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White Energy (WEC)

WEC is commissioning its first commercial plant, with first revenues due in August. Start-up should be a catalyst for new and existing partners to commit to increased production capacity. A merger with a US listed entity could provide a funding solution.

Recommendation

Spec Buy

Price

\$1.52

Target (12 months)

\$2.50

Year end June	2008a	2009f	2010f	2011f
NPAT (reported) (A\$m)	-15.0	-6.5	8.9	32.7
NPAT (adj) (A\$m)	-15.0	-6.5	8.9	32.7
EPS (adj) (cps)	-1.2	-5.9	3.8	13.5
EPS growth (%)	na	na	-163.5	257.4
PER (x)	na	na	40.3	11.3
P/Book (x)	na	na	30.4	11.3
P/NTA (x)	na	na	27.8	7.1
Dividend (\$ps)	0.0	0.0	0.0	0.0
Yield (%)	0.0	0.0	0.0	0.0
ROE (%)	-21.1	-7.4	9.2	23.8

SOURCE: SOUTHERN CROSS EQUITIES ESTIMATES

Expected Return

Capital growth **64%**

Dividend yield **0%**

Total expected return **64%**

Company Data & Ratios

Enterprise value **\$282m**

Market cap **\$234m**

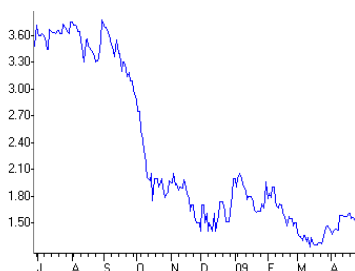
Issued capital **154m**

Free float **66%**

12 month Price range **\$1.18-3.95**

GICS sector **Materials**

Absolute Price



SOURCE: IRESS

White Coal Technology close to reality

First coal sales bring revenue and growth options

WEC has developed and demonstrated a process which upgrades low value coal to high quality export thermal coal. The construction of its first 1Mt/tpa plant at the Tabang coal mine in Indonesia in partnership with Bayan is now complete. Commissioning is underway, targeting full production in Sept 2009. Successful start-up should bring the first revenues, and generate interest from new and existing partners. As such, Bayan has agreed to increase the scope of its JV with WEC to 15Mt/tpa from 5Mt/tpa.

Global footprint continues to expand

WEC initially chose to establish partnerships to build plants in Indonesia, the US, and China. Indonesia is a key growth region for meeting Asia's growing coal demand, and the US is the largest producer of low rank coal. WEC continues to actively review other business development opportunities in these key countries and elsewhere globally. Two new agreements have been signed recently covering Mongolia and Africa.

Potential merger provides a funding solution

Now with extensive growth options, WEC is in need of additional capital. The US listed ASSAC has proposed a merger which would provide WEC with US\$100m in cash, sufficient for all near term capex requirements, in exchange for dilution to approx. 65% ownership of the operating subsidiary.

Our near term price target of \$2.50 is based on our valuation which only assumes a 3Mt/tpa plant for Bayan and 1Mt plant for NRG/Buckskin in the US, and has been diluted assuming the ASSAC merger finalises. However, in the medium term we expect further expansions to be undertaken, which could see a possible upside valuation in excess of \$10/share.

First sales catalyst for further growth

Bayan plant being commissioned

WEC has completed construction of its first 1Mtpa plant at the Tabang coal mine in Indonesia in partnership with Bayan, one of Indonesia's largest coal producers. WEC has a 51% interest in the JV company PT Kaltim Supacoal. Bayan agreed to acquire up to 1.5Mtpa from the JV for four years after production commences representing over US\$250m in revenue, which was sufficient to underpin WEC's first major project. The plant is being commissioned, and is due to be at full production in September 2009. First coal could be sold as early as August.

