# StockAnalysis

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## Hot Topics



## In This Issue



## Outlook 2017

Despite significant headwinds from expected political, social and environmental events during 2017, StockAnalysis thinks that on balance, 2017 will be a positive year for global markets, especially for resources stocks and particularly gold.

- Gold is likely to regain favour as an insurance element under the influence of rising inflation and growing social and political uncertainty.
- Copper, aluminium and nickel are likely to continue to recover from a long downtrend, under the influence of Chinese capital spending on rail and renewable energy schemes. Zinc was the best performer during 2016 and has probably run its race over the short term.
- Prices for bulk commodities (iron ore & coal) should see some retreat from recent recoveries, under the influence of increased supply. This is likely to take iron ore CFR China, back below US$55-US$60/tonne, from current levels close to US$80/t.
- The price of oil should recover to US$65/bbl (A$85/bbl). LNG is well supplied. Spot trades will be at a significant (20%?) discount to contract prices, which should recover to US$9.20/Gj through the year from just below US$8/Gj currently. China's focus on a 'blue sky' strategy should increase its use of clean burning gas, which will strengthen the LNG market over the coming 1-3 years.
- Oil stocks with leverage to growth could be the standout investment class for 2017.
- After years of QE that has inflated prices for many asset classes, US stocks look over priced.

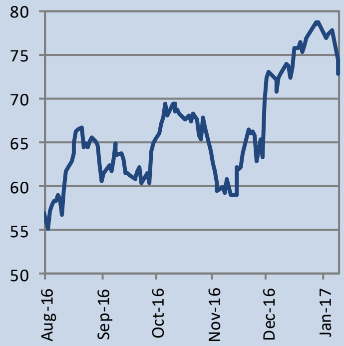
| Indices and Prices | |
|---|---|
| **All Ordinaries** | 5,813.00 |
| **Energy Index** | 9,235.50 |
| **Brent AU$/bbl** | 72.8525 |
| **AUS$/US$** | 0.7369 |
| **Live Gold/AU$** | 1611.85 |
| As at close 10 January 2017 | |

### Gold Live AU$


### All Ordinaries


### S&P ASX 200 Energy Index


### Brent Crude Oil $AU/barrel




### AU$/US$

- The Australian housing market should retreat under the influence of rising supply and (thankfully) lower population growth.
- Australian banks look fully priced. Bad debts are likely to rise as interest rates rise and property prices fall though 2017.
- Technology stocks with a focus on renewable energy, along with lithium miners, should perform well as the price of lithium chemicals remains strong through 2017 & '18.
- Selected rural/food stocks hold long term interest.
- The AUD should perform better than most expect, following commodity prices higher.

- Risks revolve around a Trump Presidency and results from European elections, as well as high levels of Chinese and European indebtedness.
- Control of the South China Sea and ongoing wars in the Middle East create an uncertain background for investors.

## Politics

Body language by attendees at this year's **Davos** economic forum in late January will set the scene for investment ahead of the inauguration of Trump as US President.

While Trump's plan for increased capital spending on infrastructure and defence along with loosening of environmental and other regulation on business is likely to initially be a positive for Wall Street, StockAnalysis believes that **Trump's presidency has the potential to ultimately rip the Union apart**. The USA is now firmly two nations. It consists of the more Liberal, heavily populated northeast US and west coast states that are largely Democrat, and the rest! Trump will face stiff protests during his period in office from a lot of people who should have gotten off their bums and actually voted in the recent election process!

American people, who have become the laughing stock of the world are waking up to the fact that they are going to be governed by the best President that Russian leader Putin could choose for them! Before the election, Trump opined that he would only accept a result from the vote if he won. StockAnalysis speculates that Trump already knew that a 'fix' was in and that there would have to be an even more awesome corrupting force at play for him to have lost!

The list of Trump's nominees for Cabinet posts appears to be dominated by Christian fundamentalists, homophobes, anti-abortion types, creationists or intelligent designers at best, anti-science climate change deniers and multi billionaires from Wall Street. Todd Ricketts, Trump's pick for deputy commerce secretary has an estimated net worth of $4.5 billion, and the new secretary of commerce, Wilbur Ross, is worth $2.5 billion. The tally on net worth of his nominees is so far running at US$16 billion. So much for draining the swamp! Rather, he is changing the flora with a new batch of wildlife.

