

23 March 2011

Produced by: RBS Morgans Limited

Buy

Important: The above recommendation has been made on a 12 month view and may not suit your investment needs or timeframe. The basis it is prepared on is summarised on the last page of this report. **PLEASE CONTACT YOUR ADVISER TO DISCUSS THIS GENERAL RECOMMENDATION BEFORE ACTING ON IT.**

High Volatility

Target price
A\$0.22 (from A\$0.21)

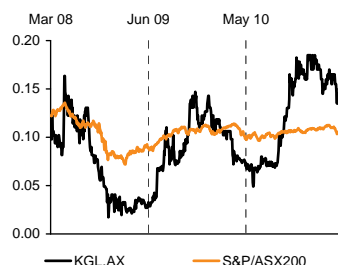
Price
A\$0.15

Short term (0-60 days)
n/a

KGL110323

Price performance

	(1M)	(3M)	(12M)
Price (A\$)	0.17	0.18	0.11
Absolute (%)	-9.1	-16.7	41.2
Rel market (%)	-4.9	-14.2	46.9
Rel sector (%)	-7.1	-16.1	25.3



Market capitalisation
A\$159.24m (US\$161.15m)

Average (12M) daily turnover
A\$0.52m (US\$0.52m)

Sector: BBG AP Mining
RIC: KGL.AX, KGL AU
Priced A\$0.15 at close 22 Mar 2011.
Source: Bloomberg

Analyst

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Kentor Gold

Gold-copper in Kyrgyzstan

Debt finance has been approved for Kentor's Andash gold-copper project (KGL 80%) in Kyrgystan to produce 70koz Au and 16mlbs Cu in concentrate annually, with potential for other Soviet-era gold-copper prospects to extend mine life.

Key forecasts

	FY08A	FY09A	FY10F	FY11F	FY12F
EBITDA (A\$m)	-1.63	-2.19	0.00	-2.04 ▲	29.20 ▼
Reported net profit (A\$m)	-5.24	-3.51	0.05	-1.99 ▲	16.20 ▼
Normalised net profit (A\$m) ¹	-4.83	-3.51	0.05	-1.99 ▲	16.20 ▼
Normalised EPS (c) ¹	-5.08	-0.89	0.01	-0.35 ▲	2.82 ▼
Normalised EPS growth (%)	217.5	-82.4	n/a	n/a	n/a
Dividend per share (c)	0.00	0.00	0.00	0.00	0.00
Dividend yield (%)	0.00	0.00	0.00	0.00	0.00
Normalised PE (x)	n/m	n/m	1,728	n/m	5.33
EV/EBITDA (x)	n/m	n/m	n/a	n/m	4.52
Price/net oper. CF (x)	-6.77	-30.0	1,728	-43.4 ▼	3.28 ▲
ROIC (%)	-30.8	-29.7	0.00	-5.95	55.60

Use of ▲ ▼ indicates that the line item has changed by at least 5%.

year to Dec, fully diluted

1. Pre non-recurring items and post preference dividends

Accounting standard: IFRS

Source: Company data, RBS Morgans forecasts

Developing the Andash #1 gold-copper deposit- (KGL 80%)

Capex of US\$96m was for annual production of 70,000oz of gold and 7,400t of copper in concentrate from the Andash #1 orebody. Projected site operating costs under US\$20/t of ore give a life-of-mine C1 cash cost of US\$310/oz of gold equivalent (cash costs are expensed against "ounces of gold equivalent" with the revenue from copper and silver in the concentrate converted to equivalent "ounces of gold"). The Andash trend includes the #2 and #3 deposits, as well as four other discoveries, including the Nakhodka deposit with 9.9m @ 7.9g/t and 8.0m @ 6.0g/t gold reported from trenches.

