located in the Northern Territory. SPI was originally a spin-off of the Pilbara manganese assets of Churchill Mining Plc, a London-listed coal development company which still holds a 24.75% stake in SPI.

SPI's core asset is the 80%-owned South Woodie Woodie Manganese Project, located 1,200km north of Perth and 230 km north east of Newman in the Pilbara Region of Western Australia. SPI has defined a near-surface manganese deposit at the Tally-Ho Prospect, which has had little previous exploration. Towards the end of last year, SPI completed a drill programme to the north of Tally-Ho which successfully expanded the limits of known mineralisation. The project lies 50km along strike from the 1.0Mtpa Woodie Woodie Mine, operated by the now privately owned Consolidated Minerals ("ConsMin").

The coal projects in Tasmania comprise thermal coal projects located close to infrastructure which provide SPI with the opportunity to enter into either local power markets or export markets via a number of possible infrastructure solutions. Diversification is also achieved from SPI's project in the Northern Territory, which is prospective for base metals.

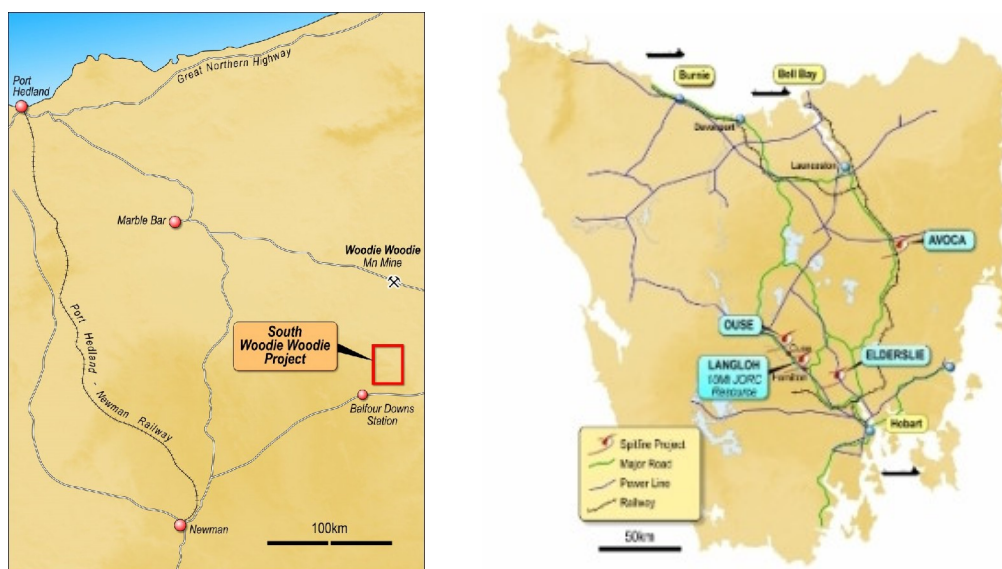


Figure 1. Locations of the manganese and coal projects

Source: SPI

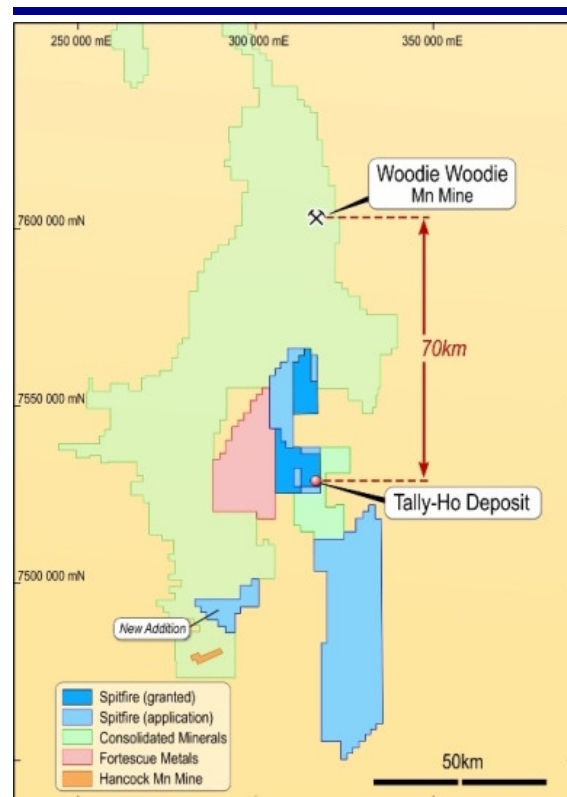
## South Woodie Woodie Manganese Project (80%)

