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## Flaherty Special Situation Newsletter #12

October 4, 2009

### Bob's October Stock Pick: Mission NewEnergy Ltd. (ASX:MBT)

**Destiny's Tot: China Natural Gas.** For four days in September my son Brian and I attended the 500 company conference of Rodman & Renshaw at the New York Palace Hotel. We caught up on old friends and listened to many unfamiliar new ideas. In our sister *Flaherty Financial News Newsletters* we will share some of our insights about the conditions around our globe and naturally spotlight individual stocks.

One presentation filled me with unexpected pleasure. Back in September 2006 I did my last *Equities Special Situation (#530)* as I retired as editor of *Equities Special Situations*, exiting after over 25 years. I wanted my final pick to be a homerun. So I chose very daring one, my first China stock ever, China Natural Gas. Then it was a tiny unknown start-up on the OTC Bulletin Board selling at \$3. Now destiny's tot has grown up a bit and has a listing on Nasdaq (CHNG-11.09) and recently was up 270% down from 500%. Best of all, this emerging growth company in China is just getting started.

Our August Flaherty Special Situation on Dan Lufkin's **Electro-Optical Sciences (Nasdaq: MELA-9.09)** is up nicely at 25% and some unknown short sellers are in retreat. Our earlier June **Tri-Valley Corp (NYSE Amex-2.51)** was recently up over 100% and also has some short sellers on the run. But what have we done for you lately?

Now let us swing for the fences with another unknown contrarian pick. Out of all the companies I met at the R&R conference I chose first for a new recommendation **Mission NewEnergy Limited (Australian Stock Exchange ASX: MBT)**. It is my first Australian-based special situation for this newsletter and it has major operations in India and other Malaysia. This start-up has experienced management which has looked at and understood the errors of North American biofuel producers and turned that losing business model upside down to create spectacular potential growth and profits. The goal of a Flaherty Special Situation is a gain of 50% to 100% over two years. We believe patient investors can even do much better than that with our new choice.

### Mission NewEnergy Limited (Australian Stock Exchange ASX: MBT)

[www.missionnewenergy.com](http://www.missionnewenergy.com)

A daring start-up backed by smart money turns North American biofuel ideas upside down, creating spectacular potential by using 126,000 subsistence Indian farmers on 350,000 acres of arid otherwise unproductive land under contract for 30 years to grow jatropha feedstock. Virtually this low cost tree oil feedstock gives MBT a 30- year call on oil at \$40 and management even hopes to cut the figure to \$20.

**By Arnaldo Arroyo with Robert J. Flaherty**

Recent Price:	A\$0.28*
Market Capitalization:	A\$54.4 million*
52-Week Range:	A\$0.16 - 0.77*
Shares Outstanding:	194 million
Shares Fully Diluted	450 million
Float:	194 million

**Balance Sheet as June 30, 2009\*\***

Total Assets:	\$117 million
Long-Term Debt:	\$49.4 million
Total Equity:	\$49.1 million
Book Value Per Share:	\$0.48

**Instructions to Access Mission NewEnergy Quotation on the Australian Stock Exchange**

Go to Yahoo Finance: <http://finance.yahoo.com>  
Click on Yahoo Finance 'investing' sub-head  
Enter MBT.AX in the empty box below, and click the 'get quotes' box  
Quote will appear in Australian Dollars ('AUD')

**Converting Mission NewEnergy Stock Price in US Dollars**

Go to 'currency converter' in Yahoo Finance: <http://finance.yahoo.com/currency-converter#from=USD;to=EUR;amt=1>

On the 'currencies center' box, you will see the tab 'currency converter'

- a. On the left side of the box, in the 'type the country or currency' option: scroll to 'Australian Dollar'
- b. On the right side of the box, in the 'type the country or currency' option: scroll to "US Dollar"
- c. Back to the left side of the box, under Australian Dollar: type 1
- d. You will see the US Dollar amount of the AUS dollar appear automatically on the right side

**Determining the US Dollar Equivalent for MBT.AX Stock at any given time**

**Multiply the current market price in Australian Dollars to the US Dollar Equivalent of the Australian Dollar.**

FOR EXAMPLE (BASED ON 9/21/09):

Australian Dollar quote of MBT.AX- \$0.28AUD

In Currency Converter: 1AUD = \$0.863 USD

MBT.AX quote in USD= \$0.28 x \$0.863= \$0.24 (USD)

\* Australian dollars

\*\* U.S. dollars

**Buy Recommendation**

Perth, West Australia-based Mission NewEnergy Limited (ASX: MBT) has an ambitious goal to become an integrated global provider of new alternative energy, especially biofuel, from sustainable low cost cap-tive jatropha oil feedstock.