**Germany will go to the polls in February** to re-elect Angela Merkel as President, but discontent with her policy of allowing rapid immigration into the nation will be the main feature to watch.

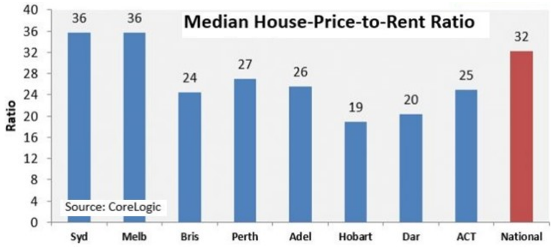
**Dutch elections in March** will certainly see a big swing to the political right. The impact on social stability resulting from decades of non-European immigration into the Netherlands has led Dutch voters to the forefront on the issue. Many are concerned about the nation's changing demographics and a resulting reduction in their security and quality of life.

March '17 will also see the **UK commence a process to exit from the European Union**.


**France will go to the polls in April to choose a new President** with one or other right wing candidate tipped to win.

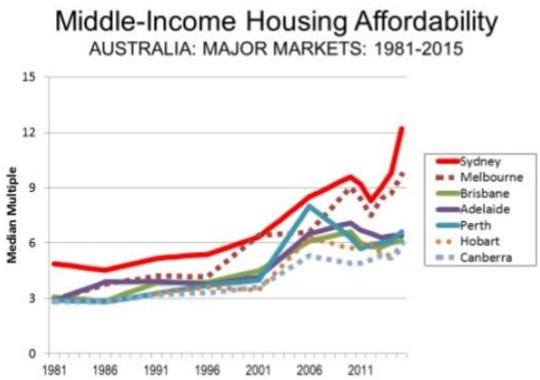
So there will be plenty of the fabled 'volatility' producing events to move markets.

## Inflation




A decade of quantitative easing has seen a steady flow of funds into investment assets, inflating prices along the way. Bond prices have boomed as interest rates fell towards zero and below in some cases, while stock markets in the USA look particularly over priced as a result of this asset class inflation.

Housing property prices have also lifted to bubble territory in selected jurisdictions. These include Vancouver, Auckland and London and large Chinese cities along with Melbourne and Sydney, whose housing bubbles have been built on the back of record breaking, immigration fuelled population expansion in those cities.




Effective PE ratios for Sydney and Melbourne housing of 36 times rental income, along with prices at multiples of over 12 times average annual incomes, compared with 3-5 times 30 years ago, demonstrate how crazy house pricing has become in an easy money environment where negative gearing, combined with capital gains tax concessions for investors, boosts price expansion that is underpinned by rapid population growth.

Outside of investment assets and housing bubbles, broader inflation gauges globally have been low. A general fall in prices following the GFC in 2008 and then weakening commodity prices post 2011 have kept a cap on underlying inflation. This is particularly the case for energy prices post mid-2014, since energy costs flow through to all other costs in an economy.

The situation will change in 2017! Inflation is back on the agenda big-time as oil and coal prices recover and metal prices rebound. Rising energy costs will filter through the economy during H1 2017 and interest rates will rise. Higher costs for debt will put an end to property bubbles in Sydney and Melbourne during 2017 and will also lead to **increasing bad debts for all the major banking lenders**.

Rising interest rates will be a boon for savers but will also create headwinds for otherwise yield rated stocks such as the banks and real-estate trusts.

Cyclical resource stocks should perform best in a rising inflationary environment of 2017 as commodity prices recover.

## Commodity Prices

The AUD oil price has recovered from a nadir of around A$40/bbl at its January 2016 lows to A$77/bbl. StockAnalysis sees this improvement continuing towards A$85/bbl by mid-'17. This oil price recovery has come on the back of ongoing increased global demand, falling supply from non-OPEC nations and agreement by OPEC to restrain output. Through 2017, oil supply will continue to be constrained by two years of falling capital spending on new field evaluation and development. The oil market is likely to move into a structural deficit in 2018 that only demand destruction will be able to rectify.