SPI's flagship project, the South Woodie Woodie Manganese Project, is located north east of Newman and south of the ConsMin Woodie Woodie operation. The Woodie Woodie operation has been in production since 1958 and encompasses a high-grade manganese deposit comprising a number of lenses and pods which collectively total 41 individual ore bodies. Grades vary between 40% and 48% Mn and reserves stand at around 15.7 Mt at an average grade of 42.1% Mn and a current production rate of approximately 900,000tpa. ConsMin is also aggressively increasing its exploration program around and to the south of their operation.

SPI's granted tenements and those under application lie between 50km and 140km south of Woodie Woodie. SPI commenced its maiden drilling program on the project in April 2008 with anomalous Mn grades being achieved in 10 out of the first 16 holes.

A second drill program was completed in November 2008 resulting in a discovery of significant near-surface Mn mineralisation at the Tally-Ho Prospect. The 26-hole RC program comprised 3,372m over a number of targets and yielded intersections of 6m at 20.48% Mn from 12m, 7m at 21.8% Mn from 9m and 7m at 15.1% Mn from 14m, hosted in dolomites with a silica cap that has acted as a trap, enabling the pooling of the Mn mineralisation.

Subsequently, in May 2009 SPI completed a 51-hole follow-up drilling program comprising 40 RC holes for 2,384m which intersected near-surface Mn mineralisation with grades up to 27.9%. The Tally-Ho Prospect was found to consist of a number of flat-lying stacked seams and remains open to the north, west and north east. A significant number of bulk samples were derived from the samples to determine the beneficiation characteristics of the mineralisation.