In North American biofuel has a bad name as biodiesel refiners have tanked and many have gone into bankruptcy. The problem is the industry is easy to enter but profits get squeezed as the prices of feed-stock commodities escalate from the competing demands of food versus fuel.

How have the Australians turned the North American model upside down?

The answer is Mission's integrated business model for long run sustainable profitability and growth. James Garton, Mission's head of corporate finance, mergers and acquisitions, notes that competition for food crops to use as feedstock has had a dramatic impact on the financial position of many North American biodiesel producers, causing many refineries to go out of business. What's the difference with Mission? "We have our own captive feedstock, and it's a non-food crop so we can avoid all of the challenges and debates around food versus fuel," he says. It also has the potential, if successful, to make his company one of the lowest cost producers on the planet.

In developing its business model, Mission recognized early on that in order to gain a competitive edge to be substituted for oil in diesel, their feedstock had to be in a low cost position. To do this, the company has been heavily focused on generating sustainable profitability from its byproducts in hopes of eventually achieving zero cost for its feedstock, or jatropha oil. "If we have the lowest cost of feedstock, that means we can compete regardless of where the price of oil sits and regardless of whether subsidies are in place or not," says Garton.

"We have 30 years of captive feedstock contracted at a price equivalent to \$40 a barrel," he adds. "If we focus on our byproducts and drive those down the way we're consistently doing, that \$40 number can consistently be reduced. We think maybe we can get it down to \$20, or maybe lower." Right now, Mission is a 30-year-call on the price of oil at \$40. That is what is special here.

This is a remarkable classic special situation. The minimum investing goal of each new Flaherty Special Situation is to achieve a gain of 50% to 100% within two years.

### **The Smart Money Remains Confident.**

To date, the smart money has remained confident about the company's prospects. Since going public in an IPO in 2006 institutional investors such as Tiger Global, Tudor Capital, QVT, Credit Suisse and DE Shaw have not decreased their holding positions in the company.

Having experienced a loss for the year ending June 30, 2009, Mission bolstered its financial position by initiating two rounds of equity financing around midyear, raising a total of US\$21.8 million. Management attributes a good part of the loss to the fact the company is still in the ramp-up phase and much of its economic capability is still under development.

Mission operates a biodiesel refinery and glycerin purification plant at Port Kuantan, near the Malaysian capital of Kuala Lumpur. The plant started up in August 2008, producing biodiesel from palm oil. The use of palm oil for feedstock will eventually be replaced by jatropha oil. The plant's annual output includes 100,000 tons of biodiesel, 4,000 tons of palm fatty acid distillate and 8,000 tons of 99.7% pure pharmaceutical grade glycerin.

Mission is also building a second biodiesel refinery adjacent to the current plant. It will produce 250,000 tons per year of biodiesel, as well as 10,000 tons of palm fatty acid distillate and 25,000 tons of 98% pure technical grade glycerin. Someday a refinery in India is contemplated since India imports most of its oil and needs alternative energy.

Within a few months of bringing the second plant online, the company expects to begin processing its first commercial quantities of jatropha from its India operations. The initial processing of jatropha-based biodiesel in 2009 will be the first ever. Mission expects production to increase each year until it reaches 100% jatropha-based biodiesel production by 2012.

"With a capacity of 350,000 tons, that makes us one of the largest biodiesel refiners in the world, and we're also the largest jatropha plantation operator," says Garton.

Both refineries are located less than 100 meters from the port and are designed for pipeline feeding of biodiesel into shipping vessels and tankers. Due to its proximity to the port, Mission will be able to minimize storage and handling costs.