Oil consumption will be reduced by its elasticity of demand as price rises, but also by substitution as EVs begin to capture market share post 2018.

Commodity prices will also be boosted by massive Chinese capital spending on transport, construction and renewable energy infrastructure. A $US115 billion railway construction plan in China will require massive amounts of wiring and rail track. Increased awareness of the negative health and social impact of pollution associated with transport fuels and coal fired power generation on the Chinese people and their perception of government has also spurred China to announce a US$360 billion capital programme to develop massive renewable power and transport infrastructure.

This will boost demand and prices for non-ferrous metals like copper, nickel, zinc and aluminium. Beijing is also seeking to eliminate old, inefficient and polluting steel production capacity in a bid to curb excess output and reduce emissions.

The iron ore market remains well supplied. High levels of inventory at Chinese ports and expanding capacity globally should cap the price at US$80/tonne and a retracement to below US$60/tonne seems likely by mid 2017.

## Market volatility

Modern stock and commodity markets have become such complex systems that nobody really knows how they really work! Strange moves now frequently occur in equity and commodity markets for no apparent reason. This level of complexity makes markets more prone to catastrophic collapse as high levels of computerised and **high frequency trading** (HFT) interact. This febrile situation has recently been fed by an experimental monetary policy, which history decrees should lead to a boom-bust scenario, which has been expressed as bubble housing and elsewhere in lithium, rare-earth and then gold prices and shares.

Sadly, HFT feeds on market liquidity as it effectively front-runs and skims funds from orders placed by legitimate savers and investors, to the detriment of market integrity.

The other new factor is a rise in the use of **Exchange Traded Funds** (ETFs). ETFs buy a basket of stocks without any reference to fundamentals. In theory, ETFs provide investors with exposure to a desired sector or theme at very low transaction costs. However in practice, an ETF buys what is going up and sells what is going down in greater quantities as a trend gains momentum. Money flows into or out of an ETF with increasing volatility on the way up and down to amplify momentum.

**The risk lies in the potential for these two factors to interact, but StockAnalysis thinks that its subscribers can make money by betting against the herd!**

## Gold

On a theme of secondary market activity, **gold companies effectively shoot themselves in the foot when they hedge their future sales**. Sure, there can be good operational and financial reasons to hedge, like a desire to stay in business if lower prices occur and also to support debt servicing with secure cash flow, but hedging gold effectively brings forward future gold sales and puts downward pressure on the current gold market. The more that gold companies choose to sell forward, the more downward pressure they put on the physical gold market.

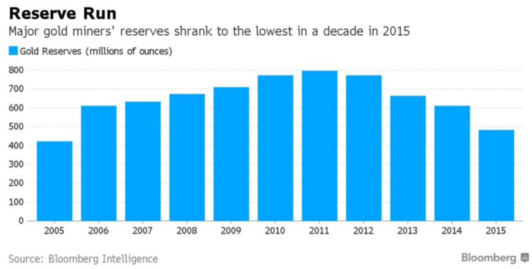
Pleasingly, some companies have taken advantage of recent low AUD gold prices to close out forward sales and make a significant margin. **Blackham Resources** (BLK: ASX) bought 41,250 ounces at around A$1,600/oz to close out hedges priced at A$1,762/oz, thus pocketing a $6.2 million gain. Having secured development funding by selling half its Gruyere deposit, **Gold Road** (GOR: ASX) pocketed a $11.9 million profit by closing out its 50,000 ounce facility at A$1,791/oz by purchasing gold at around A$1,553/oz. StockAnalysis suspects that gold companies globally with forward cover at prices over A$1,700/oz will follow this lead, with a net effect of supporting the current price of around A$1,605/oz.

# Market Moves

On top of rising inflation and the pre-emptive closing out of forward cover over gold sales by companies with high priced cover, another reason that the price of gold will rise during 2017 is a falling rate of mineral discovery over the past decade and a rising cost of production.


