

28 April 2010

BUY

Mining

Price 3.875p

Target Price 7.82p

Company description

An exploration and development company focusing on gold and high-value base metals in Turkey and Ethiopia

Key data

Ticker	STI
Listing	AIM
No. of shares (m)	286.78m
Market cap (£m)	11.113
Enterprise value (£m)	8.46

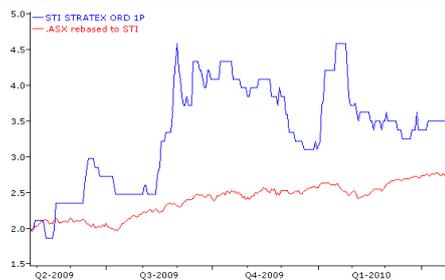
Top-five shareholders (% holding)

Teck Limited	12.46
Kairos Investment Mngmnt	11.82
Orion Trust Ltd	9.09
Nick Graham	9.25
David Hall	4.37

Relative performance

Period:	1mn	3mn	12mn
Performance (%)	+2.1	-33.6	+37.0

Price vs FTSE All-Share rebased to STI



Source: Fidessa, as of 27 April 2010.

Marketing communication

Westhouse Securities acts as Nomad and broker to Stratex International and is paid fees for these services

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Stratex International

NTF JV Finalised

Stratex International (AIM: STI) has finalised its joint venture (JV) production agreement with NTF Insaat Ticaret Ltd Sti in Turkey, with Stratex receiving US\$1m from NTF. Stratex has put its Inlice gold project into the new joint venture company, NS Madencilik. NTF will own 55% of the new company, subject to it funding a feasibility study at Inlice for up to US\$2m. In addition, NTF will fund scoping and pre-feasibility studies at Altintepe for up to US\$0.5m. If positive, NTF will have the option to spend a further US\$2m on a full feasibility study, in exchange for the project being transferred into NS Madencilik.

Investment case

- New JV company to fast track Inlice and Altintepe gold projects
- KCA contracted to commence Inlice feasibility study in May 2010
- Provides vehicle to develop other assets in Turkey
- Exploration JVs with both Centerra Exploration and Teck Resources
- New gold mineralisation province discovered in Ethiopia

Sum-of-parts valuation for Stratex International

Component	Project	Value (£m)	Per Share (p)
NTF JV	Inlice	3.99	1.39
	Altintepe	12.48	4.35
Centerra JV	Öksüt	1.97	0.69
Teck JV	Hasançelebi	1.26	0.44
Investments	Sheba Exploration	0.07	0.02
Cash		2.65	0.93
Total		22.42	7.82

Source: Westhouse Securities estimates.

Recommendation

Stratex is entering an exciting stage of its development. The new JV company provides Stratex with a vehicle to monetise both its Inlice and Altintepe gold projects, as well as any other projects that fall below its own one million ounce development target. We believe the discovery of a one million ounce resource could be achieved through one of its other JV agreements, with Centerra or Teck in Turkey or in Ethiopia, where Stratex has discovered a new gold mineralisation province. This is not included in our current valuation and represents further upside on our 7.82p target price. We therefore maintain our **BUY** recommendation, increasing the target price from 7.60p to 7.82p per share.

Stratex and NTF finalise joint venture company agreement

Stratex has now finalised the production JV agreement with NTF Insaat Ticaret Ltd Sti (NTF), which the companies formalised in February. The two companies have now established a new joint venture gold mining company, NS Madencilik (NSM), primarily to develop Stratex's Inlice and Altintepe projects. Stratex has vended its Inlice project into the new company. In return, NTF has paid Stratex US\$1.0m and will have an interest of 55% in the new company, and therefore Inlice, subject to NTF funding the Inlice feasibility study up to a maximum of US\$2.0m. This will include expenditure by NTF to date on the project. Since June 2009, when the original Memorandum of Understanding between Stratex and NTF was signed, NTF has been funding scoping and pre-feasibility studies at Inlice and, to a lesser extent, Altintepe, at a minimum of US\$50,000 per month.

NTF will also continue to finance the scoping and pre-feasibility studies at Altintepe, up to US\$500,000. If positive, NTF has the option to spend a further US\$2.0m on a full feasibility study in exchange for Stratex vending the project into the new JV company.