Successful Bayan plant should lead to new agreements

We expect that the first commercial sales from Tabang will be a key catalyst for new agreements being signed globally with new and existing partners. We believe the technical risk for new plants is low given they would be replications of the 90ktpa demonstration plant in Cessnock, Hunter Valley, NSW which has been in production since July 2008. However, we believe some partners may be waiting for the first commercial coal sales before committing.

Bayan itself announced today that it wanted to extend the scope of its JV with WEC to 15Mtpa from 5Mtpa. Additional capacity can be added over time by building successive 1Mtpa modules.

Economics remain attractive

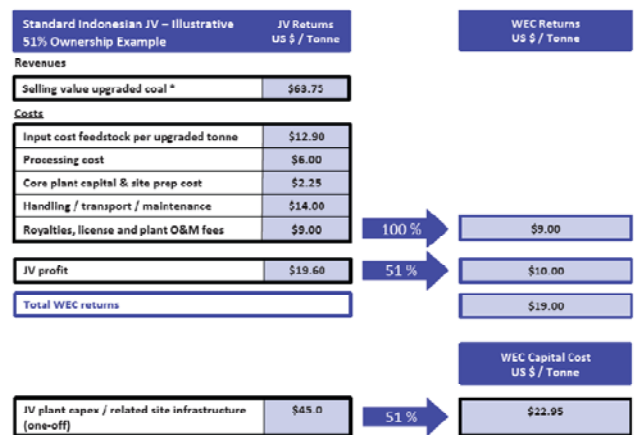
The White Coal technology upgrades cheap coal to export quality coal, for a small margin, enabling WEC and its partners to benefit from the large price differential between the input and output coal types. Sub-bituminous coal sells for less than US\$10/t, and export thermal coal ex-Newcastle is currently selling for US\$64/t. Even though export thermal prices have fallen significantly over the last 12 months, Figure 2 shows that WEC still makes US\$10/t from a 51% interest in a plant, plus licensing fees. With a capital cost of \$23/t, WEC's payback period on each module is less than 2 years.

Figure 1 - Plant at the Tabang mine ready for commissioning



SOURCE: COMPANY DATA

Figure 2 – Economics for a typical JV



* Market spot price as at 17 April 2009 for Newcastle 6300 kcal/kg = US\$63.75 per metric tonne.

SOURCE: COMPANY DATA

Expanding the global footprint

Key customers in Indonesia and the US

WEC has chosen to initially pursue commercialisation options in Indonesia, China and the US. Indonesia is a key growth region for meeting Asia’s growing coal demand. The US is the largest producer of low rank coal. WEC has agreements with the following parties to develop, construct and operate coal plants:

- **Bayan Resources (Indonesia)** First 1Mtpa plant constructed.
- **NRG/Buckskin(USA)** WEC is negotiating a contract to build a 1Mtpa plant at the Buckskin mine in Wyoming in the Powder River Basin.
- **Adaro Group/Itochu Corporation (Indonesia)** Interested in a 1Mtpa plant at its East Kalimantan mine.
- **Datang International Power (China)** Subject to a financial feasibility study, WEC is negotiating a structure and commercial terms for a JV with Datang to build the first of up to 10, 1Mtpa plants at Datang’s sub-bituminous coal mine in Inner Mongolia.

Growth profile expected to expand considerably

Our financial estimates assume 1 module in the US, and 3 at Bayan’s Tabang mine which is reasonable in the short term. However, in reality each partner has expressed interest in adding further capacity, and as WEC is in discussion with other potential partners, production could rise even further over time. Bayan has expressed interest in up to 15Mtpa, Adaro/Itochu and NRG/Buckskin each to 8Mt, and Datang to 10Mtpa, totalling 41Mtpa.