**Figure 2. South Woodie Woodie prospect location map**

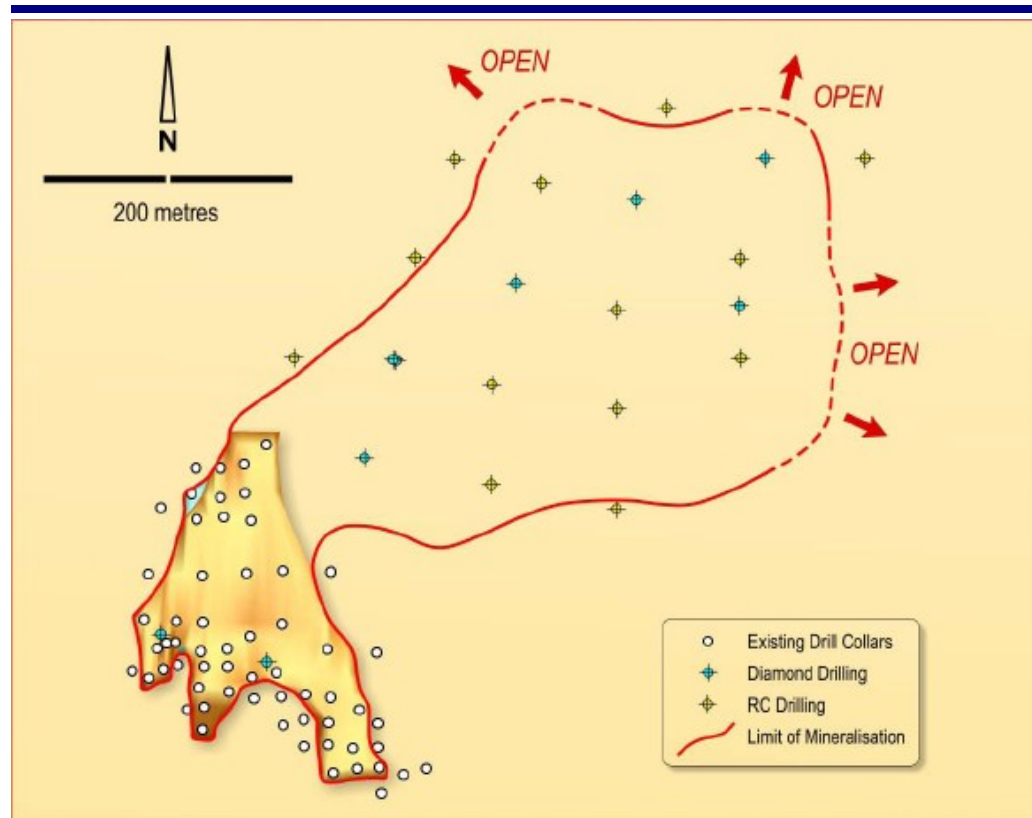
Source: SPI

### Updated South Woodie Woodie JORC Resource Imminent

In the December 2009 quarter, a further diamond and RC drilling program was completed comprising 18 RC holes (including pre-collars) and a further 9 diamond holes for a total of 1,022m, designed to test for interpreted extensions to the known mineralisation and for extractive metallurgical testwork.

After beneficiation, the Tally-Ho deposit is likely, in our view, to contain a small resource with the potential to yield a final product grading 40% Mn. SPI continues to focus on the discovery of Direct Shipping Ore (DSO) which has an in-situ Mn grade of over 40%.

The geological knowledge gleaned from Tally-Ho will be used in the 2010 drilling program to help in target generation (see below). SPI expect an inaugural resource estimate for the Tally-Ho deposit within the next week or two, performed by external consultants Optiro Pty Ltd.



**Figure 3. Extent of known mineralisation at Tally-Ho and intended drilling**

Source: SPI

### New Strategic Acquisition

On 8 April, SPI announced the acquisition of a new strategic manganese tenement, won through a ballot system. This 111km<sup>2</sup> tenement is located to the south west of the existing SPI tenement blocks and just north of the new Mineral Resources Ltd (ASX:MIN) / Hancock Prospecting Nicholas Downs Manganese Operation. Nicholas Downs is expected to produce an average 40,000t per month of 40% ferruginous manganese with first shipments of ore scheduled for April 2010.

The ballot was a result of the partial surrender of ground held by ConsMin and was won against rivals FMG Pilbara (ASX:FMG), Murchison Metals (ASX:MMX) and Hancock Balfour Downs.

The new acquisition boosts SPI's land holding in the region to 1,500 km<sup>2</sup>, with 1,125.8km<sup>2</sup> being 100% held by SPI with only the original 80%-owned tenement comprising just 430.1km<sup>2</sup> of the total.

### The 2010 South Woodie Woodie Drilling Program

SPI considers the Tally-Ho deposit to be a pathfinder for the discovery of further Mn mineralisation and the company continues to maintain its focus on the discovery of higher grade deposits.

The 2010 program is designed to test the multiple targets outside the known mineralisation at Tally-Ho. An airborne EM survey, detailed mapping and incorporation of a structural and geological model has resulted in a number of attractive targets including the potential to locate higher grade resources, which will be a very useful addition to the Tally-Ho Prospect. An initial 3,000m RC program has been developed across 16 high priority targets with the potential to drill additional metres on exploration success.

In our view, 3,000m over 16 projects does imply that the drilling will be applied quite thinly. However, as SPI has not yet effectively ranked these targets this methodical and reserved approach appears to represent the most effective utilisation of available cash resources.

The initial 3,000m drilling programme started on 9 April, 2010. In addition, SPI has contracted GPX Surveys to conduct a new 744km airborne geophysical survey concentrating on locations to the west of the current exploration area from which the company hopes to generate additional targets to be tested later in the year.

#### Other upcoming work

Other work targeted by SPI for the forthcoming year includes the finalisation of metallurgical testwork to estimate the tonnage of high grade, shippable material that can be obtained from an in-situ resource. Subsequently, and assuming the metallurgical testwork is positive, SPI needs to assess the potential logistical routes to ports and negotiate access agreements. Alternatively, SPI may have the option of considering a mine gate sale to existing operations – in this case Mineral Deposits / Hancock Downs.

#### Hot Sector, Hot Location

Merger and acquisition activity in the manganese sector has been increasing over the last 12 months with a number of large, high profile deals being achieved. The largest player in the listed Australian space, OM Holdings Limited, has been quite aggressive but a number of the smaller companies are also expanding their activities in manganese exploration and development. In exploration, Shaw River Resources (SRR), FerrAus (FRS), Aurora Minerals (ARM), AusQuest (AQD), Jupiter Mines (JMS) and others are ramping up their efforts in the Pilbara and adjacent regions. We continue to see a high level of activity in manganese driven by Asian steel production.