Mission's business model is building on a current base of 126,000 small farmers all under 30-year contracts to grow jatropha feedstock in India. Farmers in India are very familiar with jatropha. It is grown to serve as a living fence to keep free-roaming livestock from destroying their food crops. As a result, the company has access to over 350,000 acres of jatropha already planted in several states of India as well

as nurseries and seed procurement centers. Altogether, the company has planted 350 million trees. With an eye toward increasing its feedstock capacity, Mission is targeting over one million acres, which would give the company annual production of 7.2 million barrels of oil per year and equivalent oil reserves of 216 million barrels.

To monitor feedstock production, Mission has setup a network in rural hinterlands in India with 500 full time employees and over 3,000 commission -based field agents. The field agents are equipped with Java-enabled mobile phones with custom developed GPS tracking to map, manage, and monitor how the farmers are performing on their acreage. Call centers have been established in seven local dialects to manage the collection of information and to provide farmer support.

Using jatropha as feedstock has some key economic advantages. Property managed, Mission believes that jatropha will have an oil content of about 20% to 40% compared to other feedstock such as soy or palm, which contain about 20% oil content. It is also grown in arid and marginal land where food crops cannot be grown. And it doesn't need irrigation or fertilizer to grow. A small amount of rain is sufficient for the crop to sprout.

Indeed, having access to its own feedstock and operating in Australia, Malaysia, India and Mauritius, Mission is able to lower feedstock costs, offer a better price to customers, minimize risk and strengthen its ability to compete long term globally.

Mission markets its biodiesel in Europe, India and the U.S. The company has already sold over 60,000 tons of biodiesel into Europe, as it has cleared the biggest hurdle for non-European countries to market biodiesel in Europe: It is the first non-European biodiesel producer to meet German biodiesel quality specifications. Germany is the world's largest market for biodiesel and will require that all biodiesel used in the country as of January 1, 2010 be compliant with new sustainability laws. By 2011, the rest of Europe will be required to adopt the same compliance procedure.

## **Business**

Perth, West Australia-based Mission NewEnergy operates through four subsidiaries: Mission Biofuels Sdn Bhd, Mission Biotechnologies Sdn Bhd, both in Malaysia, Mission Agro Energy Ltd., in India and Mission Biofuels India Private Ltd. It operates a jatropha consultancy service also located in India. Key products include biodiesel, jatropha, wind turbines, pharmaceutical grade purified glycerin and palm fatty acid distillate.

Biodiesel is biodegradable and non-toxic, and has significantly fewer emissions than petroleum-based diesel when burned. It is made by transesterification of vegetable oils or animal fats and is an alternative to petroleum-based fuels. However, it can also be blended petroleum-based diesel. A variety of oils from feedstock can be used in the production of biodiesel such as jatropha, palm oil, soy, rapeseed and coconut.

## **Jatropha**

Since the crop yields non-edible oil, jatropha provides Mission NewEnergy with a major economic advantage as a result of not competing with the world's food supply and getting the price its feedstock supply bid up. What's more, the crop can be grown in arid and marginal land where food crops cannot be grown and in areas where there is very little rainfall. The key point is that jatropha is such a hardy plant that it grows where other crops cannot survive.

Among the other factors that make jatropha a high quality feedstock for the production of biodiesel are:

- High in oil content (30 to 40% compared to about 20% for soy and palm).
- High in energy balance with greater carbon savings.

- A source of income and livelihood for rural farmers with marginal and arid land.

## **Feedstock Development**

Through its subsidiary Mission Biofuels India Pvt Ltd, Mission has developed an extensive field network to manage harvesting, storage, extraction and transportation of jatropha oil and seeds. To date, Mission Biofuels India has achieved the following:

- Access to over 350,000 acres of jatropha already planted with an initial goal of 1 million acres.
- Developed its own nurseries and seed procurement centers in India and can supply and sell jatropha seeds to its 126,000 contract farmers.
- A strong educational and management network of 500 employees and 3,000 commission -based field professionals to manage and maximize the output of the 126,000 farmers growing jatropha.
- Partnered with the leading jatropha research center The Energy Resources Institute and Tamil Nadu Agriculture University of India, to implement optimum planting cultivation technologies and to ensure highest yields are achieved.
- Has deployed extensive technology in the form of a custom-built, web-based Acreage Management System and a custom-built GPS-PDA based solution for census.