New agreements covering Africa and Mongolia

WEC continues to actively review a number of other business development opportunities globally, and two new agreements have been signed recently. In November 2008, WEC signed a JV agreement with Black River (a Cargill subsidiary) to jointly develop and commercialise the technology throughout Africa. Black River has committed US\$70m for its 49% interest, and WEC US\$30m for its 51% interest. In February 2009 WEC entered into a Development Agreement with Mongolyn Alt Corporation (MAK), one of the largest independent miners in Mongolia and IB Daiwa Corporation (IB Daiwa), a Japanese investment group, to conduct a feasibility study to evaluate the viability of constructing plants in Mongolia.

Figure 3 – Global footprint



SOURCE: COMPANY DATA

Figure 4 – Potential capacity at least 41Mtpa

	Initial Agreement Mtpa	Upside Mtpa
Bayan	1.0	15.0
NRG/Buckskin	1.0	8.0
Adaro	1.0	8.0
Datang	1.0	10.0
	4.0	41.0

SOURCE: SOUTHERN CROSS EQUITIES ESTIMATES

Potential merger could provide funding

Funding required for new plants

With the successful Tabang start-up likely to spark new opportunities, WEC is assessing funding options for its share of new plant capex. Each 1Mtpa module is expected to cost approximately US\$45m, with local variations. Under a typical JV arrangement WEC's share would be US\$23m. WEC and Bayan are in discussions with banks to determine the possibility of debt financing an accelerated roll-out of plants, however additional capital is likely required for other opportunities.

Potential merger with US listed ASSAC

The US listed Asia Special Situation Acquisition Corp., essentially a cashbox looking for Asian investment opportunities, has proposed a merger with WEC's currently wholly owned subsidiary White Energy Technologies. This would provide WEC with US\$100m in cash, sufficient for all near capex requirements, in exchange for diluting its ownership to approx. 65%. The operating subsidiary WET, would then become a listed subsidiary approx. 65% owned by WEC and have future access to US capital markets. The merger remains subject to shareholder approval. If WEC does not proceed with this route, other options remain normal debt and equity markets and joint ventures.

Significant upside despite dilution

Our base case valuation, which assumes that a 3Mtpa plant is built with Bayan, a 1Mtpa plant with NRG/Buckskin, and adjusted for the proposed merger deal, is \$2.51. This increases considerably if we take into account the current upside potential for additional plants, and one scenario is outlined in Figure 6, with a value of \$8.56. Note this does not yet include the full potential from Bayan of up to 15Mtpa.

We have removed the Adaro plant from our base case valuation, as part of the agreement with Bayan was that its plants take preference in Indonesia, but we have included a delayed 3Mt option for Adaro in our upside case.

We have dropped our 12 month price target to \$2.50 from the previous \$4.50 when we initiated last year. This is partly due to our lower coal price forecasts, but largely due to our view that stocks with start-up and funding risk are unlikely to price in upside potential in the current risk-averse market, until there is greater certainty. However, we maintain a Speculative Buy, and the view that the company is likely to transform into a substantial growth stock over time.

Figure 5 – Base Case valuation

	\$m	\$/sh	\$/sh +1yr	\$/sh +2yr
WEC				
Bayan 3Mt	362	1.41	1.70	2.03
Buckskin	253	0.98	1.38	1.63
Corporate	-106	-0.41	-0.40	-0.40
Options	36	0.14	0.14	0.14
Cash	102	0.40	0.54	0.26
Total	648	2.51	3.35	3.66

SOURCE: SOUTHERN CROSS EQUITIES ESTIMATES

Figure 6 – Upside valuation – Plant expansions and new partners

	\$m	\$/sh	\$/sh +1yr	\$/sh +2yr
WEC				
Adaro 3Mt	312	1.21	1.33	1.47
Bayan 5Mt	553	2.15	2.51	2.92
Buckskin 3Mt	728	2.83	3.41	4.15
Datang 2Mt	268	1.04	1.24	1.42
New partner 3Mt	312	1.21	1.33	1.47
Corporate	-106	-0.41	-0.40	-0.40
Options	36	0.14	0.14	0.14
Cash	102	0.40	0.54	0.26
Total	2205	8.56	10.09	11.43

SOURCE: SOUTHERN CROSS EQUITIES ESTIMATES

White Energy

Company Description

White Energy Company is the exclusive worldwide license holder of the patented White Coal Technology, a mechanical process which uses drying and briquetting to convert poor quality coal into a higher value, cleaner product. The low cost process allows WEC and its partners to take advantage of the price differential between low and high quality coals.