Acquiring Aktash - (KGL 90%)

Aktash was tested in the Soviet era by surface and underground drilling, with 785.6m of core analysed and 2.5km of underground development. Approximately 493koz of gold at a grade of 2g/t was reported in the Soviet C1 and C2 categories, which don't meet JORC Code standards. Kentor has optioned the deposit, and will complete 1,500m of drilling to define a resource, with the price to be paid US\$20/oz of gold equivalent and US4.8 cents per pound of copper. We expect Kentor will confirm the Soviet results, as it did at Andash #1. The higher grade Aktash deposit will increase annual gold production and extend the mine life.

The Kyrgyz Republic

During the civil unrest in 2010, the Toronto-listed Centerra Gold's 600,000oz/year Kumtor mine operated uninterrupted, as it has since 1997. A subsequent referendum resulted in 90% approval of the proposed Constitution, and free elections were held in the October 2010. The sale of a 10% interest in Andash by UK interests was voided by the government for non-compliance with Kyrgyz law. This decision was upheld in court. A parliamentary Commission of Inquiry is reviewing the decision. This issue does not affect KGL's 80% interest. Kentor had net cash of A\$71m at 31 December 2010, with our valuation A\$0.24/KGL share (from A\$0.36) after the placement and rights issue at A15.5¢, with our target lifted to A\$0.22 (from A\$0.20) after acceptance of finance.

Current issues

Kentor Gold has announced acceptance of the US\$50m debt facility. The interest rate is 4.75% above LIBOR, with a three-year term. A further US\$6m is available should Kentor elect to hedge gold or copper. Coupled with the A\$71m in net cash at 31 December 2011, Kentor is well placed to fund the US\$96m development cost.

There is a dispute over ownership of 10% of the Andash licence. The sale of a 10% interest in the Andash project was voided by court decision. A parliamentary Commission of Enquiry is sitting to review the situation. It does not affect KGL's 80% interest, however Kentor has suspended work at the site pending the Commission's decision in the interests of social harmony.

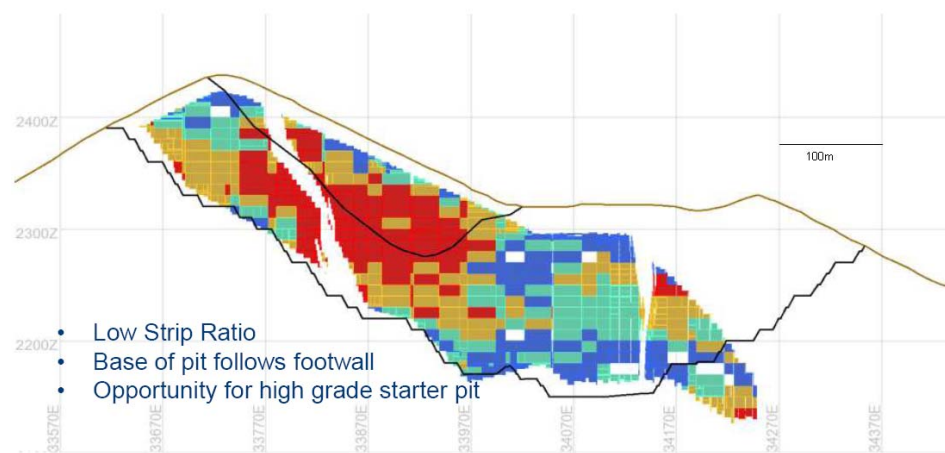
The Andash ML

Aurum Mining plc, listed on the London Stock Exchange AIM, completed a bankable feasibility study into development of the Andash gold-copper project in January 2007. An ore reserve of 16mt at a grade of 1.05 g/t gold and 0.4% copper was defined to the JORC Code standards for the Andash #1 deposit. During the Soviet era, detailed drilling and development of an adit through the deposit at the 2300mRL – slightly above the base of the starter pit (see the section below) – provided a high level of confidence in both the resource and the process metallurgy. The design documentation for the open pit was approved by Kyrgyz authorities.

