

Royalco Resources Limited

High yielding, low risk resource exposure

- RCO is an Australian royalty company targeting high margin royalty income streams in the Australasia region.
- The Company currently has a suite of 11 royalties, 2 of which are producing royalties and 2 to start in December 2010. Production royalties include the Reefton Au Royalty, Mt Garnet Zn-Pb-Ag Royalty, Mt Kelly Cu royalty and Dagworth and Huonfels Au royalty.
- The company's long term growth strategy is focused on revenue generation from existing and acquired royalties as well as converting exploration success to free carried project equity interests and/or royalties.

Exploration interests

- The company has an extensive exploration package in the Philippines acquired from Oxiana Limited (now OZ Minerals Limited) which provides potential high grade epithermal Au and large Cu-Au porphyry style discovery success.
- The company has recently signed an option agreement with Vale on its highly prospective Gambang project in the Philippines where Vale has commenced drilling on Cu-Au porphyry targets, following up previous drilling including 216m at 0.45% Cu.

Earnings and growth

- The producing royalties will provide approximately \$17m in revenue to December 2012.
- Our eps estimate in 11FY is 10.6c and in 12FY is 11.6c. On this basis RCO is currently trading at 3.9 times our 11FY and 3.6 times our 12FY earnings estimates.
- We include ongoing 2.0c fully franked biannual dividends to be paid with the first on 21 February 2011, which at current prices provides for a 9.6% annualised dividend yield.

Valuation and Recommendation

- We value RCO at A\$0.55 per share based on our dcf valuation which assumes the maximum gold royalty payable at Reefton (5kozpa) to December 2012 and growing cash and bullion of \$12.2m (23cps).
- We see RCO as providing investors a high yield, low risk exposure to the resource sector with upside from exploration.
- We recommend a BUY.

RCO.ASX

BUY

Wednesday 24 November 2010

Price	\$0.42
Price target	\$0.55
Valuation	\$0.55
Valuation Method	DCF

GICS sector	Metals & Mining	
Market capitalisation*	\$m	22
Shares on Issue*	m	52.7
Enterprise value	\$m	10
Previous rating	Buy	
* undiluted for options		

Year Ended June 30		10a	11e	12e	13e
Sales revenue	\$m	9.4	7.9	8.4	2.1
EBITDA	\$m	5.3	6.5	7.0	0.7
EBITDA margin	%	57	82	83	33
Reported NPAT	\$m	2.9	5.6	6.1	1.1
Adjusted NPAT	\$m	4.0	5.6	6.1	1.1

EPS adj	c	7.5	10.6	11.6	2.1
EPS adj growth	%		40.8	9.1	-81.7
DPS	c	0.0	2.0	4.0	4.0
Franking	%	0	0	100	100
PER	x	5.5	3.9	3.6	19.6
Dividend yield	%	na	4.8	9.6	9.6

EV/EBITDA	x	1.8	1.5	1.4	13.5
ROA	%	61	76	78	12
ROE	%	29	31	28	5
Debt / Debt + equity	%	na	na	na	na

RCO Vs ASX Small Ordinaries (XSO)



Source: IRESS

Piers Reynolds
 +61 3 8601 1196
 preynolds@veritassecurities.com.au

Royalco Resources Limited

Profit and Loss

Year ending June		2010a	2011e	2012e	2013e
Sales	A\$m	8.8	7.9	8.4	2.1
Other Revenue	A\$m	0.6	0.0	0.0	0.0
Op. costs	A\$m	0.0	0.0	0.0	0.0
Royalty	A\$m	0.0	0.0	0.0	0.0
Exploration Writeoff	A\$m	2.5	0.0	0.0	0.0
Corporate & Other	A\$m	1.5	1.4	1.4	1.4
EBITDA	A\$m	5.3	6.5	7.0	0.7
Dep/Amtz	A\$m	0.0	0.0	0.0	0.0
EBIT	A\$m	5.3	6.5	6.9	0.7
Net Interest	A\$m	0.4	0.3	0.5	0.7
Pre-Tax Profit	A\$m	5.7	6.8	7.5	1.4
Tax Provision	A\$m	1.7	1.2	1.3	0.2
Net Profit	A\$m	4.0	5.6	6.1	1.1
Abnormals	A\$m	-1.1	0.0	0.0	0.0
Reported Net Profit	A\$m	2.9	5.6	6.1	1.1