## **Wind Energy**

In February 2008, Mission Biofuels commissioned two 1.65 megawatt windmills, for a total capacity of 3.3 megawatts of electrical power. These turbines supply electricity to the local electricity distribution company under a 13-year power purchase agreement. The turbines are strategically located in high wind areas thereby enhancing generation of power throughout the year. Electricity produced from wind turbines reduces greenhouse gas emissions. As a result, the company's wind turbine projects are also eligible for Carbon Emission Reduction credits under the global Kyoto Protocol. Such credits are freely tradable in Europe.

## **Pharmaceutical grade purified glycerin**

The production of biodiesel creates crude glycerin that can be further purified into pharmaceutical-grade glycerin. Glycerin is a clear, non toxic and odorless substance that is ideal for producing a wide range of products in oral care, cosmetics and pharmaceuticals. The company's glycerin is both kosher and halal certified making available its application in other cultures and markets. It ships the glycerin in new steel drums, pallets and containers or in ISO tankers and flexi bags.

## **Palm fatty acid distillate**

Mission produces and distributes palm fatty acid distillate globally. PFAD is a by-product of refined crude palm oil. It is a light brown solid at room temperature, melting to a brown liquid on heating. PFAD is used in the manufacture of soap, animal feed industries and as raw material in the oleo chemical industry. Vitamin E can also be extracted from this byproduct.

## **Management and Key Personnel**

**Nathan Mahalingam**, Founder, serves as managing director of Mission NewEnergy, and as CEO and director of Mission Biofuels India Private Ltd. He has over 25 years of management experience in banking and finance, heavy industries and infrastructure development. He has successfully implemented numerous start-up manufacturing operations in Malaysia during his tenure with a large ... Malaysian conglomerate. From 1995 to 2000, he served as project director for Westport Holdings Malaysia Sdn Bhd.

Mahalingam has gained extensive project advisory, corporate finance, mergers and acquisitions experience while running his own boutique corporate advisory practice from 2000 and 2004. He has been a director of Mission NewEnergy since November 2005. Mahalingam has a Bachelor of Economics (Hons) from the University of Malaya and an MBA from Murdoch University.

**Guy Burnett** has been CFO since July 2008 and finance executive director since April 2009. He also serves as a director of Mission Biofuels India Private. Since June 2006, Burnett has been manager, corporate accounting and tax of Western Power. Prior to this, Burnett served as an acting financial accountant for the Water Corporation on a one year contract and also served as a manager ... with KPMG for 15 months, where he played a key role in assisting KPMG's clients in rolling out their IFRS accounting implementations. In 1996, he joined Umgeni Water as its financial accountant and served as its financial controller since 1999. He left Umgeni in 1994. He serves as member of the Finance & Treasury Association and is also an Australian chartered accountant. Burnett has a Bachelor of Commerce-Accounting degree from the University of Natal in South Africa.

**Dario Amara** is non-executive chairman of the company. He is an engineer with extensive business experience gained over 29 years in the Australian and international markets and across the resources and infrastructure sectors. Prior to co-founding Emerson Stewart in 2005 and for over 16 years, he held senior executive roles with major construction and engineering groups. Dario successfully led GRD Minproc as managing director/chief executive and John Holland Asia as chief executive officer. Dario has a record of achievement in establishing, growing and rejuvenating businesses and strategic leadership. He is currently a non-executive director of Austal and a board member of the Perth International Arts Festival. Dario has also served as chairman of the West Australian Opera Company and the Art Gallery of Western Australia. He is a Fellow of the Institution of Engineers Australia.

**Datuk Zain Yusuf** is non-executive deputy chairman. He has over 25 years experience in Shell Malaysia. From 1986 to 1988, he worked at Shell International, UK, and worked as marketing consultant at Shell UK and Shell Caribbean. Upon his return to Malaysia, he became marketing director of Shell Malaysia. He subsequently served as executive director of Shell Group Malaysia, where he was responsible for a total of 18 group subsidiaries involved in both the upstream and downstream petrochemical business. Yusuf is currently chairman of the Malaysian Australia Business Council and serves as a director of Airod Sdn Bhd, NADI Bhd, Malacca Securities Sdn Bhd, Faber Group Bhd, PJ Bumi Bhd and as chairman of Confoil (Malaysia) Bhd, a Malaysian-Australian joint venture company based in Malaysia.