As the price of gold bullion fell 41% in USD terms from a record in 2011, miners began to cut capital expenditure on exploration and development. This lack of activity has shortened mine lives at many operations since firms haven't been able to keep up with infrastructure needed to access more ore. Annual gold production is currently near record highs, but it has been on a virtual plateau since 2003.

In the face of falling Reserves, gold production is expected to peak in 2019 and keep falling through until at least 2025.




This peak gold scenario should also support prices through 2017.

# ADX Energy

## POTENTIALLY 2017'S STAR OIL STOCK

| Capital Structure | | |
|---|---|---|
| **Code** | **ADX** | |
| Shares | 920 | m. |
| Options | 67 | m. |
| New Equity (est) | 150 | m. |
| Share Price | $ 0.008 | |
| Market Cap | $ 7.4 | m. |
| Cash (est Dec '16) | $ 0.8 | m. |

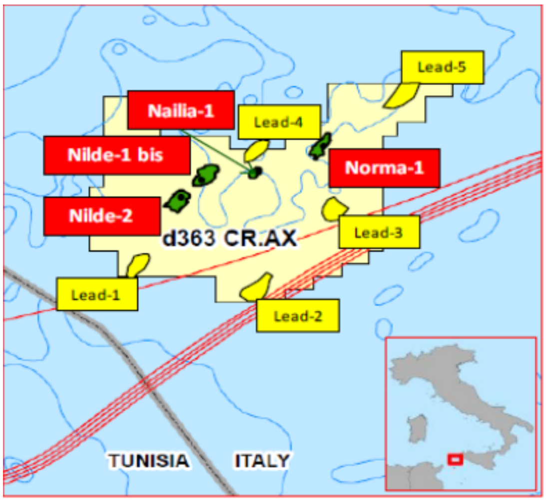
**Recommendation: *ADX is a speculative buy. StockAnalysis sees potential for ADX to be the best performing stock of 2017!***

***ADX has spectacular leverage to both project development at its 100% held Nilde oilfield, offshore Italy and a rising oil price.***

***StockAnalysis calculates that applying an oil sharing approach to a low risk redevelopment of the Nilde oilfield, in technical partnership with Calm Oceans Pte Ltd of Singapore, has upside value potential of A$272 million or 24 cps to ADX and may establish a new project development technique for application on its other projects in a market where activity for service and equipment providers is quiet.***

***The company has a market capitalisation of just 26 cents per barrel of combined 2C oil Resources at the Nilde and Nilde Bis oilfields and 4 cents per BOE of total 2C Resources, including its Dougga West gas/oil project offshore Tunisia.***

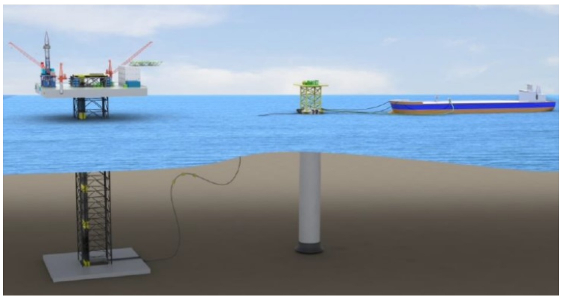
**ADX Energy** (ADX: ASX) will apply cash reserves of about $1 million towards completion of subsurface studies on reservoir simulation and obtaining 3rd party estimates of Resources and Reserves at the Nilde and Nilde Bis fields in permit d363 CR.AX during Q1'17. Meanwhile, ADX has signed an MOU with Calm Oceans PTE Ltd (COPL) of Singapore, which will conduct engineering studies to estimate capital and operating costs for a Nilde development. Both parties will cooperate with ongoing work to identify 3rd party drilling and installation services, along with equipment required for production and storage that will slot into an overall project development plan for delivery to Italian authorities by mid 2017.




COPL has designed and built self-installing mono column platforms (MCP) and has designed relocatable pivotable storage and off-take facilities (RPSO) that the partners plan to apply, in conjunction with an MCP at Nilde. This development plan supercedes a previous focus on more expensive subsea well completions and use of an FPSO, as was previously applied for early project development in the 1980's, when the Nilde field produced about 21 MMbbls of oil.