Balance Sheet

Year ending June		2010a	2011e	2012e	2013e
Cash	A\$m	7.1	10.9	14.4	12.2
Receivables	A\$m	1.3	1.3	1.3	1.3
Fixed assets	A\$m	2.9	3.5	4.0	4.6
Other assets	A\$m	5.0	5.0	5.0	5.0
Total Assets	A\$m	16.3	20.6	24.6	23.1
Creditors	A\$m	0.7	0.7	0.7	0.7
Borrowings	A\$m	0.0	0.0	0.0	0.0
Other liabilities	A\$m	1.9	1.7	1.8	1.2
Total Liabilities	A\$m	2.6	2.4	2.4	1.9
Net Assets	A\$m	13.6	18.2	22.2	21.2
Share capital	A\$m	12.3	12.3	12.3	12.3
Retained earnings	A\$m	1.3	5.9	9.9	8.9
Shareholders Funds	A\$m	13.6	18.2	22.2	21.2

Cashflow

Year ending June		2010a	2011e	2012e	2013e
Sales Revenue	A\$m	6.1	7.9	8.4	2.1
Less Outflows	A\$m	-1.3	0.0	0.0	0.0
Prod. costs in exc. sales	A\$m	0.0	-1.4	-1.4	-1.4
Net interest	A\$m	0.4	0.3	0.5	0.7
Income tax paid/Other	A\$m	0.0	-1.7	-1.2	-1.3
Operational Cash Flow	A\$m	5.1	5.1	6.2	0.0
Exploration & Development	A\$m	-0.6	-0.6	-0.6	-0.6
Capex	A\$m	0.0	0.0	0.0	0.0
Asset (Purchases)/Sales	A\$m	0.6	0.0	0.0	0.0
C/Flow from Investing	A\$m	0.0	-0.6	-0.6	-0.6
Dividends paid*	A\$m	-5.3	-1.1	-2.1	-2.1
Debt (Repay)/Borrowings	A\$m	0.0	0.0	0.0	0.0
Equity Raised	A\$m	0.0	0.0	0.0	0.0
Other	A\$m	0.0	0.3	-0.1	0.5
C/Flow from Financing	A\$m	-5.3	-0.8	-2.2	-1.6
Cash at Beginning	A\$m	7.3	7.1	10.9	14.4
Net Increase/(Decrease)	A\$m	-0.2	3.8	3.5	-2.1
Cash at end	A\$m	7.1	10.9	14.4	12.2

Directors

Directors		Major Shareholders	
Chairman	Peter Topham	Anglo Pacific Group	31.1%
Exec. Director	David Ogg	OZ Minerals	19.0%
Non-Ex. Director	Tom Eadie	Peter Topham	9.8%
Non-Ex. Director	Bruce Pertzell	David Ogg	7.3%
Non-Ex. Director	Chris Orchard		

Market Measures

Year ending June		2010a	2011e	2012e	2013e
EPS adj. (A¢)		7.5	10.6	11.6	2.1
EPS Growth (%)			40.8	9.1	-81.7
PER (x)		5.5	3.9	3.6	19.6
CFPS (A¢)		14.5	8.6	10.7	-1.1
CF Multiple (x)		2.9	4.8	3.9	na
DPS (A¢)		0.0	2.0	4.0	4.0
Div. Yield (%)		na	4.8	9.6	9.6
EV (A\$m)		14.8	11.0	7.5	9.7

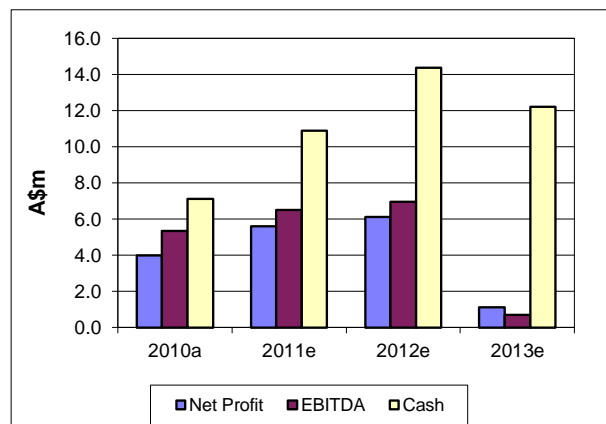
Profitability Ratios					
Year ending June		2010a	2011e	2012e	2013e
Return on Equity (%)		29.1	30.8	27.5	5.3
Return on Assets (%)		60.9	76.2	77.7	12.4
NPAT / Sales (%)		45.3	70.6	72.9	52.5
Total Debt / (Debt + Equity) (%)		na	na	na	na
EBITDA / Sales (%)		60.7	82.1	83.0	33.1