The Feasibility Study was refreshed in mid 2010 and, subsequent to acquisition of the mill and some other equipment, Capex was revised to US\$96m in July 2010. Production was upgraded to 70koz per year of gold and 7,400t of copper in concentrate, and cost were revised. We have modelled marketing costs and concentrate transport charges, together with standard treatment and refining charges to estimate a C1 cash cost close to US\$370/oz of gold equivalent over the life of the mine. The gold equivalent is based on converting the value of copper and silver in the concentrate to the weight of gold which would generate comparable revenue based on our projected gold and copper prices for 2011. Offsetting the value of copper and silver credits against costs, generates a C1 cash cost of US\$35/oz of gold produced.

The Andash project is well located, largely eliminating the requirement to house the workforce. It is also well located for road access, water supply and grid power. Kentor Gold has purchased the mobile plant and equipment for the mine development and operation of the Andash #1 open pit.

Figure 1 : Andash Pit Cross Section

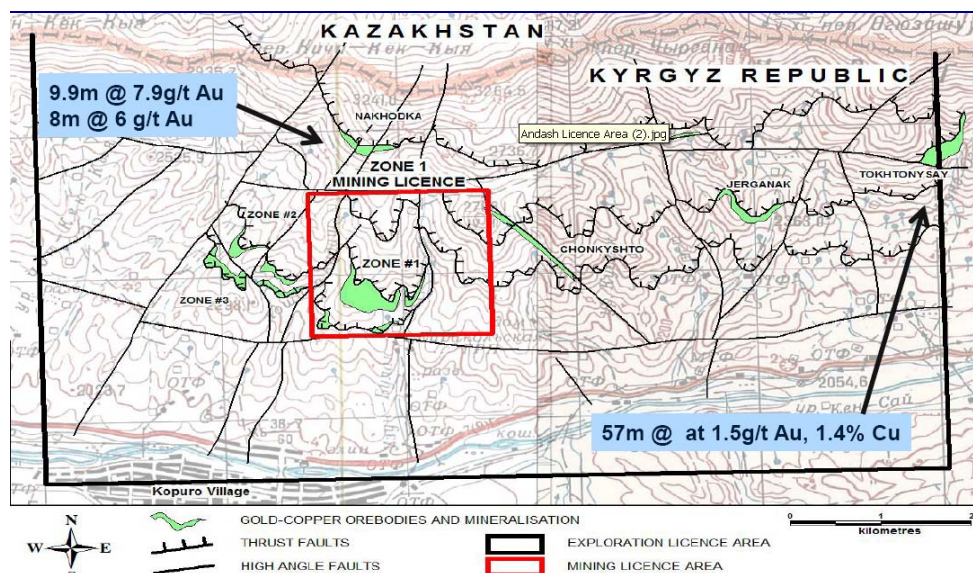


Source: Kentor Gold Presentation – March 2010

The Andash Licence

Figure 3 (The Andash Licence and the Andash ML) shows there are a number of other gold prospects identified during the Soviet era, and followed up by Aurum Mining plc with sampling and trenching. The Tokhtonysay project, 6km east of the ML, reported a diamond drill intersection of 57m at 1.5g/t gold and 1.4% copper. At Nakhodka, 2km north of Zone #1 in the ML, trenching reported high grade gold, with the best results 9.9m @ 7.9g/t gold, and 8.0m @ 6.0g/t. Evaluation of these and the four other known prospects in the licence will be undertaken together with development of the Andash project.

Figure 2 : The Andash Licence and the Andash ML



Source: Kentor Gold Presentation – March 2010

The Aktash deposit – KGL 90%

Kentor has paid a US\$200,000 option fee for a 12-month period, with a 6-month extension available for a further US\$200k. During the option period it has agreed to complete 1,500m of drilling to establish a resource to JORC Code (2004) standards. It can acquire the project for US\$19 per ounce of gold, US\$105/t of copper and US\$0.30/oz of contained silver. This represents 2% of the in-ground metal value at current prices. It can also be viewed as US\$20/oz of gold equivalent (with silver converted to gold on the basis of price) and US4.8 cents per pound of contained copper.