COPL will own and operate these major pieces of equipment that will then be leased to ADX's project. The partners will also locate additional equipment required for the platform such as accommodation and a drilling rig that can be leased or purchased by COPL for lease to the project. Any out-of-pocket expenses by COPL are likely to be repaid out of early oil production from Nilde.

**Planned Nilde development configuration**



Application of an MCP and RPSO will enable well heads to be located on the platform. This development process is much cheaper and quicker to achieve than previously planned subsea completions, enabling a cheaper completion technique, easy access for drilling of additional wells and subsequent work-over procedures on wells, as well as a rapid move to production that does not involve drilling with a separate rig and then installing production facilities, since they will be all available on the MCP.

The current plan is to locate the MCP between Nilde and Nilde-Bis, so that low angle wells can be drilled into both structures. StockAnalysis assumes that production will commence as soon as the Nilde well is completed in 2019 and that a Nilde-Bis well will follow in 2020.

Development at Nilde is similar to the way Havilah Resources (HAV: ASX) has worked with CMC to develop the Portia gold project. CMC supplied all the mining equipment and undertook all mining activity, for which it is receiving 50% of the gravity gold recovered.

ADX calculates that the operating cost of this project should run at around US$49 million pa, including all equipment lease costs for the MCP and topside production facilities, and the RPSO as well as running costs for daily management, boats, helicopters and supply vessels and overhead costs.

The company estimates that after subtracting previous production of 21 MMbbls of oil from an estimated 300 MMbbls of oil originally in place at Nilde, remaining 2C oil Resources at its 100% held Nilde oil project offshore Italy are 34 million barrels of recoverable oil, with 28.4 MMbbls of that oil in the Nilde and Nilde-Bis fields, while 1C Resources in the Nilde and Nilde-Bis fields are estimated at 18 MMbbls.

StockAnalysis models a project that commences oil production in mid-2019 with capital costs kept at a low US$97 million by leasing most equipment and also assuming that CAPEX costs borne by COPL are repaid from a 40% share of oil production over an initial 3 years of operation, which should amount to a payback of roughly US$177 million at the current oil price.

**Estimated Gross Contingent oil Resources (MMbbls)**

| | 1C | 2C | 3C |
|---|---|---|---|
| Nilde | 8.7 | 13.1 | 17.8 |
| Nilde-Bis | 9.3 | 15.3 | 21.0 |
| **Sub-total** | **18.0** | **28.4** | **38.8** |
| Norma | 1.2 | 3.9 | 12.9 |
| Naila | 1.0 | 1.7 | 3.7 |
| **Total** | **20.2** | **34.0** | **55.4** |

**Nilde Project Summary**

| | | |
|---|---|---|
| Production | 27.2 | MMbbls over 10 years |
| Royalty | 4% | pa after 340K bbls pa |
| Tax | 27.5% | |
| COPL oil | 3.2 | MMbbls over first three years |
| Oil price | $57.0 | USD/bbl |
| CAPEX | $ 97 | m. Including 2nd well yr 2 |
| OPEX | $ 21 | Av. US$/bbl |
| Free cash | $ 483 | on 27 MMbbls |
| $NPV_{10}$ | $193 | m USD on 2C |
| $NPV_{10}$ | $141 | m USD on 1C |

*Source: Strachan Corp estimates from ADX data*

Since COPL agreed to support the majority of the project's capital costs, StockAnalysis assumes a further modest equity raising of $3 million during 2017, to support the company ahead of cash flow from Q3 CY '19.

Ultimately, ADX may defray some up-front capital costs that will be incurred for engineering and other services at Nilde by selling down a part of the project. ADX will be able to retain a much higher final equity in the project by partnering with equipment and service providers in the project in the lead up to delivering a development proposal to Italian authorities. At that point, a clear line to value should be apparent, enabling ADX to capture some value at an early stage. ADX will be in a stronger position to finalise details of the financial arrangements between itself and COPL once a development plan is prepared and tabled for Italian authorities.