Valuation

	dr @ 10%		dr @ 5%	
	A\$m	A\$ps	A\$m	A\$ps
Mt Garnet royalty	2.8	0.05	3.6	0.07
Reefton Royalty	11.2	0.21	11.2	0.21
Exploration (Philippines)	5.5	0.10	5.5	0.10
Investments	0.3	0.01	0.0	0.00
Option Value and Misc.	0.0	0.00	0.0	0.00
Cash & receivables	12.3	0.23	9.3	0.18
Borrowings & creditors	0.0	0.00	0.0	0.00
Corporate/Other	-3.2	-0.06	-5.3	-0.10
TOTAL	29	0.55	24	0.46

Price Assumptions

Year ending June		2010a	2011e	2012e	2013e
Exchange Rate (A\$/US\$)		0.88	0.96	0.89	0.85
Nickel (\$US/lb)		8.82	7.81	7.90	7.75
Gold (\$US/oz)		1092	1294	1163	1038



* Dividends Paid includes 10FY capital return

Source: Company reports & Veritas Securities estimates

Royalco Overview

Figure 1: RCO Royalty locations



Source: Company reports

RCO is a royalty company which listed on the ASX in June 2006. The Company currently has a growing portfolio of 11 separate royalty interests with two currently in production and two with pending production commencing in December 2010. RCO is the only Australian domiciled royalty company listed on the ASX.

The company's main objectives are to generate positive and growing cashflows from royalty interests and to create growth through their exploration interests. The Company's focus is primarily in the Australasia region, with royalties currently in Australia and New Zealand and exploration interests in the Philippines.

The largest shareholder, Anglo Pacific Group PLC is a listed royalty company in London with a secondary listing on the ASX (AGP.ASX). Anglo hold a 31.1% interest in RCO after making a takeover bid for the company in 2009 at 34cps.

RCO has been active in identifying new royalties in the precious metal, base metal and energy sectors. We anticipate additional producing royalties and near to production royalties will be acquired in the medium term.

Figure 2: Summary of existing royalty interests

Project	Operator	Royalty	Commodity	Status
Reefton Gold Project (Globe Progress MP41 164)	Oceana Gold Limited	Variable, currently 5000 ounces per annum (\$NZ gold >\$900/oz) to 0.4Moz produced	Au	Production
Mt Garnet	Kagara Limited	3.0% nsr	Zn, Pb, Ag, Cu	Production
Dagworth/Huonfels	Deutsche Rohstoff Limited	1.5% orr	Au, Ag	Commissioning
Mt Kelly	CST Resources Limited	1.0% nsr	Cu, Au	Restart in December 2010
Reefton Gold Project (6 other contiguous tenements to Globe Progress MP)	Oceana Gold Limited	1.0% - 3.0% variable to Au price	Au	0.4Moz resource in two deposits, combines with Globe Progress MP for a 1.5% nsr if total production exceeds 1.0Moz
Sams Creek Gold Project	Oceana Gold Limited	1.0% nsr	Au	Scoping Study, 0.8Moz resource
Bowden's	Silver Standard Resources Ltd	1.0% - 2.0% nsr	Ag, Zn, Pb	Feasibility
Stanton	Hydromet Corporation Limited	1.0% nsr	Ni, Co	Scoping Study
LFB	Alkane Exploration Limited	3.0% nsr	Au, Cu	Pre-resource
Mt Lyndhurst	Syrah Resources Limited	1.5% nsr	Cu, U	Exploration
Gambang	Vale Exploration Inc.	1.3% - 1.5% nsr	Cu, Au	Exploration, Gambang royalty is subject to Vale purchasing the Gambang tenement

Source: Company reports

Investment Highlights

- Low risk royalty revenue providing a high margin income stream.
- Focus on revenue growth by expanding the royalty base from internal growth or via acquisition.
- Enterprise value of \$10m with 4 royalties to provide approximately \$17m in revenue to December 2012
- Intention to pay fully franked dividends from MQ11 providing for a 9.6% fully franked annualised dividend yield to investors
- Exploration upside from: 1. The Yabbe Project soil geochemistry in DQ10 and drilling in MQ11 and 2. The Gambang Project with Vale commencing a 6,500m diamond drill programme targeting 4 high order prospects.