Figure 4. Company activity in manganese in the Pilbara Region

Source: SPI

### Tasmanian Coal Portfolio

In 2008 SPI announced an agreement to acquire Black Rock Energy Pty Ltd, a privately owned company holding a prospective portfolio of thermal coal exploration projects located in the Derwent Valley, north of Hobart, Tasmania.

Many of the coal deposits in Tasmania were drilled in the late 1970's and early 1980's by large resource miners such as BHP and WMC to assess the potential for the fields to supply proposed coal fired power stations. When the energy solution for Tasmania turned to oil and subsequently hydro-electric power, further coal field developments were abandoned.

The Tasmanian coal deposits have essentially remained untouched ever since with only one operating coal mine in existence at Fingal, which produces approximately 500,000 tonnes per annum supplying a domestic industrial market.

SPI has four coal projects with the Langloh Project having an existing JORC resource that SPI intends to expand over the coming months.



**Figure 5. SPI Thermal Coal Projects in Tasmania**

Source: SPI

The coal projects are all close to existing infrastructure and Tasmania have a number of ports with suitable facilities or where facilities for the export market can be put in place. There are existing government owned rail links approximately 30km to the south that connect to ports at Bell Bay, Hobart and Burnie.

### Langloh Project

The Langloh Project consists of a tenement package totalling 103km<sup>2</sup> in the Derwent Valley. The project was sampled by Capricorn Resources and Petrecon Australia in 1981-1982 from 28 drill holes which confirmed the presence of 3 shallow seams averaging 3.6m in cumulative width at a maximum depth of 45m from the surface, in an area extending over 7.25km by 4.5km.

The existing JORC resource totals 10 million tonnes of black thermal coal and is open at depth and along strike. The coal quality statistics, on an air-dried basis, are:

Moisture (%)	4.8
Ash (%)	20.3
Volatile Matter (%)	24.5
Fixed Carbon (%)	50.4
Total Sulphur (%)	0.3
Total Phosphorous (%)	0.003
Specific Energy (kcal/kg)	5,636

**Figure 6. Langloh Coal quality statistics**

Source: SPI

SPI believes the medium calorific value of the coal may be improved by washing therefore making it potentially suitable for the export coal markets in Asia.

### 2010 Coal Project Drilling Program

A 10-hole diamond and RAB drilling program commenced in March 2010 at the Langloh (Hamilton) Coal Project with the aim of drilling 7 diamond holes to confirm coal quality and 3 RAB holes to test for extensions of the existing 10 million tonne resource. This is the first drilling program in the area since the 1980's.

Following the drilling at Langloh, SPI will move the drill rig to its coal project at Avoca further to the north with an intended program of 23 RAB holes and 2 diamond holes with the aim of obtaining enough sample to determine coal quality and to test the prospectivity of the area for the discovery of additional coal seams. The Avoca area contains outcropping coal seams.

The Avoca Project has received considerable historic attention from Western Mining Corporation in 1977, Shell Company of Australia in 1980 and Avoca Transport Company in the late 1980's. A WMC report from that time made reference to some of the coal from the Avoca Project having qualities that would indicate coking coal characteristics.

When the results from both project areas have been collated, SPI will determine the most appropriate strategy to move the Tasmanian thermal coal portfolio.