White Energy has reached agreements with major coal producers globally to commercialise the technology. A 1Mtpa plant is under construction in Indonesia in a JV with Bayan Resources (WEC 51%). An agreement has also been reached to build 1Mtpa plants in partnership with Adaro/Itochu in Indonesia, Datang in China, and NRG/Buckskin in the US. All partners have expressed interest in growing capacity rapidly beyond the initial level.

Investment Strategy

We rate White Energy a Speculative Buy with a target price of \$2.50. The Bayan plant is due to be in full production by September 2009, and is expected to be a key catalyst for the stock over the next 12 months.

Valuation

Our base case valuation, which assumes that a 3Mtpa plant is built with Bayan, a 1Mtpa plant with NRG/Buckskin, and the merger deal, is \$2.51. This increases considerably if we take into account the current upside potential for additional plants.

Risks

Risks include, but are not limited to:

- **Protection of Intellectual Property.** White Energy has patent protection over the drying and briquetting (mechanical) technology which is valid for another 16 years. However we do acknowledge that this does not provide guaranteed protection over intellectual property. We believe WEC has a five year window in which to establish the White Coal Technology in the market place before competitors may emerge, and capitalising quickly on the first mover advantage should be the best defence.
- **Funding.** The ASSAC merger provides a solution, but remains subject to shareholder approval. Debt and equity funding are other options.
- **Technology.** We believe the process risks are minimal given that a 90kt commercial scale plant is already operating in Cessnock and this is representative of the design and construction of a full scale plant. The upsize to a 1Mtpa plant involves adding a larger number of discrete briquetting units in parallel which minimises any upscale risk.
- **Altering the coal supply/demand dynamics.** The size of the seaborne thermal coal market is currently 700Mt, hence the planned 14Mt capacity should have a minimal impact on the supply dynamics and prices. Product from the US plant is for the domestic market.