Production royalties

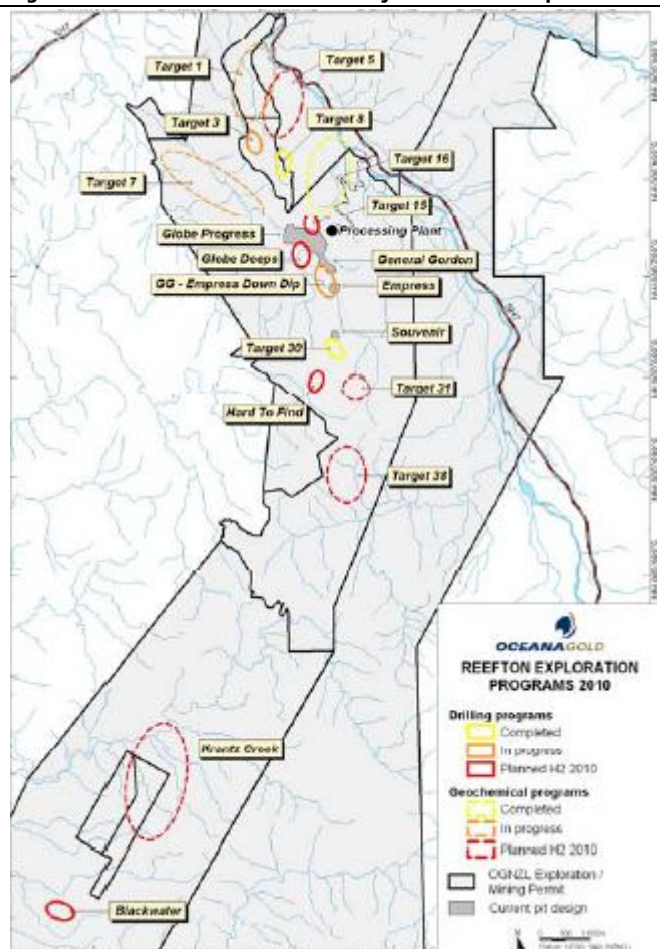
Reefton Gold Project Royalty – Globe Progress Mine

The Reefton Gold Project is located on the west coast of the South Island of New Zealand. The operation is owned and operated by OceanaGold Limited.

The Globe Progress mine commenced production in 2007 with a + 7 year reserve life. The remaining reserves as at 31 December 2009 are 5.4mt at 2.12g/t Au for 0.37Moz. The mine owner, Oceana Gold Limited, anticipates average annual production of 70kozpa over the remaining life of the mine. The Reefton project global resources (including all tenure in the project) as at 31 December 2009 was 14.2mt at 2.62g/t Au for 1.2Moz.

Oceana are aggressively exploring the near mine area for additions to resources and reserves. Extensional drilling has successfully extended mineralisation at General Gordon, Empress and Souvenir pits which is likely to lead to pit expansions. Near mine prospects Target 3, Target 31 and Hard to Find have been drill tested and a deep drilling program has commenced to increase the resource confidence at the high grade Blackwater mine.

Figure 3: OceanaGold Reefton Gold Project near mine exploration targets



Source: OceanaGold Corporation

Exploration success outside MP41 164 which leads to production will incur an additional royalty to RCO

As the Reefton royalty specifically relates to MP41 164 and the royalty will cease when cumulative production reaches 400koz the aggressive drill programme on the near mine targets is highly positive for RCO. The structure of the Reefton royalty is as follows:

- the maximum royalty payable is 5,000ozpa until the royalty ceases once the total combined production from the Globe Progress mining lease reaches 400koz, which should be reached in DH12.
- The royalty will only be reinstated as a 1.5% nsr once the total production from the Globe Progress mining lease (MP41 164) and other surrounding tenements, which are also under separate RCO royalties, exceeds 1.0Moz's.
- A sliding royalty of 1.0% to 3.0% will apply to any production where RCO has royalties from the 6 other tenements in the Reefton gold project. Other existing resources in the Reefton royalty asset portfolio are the historic underground Blackwater mine (340koz at 21.9g/t, EP40 542) and the shallow Supreme deposit (40koz at 1.5g/t Au, EP40 183).
- At the Sam's Creek gold project located to the north-east of Reefton, a separate 1.0% flat royalty applies (31 Dec 09 resource of 0.8Moz).

RCO royalties are for tenements:

MP41 164
EP40 183
EP40 334
EP40 530
EP40 542
EP40 604
EP40 705

Mt Garnet Project royalty – Mt Garnet mine

The Mt Garnet deposit and treatment plant is located in north Queensland and is owned and operated by Kagara Zinc Limited. The treatment plant receives ore from various Zinc rich deposits up to 200km from the Mt Garnet plant.

The Mt Garnet deposit is being campaign mined, and blended through the Mt Garnet mill at an estimated rate of 100,000tpa. The reserves at 30 June 2010 were 0.6mt at 5.8% Zn, 0.3% Cu and 15 g/t Ag, which we estimate are sufficient for 5 years.

Mt Kelly Cu Deposit royalty – Lady Annie mine

The Lady Annie Cu project is located 120km north of Mt Isa in Queensland. In early 2010 Mt Kelly was acquired by China Sci-Tech Holdings Limited, a Hong Kong listed entity. The recommencement of production is planned for December 2010.

As the royalty is capped at \$1.0m from two separate royalty areas, only an additional \$0.6m is payable.