### SPI targeting 35 to 45 Million Tonnes

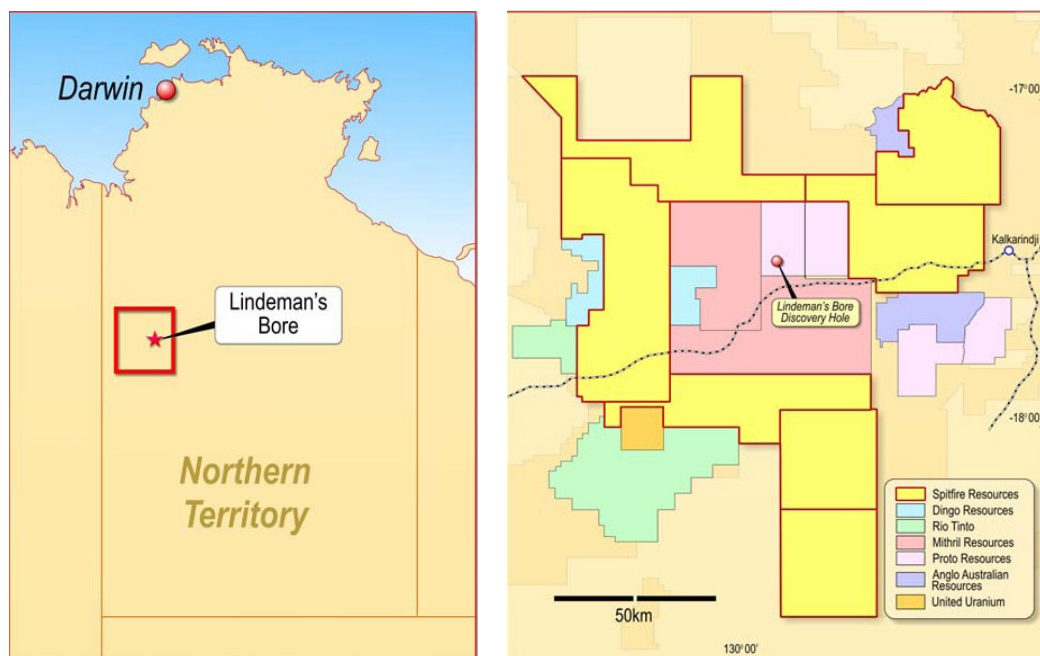
SPI is targeting open pitable coal resources of between 35 to 45 million tonnes. Drilling started in late March and is expected to continue for a period of approximately six weeks with the coal quality data analysis to be finalised 10 weeks after the completion of the program. We therefore expect initial results from the drilling to be announced mid-to late May and the quality data to be announced by late June.

### Northern Territory Base and Precious Metal Project

SPI also has a base and precious metal project in the Northern Territory. SPI was successful last year in securing a 70% interest in the project, which comprises seven Exploration Licence Applications located 380km south west of Katherine, covering an area of 9,000km<sup>2</sup>.

The ground abuts the Lindeman's Bore Prospect, owned and operated by Proto Resources and Investment Ltd (ASX: PRW), which reported a mineral discovery at the LBD-1 target, which is a Norilsk-style nickel-copper-PGE target. This hole intersected anomalous cobalt-copper-gold and silver mineralisation with a silver intersection at relatively shallow depths.

Proto is targeting a magnetic anomaly in LBD-2 and an off-hole electromagnetic (EM) conductor in LBD-3. In LBD-2 anomalous gold (7m at 1.1g/t gold from 424m) and elevated copper values were recorded in sulphide minerals in a metamorphosed black shale member. The drill hole LBD-3, located 500m to the northwest of LBD-2 is targeting elevated nickel and cobalt values.



**Figure 7. Location and tenement map, Northern Territory**

Source: SPI

While this is an interesting project, we see SPI continuing its focus on its manganese and coal portfolios, making decisions on its Northern Territory Project as and when new exploration data comes to hand.

## Capital Structure and Corporate Activity

SPI has 115m shares on issue and a undiluted market capitalisation of \$14.9m at a share price of \$0.13. Current cash of \$4.1m as at the end of the 1QCY2010 results was supplemented by a \$1.82m raising to strategic and sophisticated investors in April 2010 to raise the cash balance to \$5.6m, resulting in an Enterprise Value (EV) of just \$9.0m on an undiluted basis. The SPIO listed option tranche is a 20c option exercisable on or before 30 June, 2010 which would net SPI with a cash injection of \$4.88m if they were all converted.

CODE	Description	No. Securities (m)	Market Capitalisation (\$m)
<b>Listed Securities</b>			
SPI	Ordinary Fully Paid	115.0	14.9
SPIO	Option Expiring 30-Jun-2010	24.4	0.3
<b>Total Listed Securities</b>		<b>139.4</b>	
Unlisted Securities - options		25.4	
<b>Total diluted capital</b>		<b>164.8</b>	

**Figure 8. SPI Capital Structure**

Source: IRESS/DJC

The cash position of \$5.6m will provide the funds for SPI's manganese and coal portfolio drilling campaigns and allows the company to fully evaluate the results and determine the next steps.