Table 1 - Financial summary - Assumes ASSAC merger

White Energy (WEC)						Share price:					1.52	
As at						28-Apr-09					Market Cap:	\$ 392
PROFIT AND LOSS						VALUATION DATA						
Y/e June 30	2007a	2008a	2009f	2010f	2011f	Y/e June 30	2007a	2008a	2009f	2010f	2011f	
Sales revenue	0	0	12	41	142	Net profit adj (\$m)	-10	-15	-6	9	33	
EBITDA	-7	-11	2	17	64	EPS (c)	-8	-1	-6	4	13	
Depreciation	-3	-4	-2	-2	-11	EPS growth (%)	na	na	na	-163	257	
EBIT	-10	-14	0	14	53	P/E ratio (x)	na	na	na	40	11	
Net Interest Expense	1	1	-4	-1	-7	CFPS (c)	na	na	na	5	13	
Pre-tax profit	-10	-15	-3	13	47	Price/CF (x)	na	na	na	30	11	
Tax	0	0	-3	-4	-14	DPS (c)	0	0	0	0	0	
Net Profit	-10	-15	-6	9	33	Yield (%)	0	0	0	0	0	
Adjustments	0	0	0	0	0	Franking (%)	0	0	0	0	0	
SCEQ adj profit	-10	-15	-6	9	33	EV/EBITDA	na	na	na	28	7.1	
One-off items	0	0	0	0	0	EBITDA margin (%)	na	na	na	40	45	
Reported net profit	-10	-15	-6	9	33							
CASHFLOW						LIQUIDITY AND LEVERAGE RATIOS						
Y/e June 30	2007a	2008a	2009f	2010f	2011f	Y/e June 30	2007a	2008a	2009f	2010f	2011f	
Receipts from customers	0	2	21	37	126	Net debt/(cash) (\$m)	-15	12	-47	72	62	
Payments to suppliers	-3	-10	-25	-18	-64	Net debt/equity (%)	-19	18	-54	74	45	
Net interest	1	1	-2	-1	-7	Net interest cover (x)	na	na	na	10	8	
Tax paid	0	0	-3	-4	-14	Current ratio (x)	2	1	na	-18	-4	
Other	0	0	-1	-2	-8	Inventory turnover	0	0	na	7	7	
Operating cashflow	-1	-8	-11	12	33	Inventory/sales	0	0	na	5	6	
Capex	-9	-43	-104	-131	-31							
Investments	0	0	0	0	0							
Asset sales	0	0	0	0	0							
Other	-4	-1	-1	0	0							
Investing cashflow	-13	-44	-105	-131	-31							
Change in borrowings	0	15	19	36	0							
Equity raised	22	2	7	0	8							
Dividends paid	0	0	0	0	0							
Other	1	55	161	0	0							
Financing cashflow	23	72	187	36	8							
Net change in cash	9	20	71	-83	10							
Cash at end of period	15	35	106	23	33							
BALANCE SHEET						INTERIMS						
Y/e June 30	2007a	2008a	2009f	2010f	2011f	Y/e June 30 (\$m)	2007a	2008a	2009f	2010f	2011f	
Cash	15	35	106	23	33	Sales revenue	0	0	0	14	49	
Receivables	3	5	3	7	23	EBITDA	-2	-4	-10	6	22	
Inventories	0	0	1	3	11	Depreciation	-2	-2	-2	-1	-4	
Investments	0	0	0	0	0	Amortisation	0	0	0	0	0	
Other	0	0	-150	-150	-150	EBIT	-4	-6	-12	5	19	
Current assets	18	40	-40	-117	-83	Other income (expense)	0	0	0	0	0	
PPE	9	52	167	295	315	Net interest	0	0	-1	0	-3	
Investments	0	0	0	0	0	Pre tax profit	-4	-7	-14	5	15	
Intangibles	56	54	53	53	53	Tax	0	0	0	-2	-5	
Other	2	3	2	2	2	Net Profit	-4	-7	-14	4	11	
Non-current assets	67	108	222	351	371	Adjustments	0	0	0	0	0	
Total assets	86	148	182	234	288	SCEQ adj profit	-4	-7	-14	4	11	
Payables	8	30	0	6	20	One-off items	0	0	0	0	0	
Debt	0	47	59	94	94	Reported net profit	-4	-7	-14	4	11	
Provisions	0	0	0	0	0							
Other	0	0	36	36	36							
Total liabilities	8	77	95	137	151							
Shareholders' equity	77	71	88	97	137							
Minorities	0	0	0	0	0							
Total shareholders funds	77	71	88	97	137							
Total funds employed	62	83	40	168	199							
W/A diluted shares on issue	118	126	195	237	242							
						Thermal (US\$/t)	50	74	118	68	69	

SOURCE: SOUTHERN CROSS EQUITIES ESTIMATES. NOTE: FINANCIALS ASSUME MERGER WITH ASSAC WHICH REMAINS SUBJECT TO SHAREHOLDER APPROVAL

Recommendation structure

Spec Buy: Expect >30% total return on a 12 month view but carries significantly higher risk than its sector

Buy: Expect >15% total return on a 12 month view

Accumulate: Expect total return between 0% and +15% on a 12 month view

Reduce: Expect -15% and 0% total return on a 12 month view

Sell: Expect <-15% total return on a 12 month view

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Southern Cross Equities Ltd and its associates hold 109,550 shares and 2,000,000 options in WEC as at the date of this report. This position is subject to change without notice.



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