Dagworth and Huonfels royalty – Red Dam project

The Red Dam Au project is located in north Queensland and is owned by a private German based group, Deutsche Rohstoff Australia Pty Ltd. RCO have recently been advised that environmental approvals have been received and that it is commencing development of the project, with a view to first production in December 2010.

A milestone payment on the first production of \$0.1m is payable, with \$10/oz on the first 10,000 ounces of gold produced and a 1.5% overriding royalty on production thereafter.

Royalty acquisition strategy

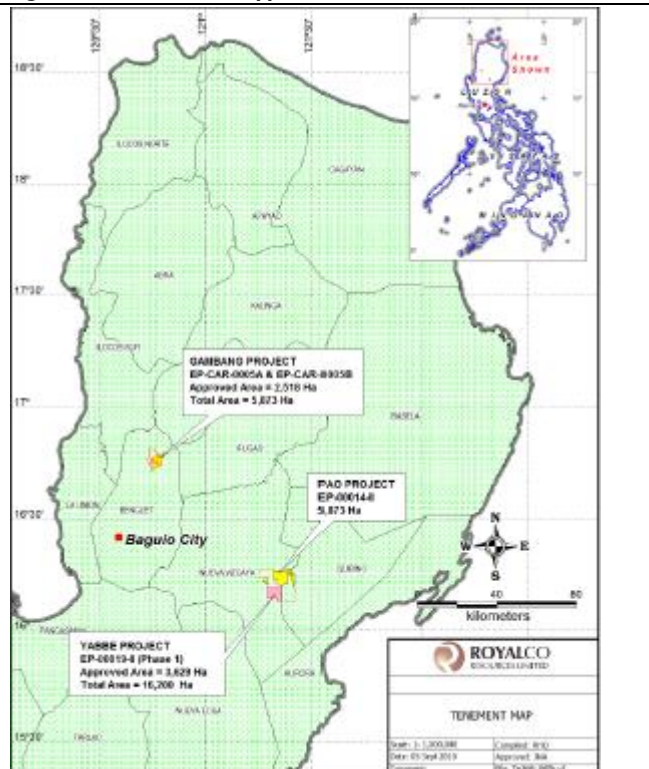
RCO is active in assessing and bidding for existing royalties. The Company uses a low risk approach to valuing royalties and has bid for numerous royalties, however too date they have not been successful. RCO is also focused on oil and gas royalties to include in their suite of royalties to provide long term revenue streams.

Exploration Projects

RCO's exploration interests are focused on generating royalties and free carried project equity interests in a portfolio of projects. The company does not intend to operate, with third parties introduced to develop and mine any discoveries made.

In 2004 RCO acquired Oxiana's (now OZ Minerals Limited) Philippine interests. The Filipino tenement package, hosts highly attractive porphyry copper and high grade epithermal gold targets. These areas were accumulated by Oxiana over a substantial period of time and represent underexplored to advanced exploration plays.

Figure 4: Location of Philippine tenure



Source: Company reports

Pao-Yabbe

The Philippine exploration assets provide a low cost potentially high impacting upside

The Pao – Yabbe tenement group lies in the Caraballo Mountains, midway between the Cordillera and the Sierra Madre ranges in northern Luzon. The highest elevation is 1530m. The Pao area is located in Kasibu, Nueva Vizcaya, and lies approximately 8 km southwest of the Didipio Copper project (124 Mt @ 1g/t Au, 0.4% Cu) of OceanaGold.

Using the Didipio project as a model, the principle exploration target in the Pao project area appears to be structurally controlled epithermal style Au-Cu mineralization. At Didipio, there appears to have been an initial phase of structurally controlled low grade porphyry mineralization hosted within a porphyry dyke, overprinted by later stage economic grade Au mineralization focused along a reactivated structure.

A monzonite body occurs in the tenure which is quite significant as at Didipio, the Tunja monzonite forms the Dinkidi Ridge and is the outermost zone of pervasive alteration.