### Strategic Investors Appear on Register

The \$1.82m placement was within the 15% limit allowed under the ASX listing rules and all the shares issued were fully paid ordinary shares. Subsequent to the placement, a Singapore-based trading company, Prosperity Steel United Singapore Pte Ltd (Prosperity), lodged a significant shareholder notice with the ASX and from participation in the placement and on-market purchases, has emerged with a 8.37% stake in SPI.

SPI understand that the investment was based on the company's manganese projects. In our view, given the rampant upstream resource asset acquisitions being carried out by Asian, and specifically Chinese, companies in recent times, commodities trading companies are also looking to place footprints on upstream assets, to maintain a pipeline of projects that will provide them with metal and bulk commodities to trade in the future.

Also at the end of April, SK Resources Limited announced a 7.03% interest in SPI, also from participation in the recent placement and through on-market purchases. SK Resources is a multi-faceted global mining, manufacturing and trading business. Its key product interests include manganese ore, iron ore, steaming and coking coal, coke, nickel ore, pig iron, bauxite, ferro alloys and steel products.

We see SK Resources having the same aim as Prosperity – to secure upstream assets to ensure a pipeline of access to minerals involved in the steel and energy markets. This bodes well for SPI as these companies would look towards off-take agreements in the future should the manganese and coal exploration prove successful.

## Peer Companies

Activity in the manganese sector has been high recently, both in mergers and acquisitions and in the junior end of the market where explorers have been spending increasing amounts of money in the ground to develop their projects.

Excluding the massive Groote Eylandt deposit located in the Gulf of Carpentaria and operated by BHP, the table below provides characteristics of the current operating manganese mines.

### The Manganese Miners (ex Groote Eyland – BHP)

Project	Owner	Shares on Issue (m)	Market Cap (\$m)	Ore Reserve (mt)	Grade (% Mn)	Production (tpa)	Production Grade (%Mn)	Occurrence	Strike Extent
Bootu Creek	OM Holdings	498	952	22.4	22.1	650,000	41.9	Lenses and Pods	20kms
Woodie Woodie	ConsMin	na	na	15.8	42.1	900,000	48.0	Lenses and Pods	20kms
Nicholas Downs	Mineral Deposits	na	na	20.0	na	480,000	40.0	Mesa & Detrital	N/Aa

### The Manganese Pure Play Explorers in WA

Company	Main Metal	Strike Length (km)	Shares on Issue (m)	Options (m)	Share Price (A\$)	Market Cap (\$m)	Cash (\$m) (DJC est)	EV (\$m)
Shaw River Resources	Manganese - drilling	102	196.2	21.4	0.17	33.4	4.3	29.1
Aurora Minerals	Manganese - drilling	53 (+42) *	104.2	34.6	0.66	68.8	20.0	48.8
Spitfire Resources	Manganese - drilling	na	115.0	24.4	0.13	14.9	5.6	9.3

Figure 9. Operating Manganese sites and Pure Play Explorers

Source: DJC

The junior explorers end of the market is a much more diverse group and includes companies who, although are exploring for manganese, are not doing so as their sole focus. These companies include AusQuest, Jupiter Mines and Ferraus. However, from the data in the tables above, there does appear to be a disparity in the EV's between the juniors. This could be a result of the considerable land holdings and implied strike lengths of the prospective geology and the way the companies have promoted themselves, particularly Aurora Minerals (ARM), over the course of the lead up to their drilling programs.

#### Value Proposition yet to be elucidated to the market

We understand that SPI has not undertaken a publicity drive prior to the initiation of their drilling campaign, or fully elucidated the nature and prospectivity of their exploration targets outside of the Tally-Ho discovery. We take the view that SPI are taking a deliberate and methodical approach and do not want to prematurely promote a project without first having an understanding of the likely prospectivity from the various targets under consideration. We believe this part of the process is still to come and see the opportunity for investors to take early positions prior to the results being released.

This of course carries additional risk but, with drilling campaigns underway at both the manganese and the thermal coal projects, we believe that news flow will be greatly increased over the course of the next few months. The addition of two strategic investors to the register in the last few weeks adds an additional level of interest and these parties are likely to be useful to SPI should they have exploration success.