Stratex projects to form basis of JV company

Inlice

Inlice has a total resource of 262,300oz Au, comprising 98,300oz of oxide Au and 164,000oz of sulphide Au. Of the oxide material, 28,000oz is contained in loose sediment (talus) in the SE of the project, on the southern edge of the Ana East prospect.

Wardell Armstrong International (WA) carried out metallurgical test work at Inlice in January 2007, and found initially that the sulphides were not amenable to direct cyanidation, with recoveries being inversely correlated to sulphur content. Finely ground samples gave recoveries ranging from 21% to 28% over a 48-hour period and these fell further when using coarser ground material. However, the one oxide sample WA analysed, which graded 2.92g/t Au, gave an excellent recovery of 95% over a 48-hour period. Subsequent bottle roll tests of coarse oxide material (<12mm) confirmed exceptionally high recoveries over a shorter time frame, with 92.6% of the gold being recovered within 24 hours. This suggests that the oxide gold would be readily recoverable by heap-leaching. WA carried out follow-up flotation test work on the sulphides in May 2008, which gave recoveries of 74.3-78.4%, depending on grind size and pre-cleaning. Stratex proposes initially just processing the oxide material, but is also considering commissioning bio-leach test work on the sulphide material.

Independent consultant, SRK, carried out a preliminary Environmental Baseline study in 2008, covering soil characterisation; surface water quantity and quality; groundwater flow and quality; flora and fauna surveys; and socioeconomic studies. No major issues were identified and the study will form the basis of the Environmental Impact Study (EIS).

Inlice update

NTF has been funding the pre-feasibility study at Inlice since June 2009, allowing Stratex to progress the development of the project. Since June Stratex has completed:

- 899m of infill drilling to define the *in-situ* resource of the Ana East and Gap Zones and provide material for detailed metallurgical test work
- 58 drill holes totalling 835m and 104 pits completed to define overlying talus resource, which contains oxide gold
- Five drill geotechnical holes completed and all mechanical rock and soil studies completed. These holes are now being used for piezometric studies investigating the sub-surface water table
- Five water-well holes have been drilled to define hydrogeological parameters of possible aquifers in the proposed mine area; three contained water and pumping tests are now under way
- The construction of a new access road to the mine site

The results of the pre-feasibility study have been very encouraging so far and both companies now want to fast track the project to full feasibility. As a result Kappes, Cassiday & Associates (KCA) has now been appointed to manage the feasibility study. KCA has a strong track record of taking multiple heap-leaching gold and silver projects into

production, and Stratex and NTF believe that this will enable them to get Inlice into production quickly. KCA has been contracted to complete the feasibility study within a period of six months, starting in May 2010.

The immediate plan is to conduct a full feasibility study and get Inlice into production within 18 months. Production will be from an open pit with a modest heap leach operation targeting just the oxides. The anticipated production will be 20,000-25,000oz Au *per annum*, for an initial mine life of two to three years, although a more accurate assessment of production rates will depend on the outcome of the feasibility study.

Altintepe

Altintepe or 'Gold Hill' is located close to the Black Sea coast of northern Turkey. In April 2007, Stratex entered into an option agreement to acquire 100% of the Altintepe project from Teck Cominco's Turkish subsidiary, Teck Cominco Arama ve Madencilik San. Tic. A.S. (TCAM). In August 2008, Stratex fully exercised its option agreement with TCAM to acquire 100% of the property, by completing a total of 4,752.5m of diamond drilling. TCAM then waived any right to earn back into the project and merely retains an underlying 1.5% Net Smelter Return (NSR) royalty from any future production. A portion of the property is also held by a third party that holds a NSR royalty of 2.5%, which can be reduced to 1.25% with a payment of US\$0.75m.

Altintepe has an oxide resource of 472,318oz Au contained within 13.1Mt of ore grading at 1.12g/t Au. Within this, there is 8.3Mt of ore grading at 1.48g/t Au. Further infill drilling is likely to focus initially on the higher-grade Extension Ridge Zone, which has an inferred resource of 120,906oz Au within 1.73 Mt of ore grading at 2.17g/t Au.

In 2008, preliminary cyanide-leach test work was completed by WA on oxide samples from all five main zones. Carbon-in-leach (CIL) tests on material ground to less than 75 micron and bottle roll tests on material crushed to less than 12mm were carried out and indicated the potential for high gold recoveries from all oxide material at Altintepe, although a lower recovery (68.5%) was recorded for the leach tests on coarse material from Extension Ridge.