As Figure 1 shows, the Aktash deposit is located 8km north east of the Andash plant site, while the plant is located 5km south east from the Andash #1 deposit. Aktash was evaluated during the Soviet era – as was the Andash #1 deposit – by drilling and underground development with this work including 2.5km of underground development, and analysis of 785.6m of drill samples from 11,000m of drilling, leading to C1 and C2 classification under the Soviet system.

It is anticipated that the proposed 1,500m of drilling will provide the Quality Assurance and Quality Control for the Soviet data to meet JORC Code (2004) standards. Based on the Soviet data, the exploration target is reported to be between 2mt @ 3.5g/t Au, 0.7% Cu, 12g/t Ag, and 5mt @ 2.0g/t Au, 0.3% Cu, 8g/t Ag. On current commodity prices and using the projected recoveries from the Andash deposit, this equates to between 300koz and 500koz of gold.

Our expectation is that, subsequent to the evaluation confirming the Soviet interpretation, that the higher grade Aktash ore will be processed through the Andash plant, increasing gold production from Year 3 (2014) and leading to a longer project life.

Other exploration – KGL 80%

Kentor Gold maintains an active exploration programme in the Kyrgyz Republic. A geological and geophysical exploration programme is planned for the Bashkol Licence area, where soil sampling and channel sampling have indicated a gold-anomalous area.

Kentor Gold has withdrawn from the Savoyardy gold-antimony project, and exploration results in the Kurgan Licence have proven less attractive than anticipated.

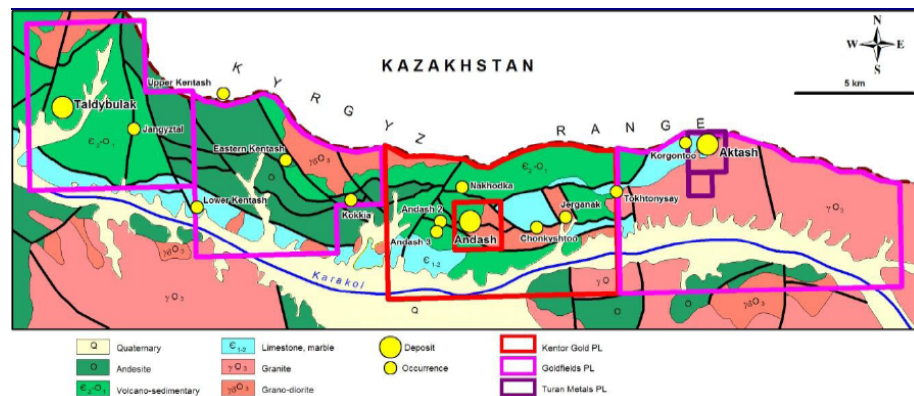
Company overview

Kentor Gold Limited (ASX:KGL) is an Australian-based company with resource exploration and development interests in Central Asia. Its current focus is the development of the Andash gold-copper mine, in the Kyrgyz Republic, in which it has a 80% interest with the Kyrgyz government holding 10%, and ownership of 10% disputed. KGL has other interests in exploration and evaluation of gold and base metals prospects in the Kyrgyz Republic.

Andash is a gold-copper project targeted for production late in 2012 at the rate of 70,000 oz gold and 7,400 tonnes copper per year, with a six- to seven-year mine life. Evaluation of other prospects identified in the Soviet era has the potential to deliver a substantially increased resource to support longer operation of the Andash plant in the southeast corner of the broader licence area.

Kentor has an 18-month option to complete 1,500m of drilling on the Aktash Au-Cu deposit, 8km north east from the Andash plant site. As with Andash #1, Aktash was evaluated during the Soviet era, and confirmation of the Aktash deposit parameters with between 300koz and 500koz of gold equivalent would significantly increase the value of the Andash project.

Figure 3 : The Andash ML and Licence, and the Aktash Licence



Source: Kentor Gold Release – July 2010

Valuation and risks

In our simple DCF valuation of the Andash #1 project we have used the Kyrgyz Republic's 5% royalty on gold revenue, 3% royalty on copper, and a 10% net profits tax rate, with our valuation approximately US\$180m. We have further discounted this valuation for development risk, and also heavily discounted the value of the Aktash asset with the resource determined in the Soviet era yet to be confirmed. Our valuation is A\$0.24 per KGL share, in line with the table below. Once incorporated into the earnings model, we expect an increase to this valuation.