Based on work to evaluate production of 1C oil Resources at Nilde and Nilde-Bis, StockAnalysis assesses a value of ~17 cps for ADX for this project alone.

| Risked Valuation | $m | $/shr | Comment |
|---|---|---|---|
| Cash (est) | 1 | $0.001 | Post new issue in '16 |
| New Equity (est) | 3 | $0.003 | Dillution @ 2 cps |
| Mining assets | 0 | $0.000 | 20.5m RIE |
| Nilde | 191 | $0.168 | NPV at $57/bbl for 1C |
| PARTA | 5 | $0.005 | 60% of risked Exp'n value |
| Dougga West | 34 | $0.030 | 20% of risked Exp'n value |
| Options | 1 | $0.001 | Nov-Dec '17 |
| Corporate | -3 | -$0.002 | 4x annual |
| **Sub-total** | 233 | $0.205 | |
| **Risked Petroleum Exploration Assets** | | | |
| Tunisia | 80 | $0.070 | Largely Dougga |
| Nilde Area | 17 | $0.015 | 30% of Lead 4 only |
| Romania | 7.6 | $0.007 | Half of larger risked potential |
| | $ 338 | $0.297 | |
| **Initial Target Price** | | $0.037 | |

*Source: Strachan Corporate*

In Tunisia, the company is working to renegotiate a more workable fiscal position over its 100% held permits. These permits contain at least 12 leads and prospects, including the Dougga West discovery, which is estimated to hold Resources of 180 Bcf of sales gas and 127 MMbbls of condensate, plus associated carbon dioxide, for which a market may be available.

A combined value of 10 cps to ADX is assessed for the Dougga and Dougga West prospects, based on retaining a 20% working interest in Tunisian waters after farming-out to fund. This value is dependent on the company retaining an interest and establishing a workable tax/royalty regime in Tunisia, otherwise they will have no value. ADX's progress in nearby Italian waters is likely to impress Tunisian authorities and strengthen its claims for a more equitable fiscal regime.

Romanian oil and gas prospects are risked with a total value of ~$13 million or 1.2 cps, assuming that ADX farms down from a 50% interest to retain 25% to 30% interests in that country.


Following disappointing evaluation results from drilling in Tunisian waters in 2013, the stock has made a long and slow recovery through a low oil price environment from mid 2014. Recognition of potential value in the Nilde assets should restore the stock to resistance at 2.5 cents, from where a staged recovery towards 6.4 cps is possible on the back of developments at Nilde.

# Soapbox

My correspondent from Germany (a retired industrialist and engineer), struggled to deliver a concise answer to the question we are all asking, '**How are the German people coping with a rapid influx of immigrants?**'

There are so many moving parts! Like the USA, Germany is also split with the north around Berlin, Hamburg and Hannover, being more Liberal/Left and the south, which is the heartland of German manufacturing around Stuttgart and Munich, being more conservative. However, the mood that is common in Germany is similar to what we see everywhere. People have become disillusioned with the judgement of their political elite and distrustful of the mainstream media which supports its business model by buttressing the political power structure to maintain the *status quo*.

German politicians are putting lipstick on a pig at the moment. They have lied to the German people, telling them that their nation needs these young immigrants because it has a declining and aging population. They misled people by saying that most of the immigrants have higher levels of education than the average German! On cue, the media dutifully trots out a young professional from Syria who speaks almost perfect German! Later the truth emerges as people find out that almost 70% of immigrants have no education at all!

Meanwhile the German Greens Party maintains a policy that equates to treason. On the basis that Germany was instrumental in starting two wars during the last Century, they actively promote destroying modern Germany and its culture by bringing in as many people as possible to drastically alter and dilute the German psyche. They would prefer Germany to become Syria or Turkey MKII than retain its rich cultural and economic heritage!

At the country's elections in February '17, the bottom line for German President Angela Merkel is that there is little real alternative for voters and no heir-apparent in opposition. In times of social and economic stress, voters will be reluctant to seek change, preferring the stay with the devil they know.

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