## Directors and Management

### **James T Hamilton – MAICD, Managing Director and Executive Chairman**

Mr Hamilton is a former award-winning Financial Journalist who has specialised in covering the global resources industry. For 13 years Mr Hamilton travelled extensively analysing exploration projects, mines and management teams across a variety of mineral commodities, including precious metals, base metals, diamonds, energy minerals and industrial minerals. He is the former Editor of Australian technical mining journal Australia's Mining Monthly. He has also been editor of dedicated mining investment magazine ResourceStocks and is the founder of mining information news service, MiningNews.net. From 2005 to 2009 James was Joint Managing Director of AIM-listed company Churchill Mining Plc and helped grow the company from IPO into a successful mid-tier company following the greenfields discovery of the 3 Billion Tonne East Kutai Coal Deposit in Indonesia. In his position as Joint Managing Director he held senior management roles in operations management, marketing, treasury, project development and corporate compliance.

### **Christopher J Daws: MAICD, SA Fin – Non Executive Director**

Mr Daws is the former CEO for ASX-listed company Niagara Mining Limited – a position which he held for 4 years. In this role Mr Daws helped grow Niagara Mining from a sub-A\$10 million market capitalisation to an organisation with a market value of more than A\$200 million. Mr Daws has a strong background in finance and economics having spent 10 years involved in Australian equities markets and has worked within some of the largest broking organisations in the world. Mr Daws has undertaken various capital raisings for Australian companies listed upon the ASX, many of them junior mining houses. Mr Daws is an Affiliate member of the Securities Institute of Australia and a qualified Environmental Officer having completed an Associate Diploma in Applied Science (Environmental Technology). Mr Daws is an Executive Director of US Nickel Limited.

### **Russell P Hardwick: MAICD, BBus, ACIS CPA – Director and Company Secretary**

Mr Hardwick is an Accountant with 15 years experience with a variety of private and public companies. Most recently he has served as Company Secretary for AIM-listed minerals exploration company Churchill Mining PLC. He is a Certified Practising Accountant and a member of the Institute of Chartered Secretaries and Institute of Company Directors. Mr Hardwick has experience in capital raisings, ASX and ASIC compliance and general business and financial management.

### **Nat Cull: Exploration Manager**

Mr Cull is a Geologist with over 17 years experience in the exploration and mining sectors, including several years of experience in resource estimation and two years working in the former Soviet Union. He has worked in commodities such as gold, silver, copper, chrome, iron and manganese. Most recently, he served as Senior Resource Geologist at Consolidated Minerals. In addition to this, he fulfilled the role of Chief Mine Geologist overseeing the mine geology at the Woodie Woodie manganese and Coobina chromite operations in Western Australia. Other roles held by Mr Cull include Senior Mine Geologist, Underground Geotechnical Engineer, Technical Services Director and Alternate Mine Manager.

**Disclosure****RCAN0877**

This Research report, accurately expresses the personal view of the Author.

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The Authors of this report made contact with the companies mentioned in this report for assistance with verification of facts, access to industry/company information. DJ Carmichael have produced this research paper on a commissioned basis and have been paid a fee by **Spitfire Resources Ltd** for this service. No other inducements have been made or accepted.

The recommendation made in this report is valid for four weeks from the stated date of issue. If in the event another report has been constructed and released on the companies mentioned in this report, the new recommendation supersedes this and therefore the recommendation in this report will become null and void.

**Recommendation Definitions**

**SPECULATIVE BUY** - 10% or more outperformance, high risk

**BUY** – 10% or more outperformance

**ACCUMULATE** - 10% or more is contingent on entry price and suggests exploiting any share price weakness

**HOLD** – 10% underperformance to 10% over performance

**SELL** – 10% or more underperformance

**Period:** During the forthcoming 12 months, at any time during that period and not necessarily just at the end of those 12 months.

1. Stocks included in this report have their expected performance measured relative to the ASX All Ordinaries index. DJ Carmichael Pty Limited's recommendation is made on the basis of absolute performance. Recommendations are adjusted accordingly as and when the index changes.

Risk Rank is developed to incorporate both market and total risk. The rankings for each category are based on the position of each stock relative to all other stocks covered in ASX300. The risk ranking is based on the following percentages:

1 = best 10%

2 = next 20%

3 = middle 40%

4 = next 20%

5 = bottom 10%

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