Realisation of the Andash Zone 1 development and confirmation of the Aktash deposit size would be expected to see the share price increase, and support a trebling in the share price from current levels based on current issued capital. Downside risk lies with delivering the Andash project in line with current expectations, and with weakness in the gold and/or copper prices. A strengthening of the Kyrgyzstani "som" against the dollar, and a rise in Kyrgyzstani costs would also prove to be negatives for Kentor Gold, and our valuation, as would civil unrest. Our target is 90% of our valuation – A\$0.22/KGL share.

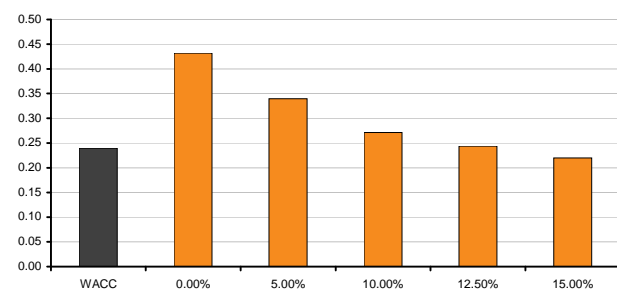
KGL – financial summary

Year to 31 Dec (A\$m)	AIFRS 2008A	AIFRS 2009A	AIFRS 2010F	AIFRS 2011F	AIFRS 2012F	Price target (A\$ps)	0.22			
Income statement						Valuation (A\$ps)	0.24			
Divisional sales	0.0	0.0	0.0	0.0	60.8	Valuation summary	A\$m	A\$ps	DCF valuation inputs	
Total revenue	0.0	0.0	0.0	0.0	60.8	Andash Mining Lease (80%)	135.4	0.13	Rf 5.25%	
EBITDA	-1.6	-2.2	0.0	-2.0	29.2	Andash Licence (80%)	31.9	0.03	Rm-Rf 6.00%	
Depreciation & amortisation	0.0	-0.1	0.0	0.0	-10.1	Other exploration	5.0	0.00	Beta 1.94	
EBIT	-1.7	-2.2	0.0	-2.0	19.0	Net cash	71.0	0.07	CAPM (Rf+Be) 16.9%	
Net interest expense	0.1	0.1	0.1	0.1	0.1	Corporate	-25.0	-0.02	Tax rate (t) 30.0%	
Pre-tax profit	-4.8	-3.5	0.1	-2.0	19.1	Total Value	254.2	0.24	WACC 12.75%	
Income tax expense	0.0	0.0	0.0	0.0	-2.9	Mark to Market	0.0	0.0	Shares 576.0	
After-tax profit	-4.8	-3.5	0.1	-2.0	16.2	Production (Mt)	2009A	2010F	2011F	2012F
Minority interests	0.0	0.0	0.0	0.0	0.0	Gold Production (moz)	0.00	0.00	0.00	23.24
NPAT	-4.8	-3.5	0.1	-2.0	16.2	Copper Production (mlbs)	0.00	0.00	0.00	3.77
Significant items	-0.4	0.0	0.0	0.0	0.0	Key assumptions	2009A	2010F	2011F	2012F
NPAT post abnormal	-5.2	-3.5	0.1	-2.0	16.2	USD / AUD exchange rate	0.75	0.88	0.98	1.02
						Copper price (US\$/lb)	2.24	3.03	3.62	3.88
						Gold price (US\$/oz)	874.55	1091.72	1320.68	1275.00
Growth ratios	2008A	2009A	2010F	2011F	2012F	Per share data	2009A	2010F	2011F	2012F
Sales growth		n.m.	n.m.	n.m.	n.m.	No. shares	393.0	576.0	576.0	576.0
Operating cost growth		n.m.	n.m.	n.m.	n.m.	EPS (cps)	-0.9	0.0	-0.3	2.8
						EPS (normalised) (c)	-0.9	0.0	-0.3	2.8
						Dividend per share (c)	0.0	0.0	0.0	0.0
						Dividend payout ratio (%)	0.0	0.0	0.0	0.0
						Dividend yield (%)	0.0	0.0	0.0	0.0
						Operating performance	2009A	2010F	2011F	2012F
						EBIT growth	33%	n.m.	n.m.	n.m.
						NPAT growth	n.m.	n.m.	-4078%	n.m.
						Normalised EPS growth	-82%	n.m.	n.m.	n.m.
						Asset turnover (%)	0%	0%	0%	137%
						EBITDA margin (%)	n.m.	n.m.	n.m.	48%
						EBIT margin (%)	n.m.	n.m.	n.m.	31%
						Net profit margin (%)	n.m.	n.m.	n.m.	27%
						Return on net assets (%)	-6%	0%	-6%	37%
						Net debt / (cash) (A\$m)	-13.1	-13.1	-11.2	-27.4
						Net debt/equity (%)	n.m.	n.m.	n.m.	n.m.
						Net interest/EBIT cover (x)	0%	0%	0%	0%
						ROIC (%)	-30%	0%	-6%	56%
						Comparable multiples (x)	2010F	2011F	2012F	
						Kentor Gold	EV/EBITDA	-8.7	1.2	
						Year to 31 Dec	PE	-9.1	3.7	
						Discovery Metals	EV/EBITDA	-57.6	-62.5	
						Year to 30 Jun	PE	-73.9	-40.7	
						Intrepid Mines	EV/EBITDA	-115.8	-103.6	
						Year to 31 Dec	PE	-109.0	-107.7	