The high priority targets at Pao remain untested

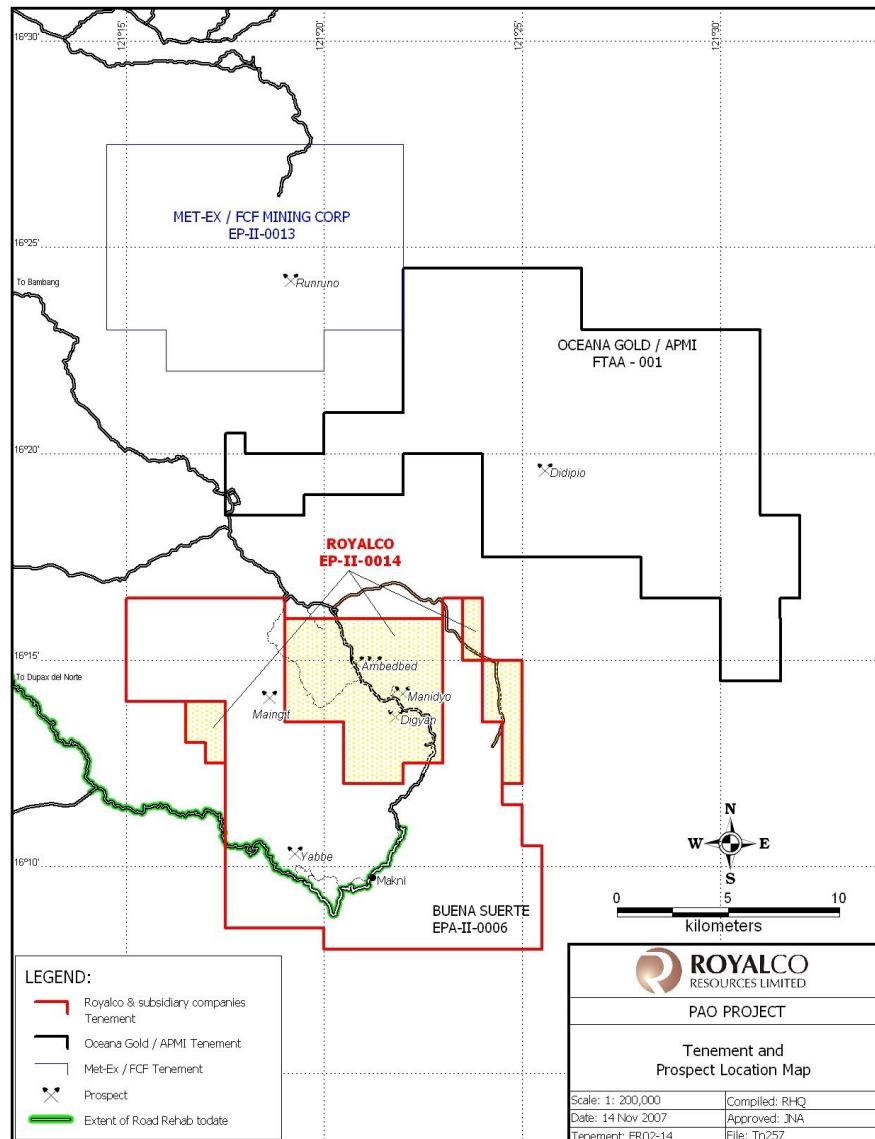
Pao exploration: Exploration at Pao is targeting a high sulphidation epithermal vein system which has returned grab samples up to 49g/t Au, 348g/t Ag and 3.94% Cu.

Drilling was scheduled for the DQ09, however this did not eventuate as the rig was unable to mobilise to site, due to non-representative protestors barricading the access track.

Yabbe exploration: The Yabbe tenement is contiguous with Pao to the north. Exploration in the 1980's returned stream sediment samples up to 30g/t Au and rock chip samples up to 3.1g/t Au from local workings.