Leaching rates were high and both cyanide and lime consumptions were low to moderate. This reinforced the earlier bottle roll and column leach tests carried out on oxide material from Çamlık East which Odyssey Resources, the previous owners of Altintepe, had carried out at the KCA Research Lab in Reno, Nevada. Very high gold recoveries were obtained, ranging from 91.4% to 97.9%, with low sodium cyanide and lime consumption even for low-grade ore material.

Altintepe update

Although most of the NTF funding has concentrated on Inlice, work has been ongoing at Altintepe. Golder Associates has been advancing the Environmental Baseline study and SRK Consulting (UK) Ltd has been reviewing past drilling and has made recommendations for the infill resource drilling.

Subject to a successful pre- and full feasibility study at Altintepe, production is provisionally targeted to commence in 36 months. At this stage, production from the open pit is anticipated to be 30,000-50,000oz per annum, with recovery from a CIL/CIP (carbon-in-leach/-pulp) giving a mine life of eight to nine years.

Valuation

For Inlice, we have assumed that only 69,324oz of oxide gold is mined from an open pit at a head grade of 2.29g/t gold, with a waste to ore strip ratio of 0.5:1.0. Recoveries in the initial metallurgical test work were good and so we have used an 80% recovery from the heap leach. Capex costs are estimated at around US\$10m and our total operating costs are estimated at US\$280 per oz in the first year and US\$208 per oz subsequently, which includes both depreciation and ongoing reclamation costs. We would expect production to start within 18 months and have used a Turkish corporate tax rate of 20%, with a 2% government gold royalty. Our base case project NPV is US\$13.53m, using a 10% discount rate and our current gold price forecasts.

Based on Stratex's 45% equity stake in NSM, the value of Inlice to the company is US\$6.09m or 1.39p per share (US\$1.54/£1.00).

For Altintepe, we have assumed that only the higher grade material of 8.3Mt at 1.48g/t (395koz) is mined from an open pit. However, the stripping ratio is higher at Altintepe than Inlice at 1.0:1.0. We envisage a CIL/CIP plant will be built for a total capex cost of US\$20m, with US\$9m of this attributable to Stratex in 2011. We have assumed very conservative recoveries of 75%. Total cash costs including depreciation and reclamation are expected to be

US\$322 per oz. This is slightly higher than Inlice due to the lower grade and recovery we have used at Altintepe, but this may come down once feasibility studies are completed. Production is assumed to start within 36 months. There is a 2.5% royalty to be added at Altintepe, payable to a third party, in addition to the tax and royalties due to the government and Teck Cominco.

As before, our base case project NPV is US\$42.33m, using a 10% discount rate, with the value attributable to Stratex of US\$19.05m or 4.35p per share.

Including our valuations for the Teck JV at Hasaңeılebi, the Centerra JV at Öksüt, the holding in Sheba Exploration and cash, we calculate a value for Stratex of £22.42m or 7.82p per share. This ascribes no value for the company's Ethiopian projects.

Current Sum-of-the-parts valuation of Stratex International

Component	Project	Value (£m)	Per share (p)
NTF JV	Inlice (45% of NPV 10%)	3.99	1.39
	Altintepe (45% of NPV 10%)	12.48	4.35
Centerra JV	Öksüt	1.97	0.69
Teck JV	Hasaңeılebi	1.26	0.44
Investments	Sheba Exploration	0.07	0.02
Cash		2.65	0.93
Total		22.42	7.82

Source: Westhouse Securities estimates.

Recommendation

Stratex is entering an exciting stage of its development. The signing of the production joint venture agreement with NTF provides Stratex with a vehicle to monetise both the Inlice and Altintepe gold projects, as well as any other projects that fall below its internal one million ounces of gold development target. We believe that the discovery of one million ounces could be achieved through one of its other JV agreements with Centerra or Teck, but we consider that the really exciting opportunities lie in Ethiopia, where Stratex believes it may have discovered a new gold province. This is not included in our current valuation and represents further upside potential. We therefore maintain our **BUY** recommendation, increasing the target price from 7.6p to 7.82p per share, due to fluctuations in currency rates.

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Valuation basis

In attributing a value to Stratex International we have completed a sum-of-the-parts valuation utilising NPV calculations to proposed projects and value attributed to projects by JV partners contributions to the project

Risks to our valuation

Exploration is speculative and the announcement of a resource does not indicate that the resource is economic. Other risks include Currency risk and fluctuations in the gold price.

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