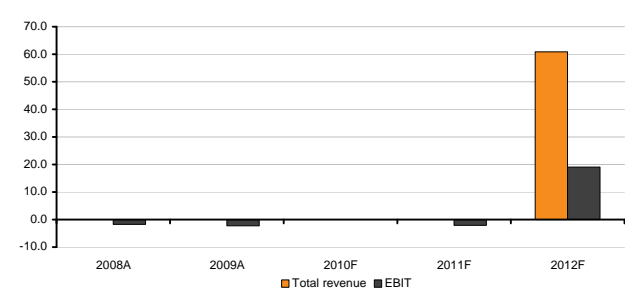
Cash flow statement	2008A	2009A	2010F	2011F	2012F
EBITDA	-1.6	-2.2	0.0	-2.0	29.2
Cash flow from ops (1)	-2.1	-2.0	0.1	-2.0	26.4
Capex (2)	-3.1	-1.5	0.0	0.0	0.0
Disposals/(acquisitions)	0.1	-2.0	0.0	0.0	-10.1
Cash flow from invest (3)	-3.0	-3.4	0.0	0.0	-10.1
Inc/(decr) in equity	4.0	34.1	0.0	0.0	0.0
Inc/(decr) in debt	0.0	-15.1	0.0	0.0	0.0
Ordinary dividend paid	0.0	0.0	0.0	0.0	0.0
Other financing cash flow	-0.2	-1.8	0.0	0.0	0.0
Cash flow from fin (5)	3.8	17.3	0.0	0.0	0.0
Forex and disc ops (6)	0.0	0.0	0.0	0.0	0.0
Inc/(decr) cash (1+3+5+6)	-1.3	11.9	0.1	-2.0	16.2
Equity FCF (1+2)	-1.3	11.9	0.1	-2.0	16.2