Figure 5: Pao/Yabbe tenement location adjacent to OceanaGold's Didipio project

Pao/Yabbe host similar mineralisation styles as the nearby Didipio project



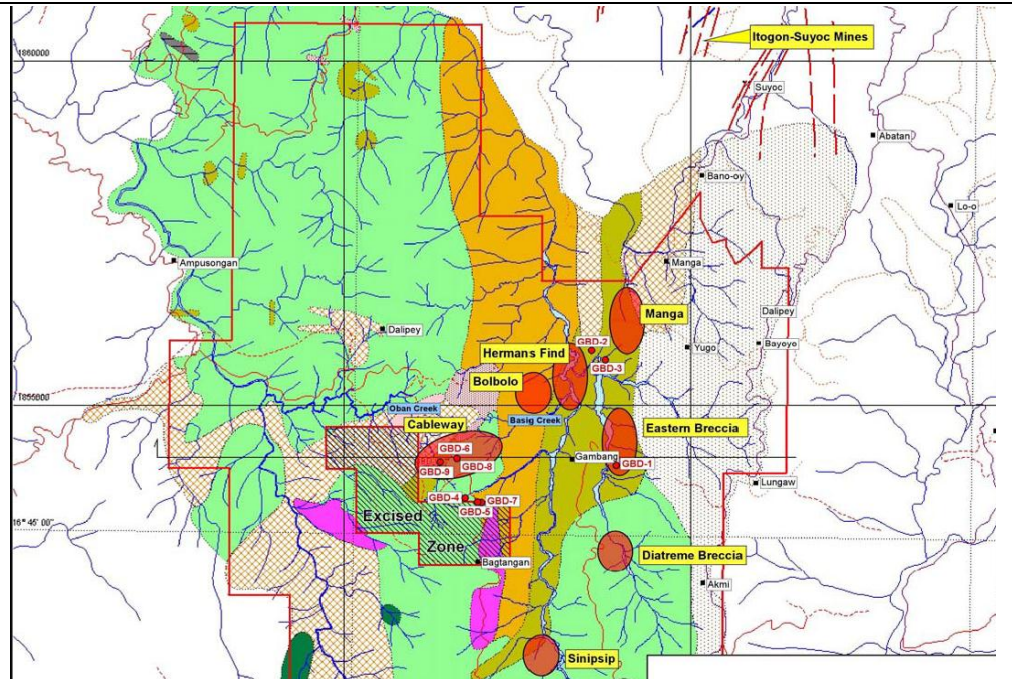
Source: Company reports

With the recent approval of the tenement, RCO will complete a programme of soil sampling, commencing in November 2010. Results from this soil programme will be used to generate targets for drilling in MQ11.

Gambang

The Gambang tenement group covers 5,241 hectares within the Cordilleran Mountain Range, along the southern margin of the Mankayan district, Benguet province. The centre of the tenure is located approximately 10km southeast of the Lepanto high sulphidation Cu-Au mine and the Far South East Goldfields JV which is targeting porphyry mineralisation below the Lepanto epithermal deposits.

Figure 6: Gambang Project regional geology and prospects



Source: Company reports

The region is highly mineralised with the Itogon-Suyoc Mines located 2km to the north of the tenement. The only record of mining in the Gambang tenement is shallow hard rock artisanal Cu-Au mining in the 1960's and 1970's. The target deposit is a large tonnage porphyry Cu-Au system.

Vale option agreement

RCO announced in February 2010 the completion of an option agreement with Vale S.A. for the Gambang project. The key terms of the agreement include:

- (i) Payments to RCO of US\$530,000 on completion of conditions precedent and a further payment of US\$500,000 twelve months later, subject to standard administrative conditions,
- (ii) An option to acquire the tenement after the expenditure of up to US\$3.5m within 3 years, once all documentation has been registered with the Philippine authorities,
- (iii) A minimum expenditure of US\$1.5m, including drilling on the highly prospective Cableway prospect,
- (iv) A payment of US\$5.0m on exercise of the option,
- (v) Royalty on production varying between 1.31% and 1.5% NSR.

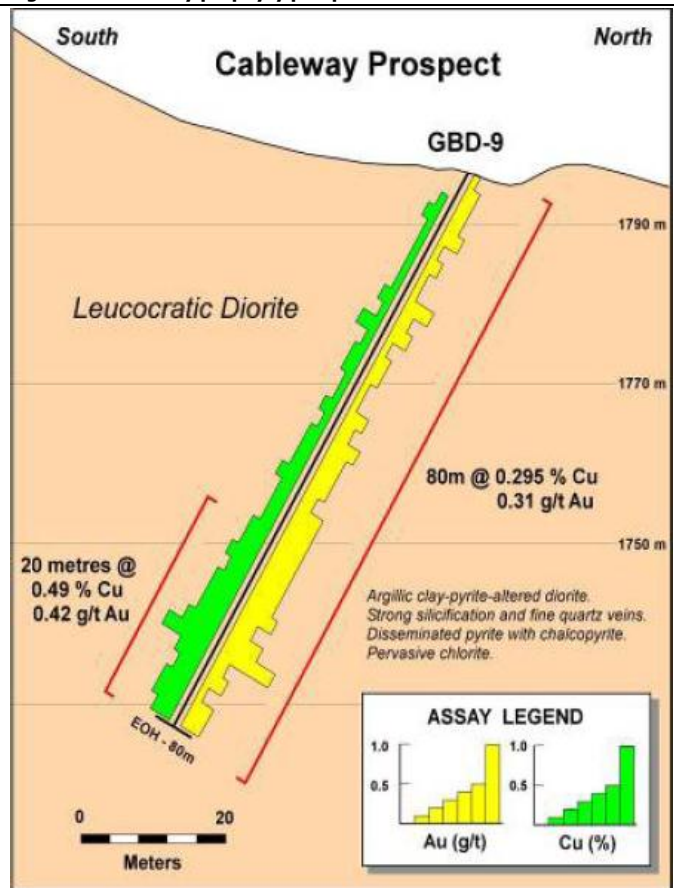
The Gambang prospects are underexplored and highly prospective

Geology and prospectivity

The geology of the tenement consists predominantly of volcanic units of various occurrences, generally trending north-northwest. Intrusive bodies bound the tenement on the northeast and another younger intrusive outcrop in the southwest. Gambang includes six highly prospective porphyry Cu prospects. These include:

- Cableway: This prospect returned the highest order of Au and Cu anomalism with gold values as high as 1.2g/t Au. Previous drilling yielded 20m at 0.49% Cu, 0.42g/t Au in GBD9 and 44m at 0.13% Cu, 0.20g/t Au in GBD8. The grades reported in GBD9 appear to be increasing with depth highlighting the upside of the area.

Figure 7: Cableway porphyry prospect drill section



Source: Company reports

- Manga: The prospect lies in the northeast corner of the tenement and south west of the Suyoc Mines. It is a Cu-Au breccia that is developed within strongly clay altered diorites. Significant Cu anomalism has been returned around the periphery of an intense magnetic high.
- Eastern Breccia: Copper mineralisation is hosted by volcanogenic sediments, a massive sedimentary breccia and a porphyritic intrusive body where mineralisation is best developed in the wall rocks of this intrusive.
- Tokla Diatrema Breccia: has copper mineralisation present in a variety of rock types with intrusives and breccias intersected. RCO drilling returned abundant propylitic alteration indicating drilling has intersected the halo of a mineralised system. Significant intercepts included 216m at 0.45% Cu, 0.03g/t Au are listed in Figure 8.
- Sinipsip.

Vale will be drilling the five highest order prospects in a 6,500m drill programme

Vale will be drilling the five highest order prospects in a 6,500m drill programme

Figure 8: Tokla Prospect significant intercepts

Hole ID	Prospect	From (m)	To (m)	Interval (m)	Cu %	Mo %	Au g/t
GDH-005	Tokla	38.00	254.00	216.00	0.45	0.012	0.026
	includes	124.60	158.00	33.40	0.96	0.016	0.029
	and	181.35	228.00	46.65	0.80	0.032	0.086
GDH-006	Tokla	10.60	142.50	131.90	0.32	0.006	0.024
	includes	44.50	84.50	40.00	0.72	0.000	0.008
GDH-006	Tokla	168.50	230.50	62.00	0.15	0.002	0.024
GDH-006	Tokla	276.50	292.50	16.00	0.40	0.000	0.008
GDH-007	Tokla	44.00	78.00	34.00	0.35	0.014	0.048

Source: Company reports

Vale has commenced a 6,500m diamond drilling programme at the Manga, Cableway, Eastern Breccia and Tokla Prospects with first results expected in MQ11.

Dividends

In June 2010 RCO made a 10cps return of capital to shareholders. Future returns will be paid as dividends with the company targeting a payout ratio of up to 60%. An interim dividend is to be paid on 21 February 2011 at 2cps fully franked as the first biannual dividend payment. We anticipate a fully franked annual dividend of 4cps.

This places RCO on a prospective 9.6% fully franked dividend yield at current prices.

Summary

We see RCO as providing high yields and low risk to the resource sector. The company's ongoing royalty acquisition and exploration strategy is likely to provide growth in the medium term.

We recommend a Buy and value the company at 55cps based on the maximum royalty payable at Reefton to December 2012 and growing cash and bullion of \$12.2m.

A 2cps fully franked dividend is to be paid on 21 February 2011

Sales

Tony Bonello +61 2 8252 3230
 Robert Scappatura +61 2 8252 3240
 Andrew McCauley +61 2 8252 3260
 Patrick Ford +61 2 8252 3208
 Bryce Reynolds +61 2 8252 3215
 Clay Melbourn +61 2 8252 3220
 Stephen Murphy +61 8 9380 8351

Research

Resources
 Piers Reynolds +61 3 8601 1196

Industrials
 Brent Mitchell +61 3 8605 4830

RATING

BUY – anticipated stock return is greater than 10%
 SELL – anticipated stock return is less than -10%
 HOLD – anticipated stock return is between -10% and +10%
 SPECULATIVE – High risk with stock price likely to fluctuate by 50% or more

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Veritas Securities Limited A.B.N. 94 117 124 535 AFSL No. 297 043 GPO Box 4877, Sydney, NSW, 2001 www.veritassecurities.com.au	Sydney Level 4, 175 Macquarie Street Sydney, NSW, 2000 Tel: (02) 8252 3200 Fax: (02) 8252 3299	Melbourne Level 8, 350 Collins Street Melbourne, VIC, 3000 Tel: (03) 8601 1196 Fax: (03) 8601 1180	Perth Suite 5, 531 Hay Street Subiaco, WA, 6008 Tel: (08) 9380 8351 Fax: (08) 9380 8300
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