Balance sheet	2008A	2009A	2010F	2011F	2012F
Cash & deposits	1.2	13.1	13.1	11.2	27.4
Trade debtors	0.1	0.1	0.1	0.1	0.1
Inventory	0.0	0.2	0.2	0.2	0.2
Investments	0.0	0.0	0.0	0.0	0.0
Other intangible assets	0.0	0.0	0.0	0.0	0.0
Fixed assets	0.2	6.5	6.5	6.5	6.5
Other assets	5.3	18.4	18.4	18.4	18.4
Total assets	6.8	38.3	38.4	36.4	52.6
Short-term debt	0.0	0.0	0.0	0.0	0.0
Trade payables	0.1	1.0	1.0	1.0	1.0
Long-term borrowings	0.0	0.0	0.0	0.0	0.0
Provisions	0.0	0.0	0.0	0.0	0.0
Other liabilities	0.2	0.3	0.3	0.3	0.3
Total liabilities	0.4	1.2	1.2	1.2	1.2
Share capital	17.4	49.0	49.0	49.0	49.0
Other reserves					
Retained earnings	-10.5	-15.9	-15.9	-17.9	-1.6
Total equity	6.4	34.6	34.7	32.7	48.9
Minority interest	0.0	2.5	2.5	2.5	2.5
Total shareholders' equity	6.4	37.1	37.1	35.1	51.4
Total liabilities & SE	6.8	38.3	38.4	36.4	52.6

Valuation sensitivity to discount rate (A\$/share)



Total revenues and EBIT (A\$m)



Source: Company data, RBS Morgans forecasts

RESEARCH TEAM

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CHRIS BROWN	-	Senior Analyst	SCOTT POWER	-	Director - Research
ALEX CLARKE	-	Analyst	TOM SARTOR	-	Associate Director - Research
FIONA BUCHANAN	-	Director - Research	TAMARA STRETCH	-	Associate Director - Research
NICK HARRIS	-	Senior Analyst	TANYA SOLOMON	-	Associate Director - Research
MICHAEL KNOX	-	Executive Director - Economic Strategy	REBECCA SULLIVAN	-	Research/Special Projects
JAMES LAWRENCE	-	Analyst	VIOLETA TODOROVA	-	Technical Analyst
JOSEPHINE LITTLE	-	Associate Director - Research	MARCEL VON PFYFFER	-	Director - Strategy
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RBS Morgans Corporate Limited was a Joint Lead Manager to the Kentor Gold Limited placement and rights issue in November 2010 and received fees in this regard: **KGL.AX**

RBS Morgans Limited was a Joint Lead Manager to the Kentor Gold Limited placement and rights issue in July 2010 and received fees in this regard: **KGL.AX**.

RECOMMENDATION STRUCTURE

Absolute performance, long-term (fundamental) recommendation: The recommendation is based on implied upside/downside for the stock from the target price. A Buy/Sell implies upside/downside of 10% or more and a Hold less than 10%. The target price is the level the stock should currently trade at if the market accepted the analyst's view of the stock, provided the necessary catalysts are in place to effect the change in perception. If it is felt that the catalysts are not fully in place to effect a re-rating of the stock to its warranted value the target price will differ from 'fair' value. Given the volatility of share prices and our pre-disposition not to change recommendations frequently, these performance parameters should be interpreted flexibly. Performance in this context only reflects capital appreciation and the horizon is 12 months.

For listed property trusts (LPTs) the recommendation is based upon the target price plus the dividend yield, ie total return. A Buy implies a total return of 10% or more; a Hold 5-10%; and a Sell less than 5%.

Absolute performance, short-term (trading) recommendation: The Trading Buy/Sell recommendation implies upside/downside of 3% or more. The trading recommendation time horizon is 0-60 days.

Each stock has been assigned a Volatility Rating to assist in assessing the risk of the security. The rating measures the volatility of the security's daily closing price data over the previous year relative to other stocks included in either the S&P/ASX200 Index (large caps) or the Small Ordinaries Index (small caps) of which it is a member. This rating is a quantitative (objective) measure provided as an additional resource and is independent of the qualitative research process undertaken by our research analysts.

A rating of Low indicates very little movement in price over the previous year (Coefficient of Variation < 4 for small caps or < 5 for large caps). A Moderate rating implies average price movement over the previous year (Coefficient of Variation of 9 - 21 for small caps or 7.25 - 15 for large caps). A High rating implies significant price movement over the past year (Coefficient of Variation greater than 25 for small caps or 35 for large caps).

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