**Tan Sri Anwar** is non-executive director. Among the number of positions he holds in the corporate sector, Tan Sri Anwar is also a corporate advisor to Sime Darby Bhd, the largest plantation company in the world. He also chairs the board of the Armed Forces Fund Board, a multibillion dollar fund with investments in banking, plantations, petrol retail and hotels.

He made history in April 2005 when he became the first naval chief in the Malaysian Armed Forces (MAF) to ascend to the Chief of Defense Force, the highest military office in the country. With nearly 40 years of military experience with the Royal Malaysian Navy and MAF, he has acquired a massive portfolio of achievements.

His academic achievements include stints at the Naval Staff College (Rhode Island, U.S.), Navigation and Direction Course and Principal Warfare Officers Course (HMS DRYAD, UK). He also holds a Master of Science in engineering business management from the University of Warwick, UK.

**Arun Bhatnagar** first joined the company as chairman of its Mission Biofuels India Pvt Ltd in June 2008. Bhatnagar is currently the chairman of the Government of India owned television and radio broadcaster, Prasar Bharti (likened to the BBC of India).

Prior to this, he was the Secretary of the National Advisory Council, a body tasked with the implementation of the National Common Minimum Program and to provide inputs in the formation of policy and sup-

port to the government in its legislative business.

Having worked for the government since 1966, Bhatnagar has served as head or in senior positions in various ministries, including the Ministries of Rural Development, Energy, Irrigation and Personnel. He also served as Minister of Economics in the Indian High Commission in the UK.

**James Garton**, head of corporate finance, mergers & acquisitions, worked for the company for a number of years. He met the founders during their IPO in 2006 and has worked closely with them ever since. Garton has over 10 years experience in corporate finance and investment banking. He worked for U.S investment bank FBR Capital Markets and earlier with in corporate finance and equity capital markets with Australian firm BBY Limited, which has Jefferies Inc as an equity partner. Even earlier Garton worked in private equity with Australian advisory firm Investment Capital Limited. Garton has a Masters of Applied Finance from Macquarie University Sydney, a Bachelor of Science in Economics and a Bachelor of Business Administration in Finance from Texas A&M University.

## Finances

For the year ending June 30, 2009, Mission NewEnergy posted a loss of \$25 million compared with a \$4.9 million profit for the year ending June 30, 2008. In the comparable periods, revenue increased to \$52.8 million from \$27.8 million.

Management attributes the loss to significant non cash losses and the fact the company is still in the ramp-up phase and much of its economic capability is still under development.

According to James Garton, head of corporate finance, "We've got 14 months of cash if we do nothing to improve it. When our second refinery comes online that should improve. We wouldn't sell more stock at our current valuation."

Garton notes that the company will seek a U.S. listing when it is ready.

## History

Founder Managing Director Nathan Mahalingham, of Maylay-Indian descent with Malaysian knowhow, and co-founder Executive Director Arvid Vansal, based in India with agriculture and finance knowhow there, have made an ideal team to seek sustainable low cost jatropa oil feedstock .

After a \$40 million IPO, Mission NewEnergy listed on the Australian Securities Exchange in May 2006. At the time, the company had established a 100,000-ton-per-year biodiesel refinery near the Port of Kuantan, Malaysia and is months away from opening a second one nearby.

While the company's initial focus was solely biodiesel, it became clear that margins would diminish for biodiesel refiners without feedstock, that the company should own its own low cost captive source of raw material with the goal of becoming a low cost producer. Further, that feedstock supply should be sustainable and not compete with food. To accommodate its expanded focus and better reflect its position as an emerging player in the renewable energy sector, in August 2008 the company changed its name from Mission Biofuels Limited to Mission NewEnergy Limited. With over 500 employees in India and having planted over 350 million jatropa trees the company has come a long way. It also is the first non-European biodiesel producer to meet German specifications. The ability to sell in Europe is a major positive.

## Competition

Mission NewEnergy's top competitors include D1 Oils plc, Australian Renewable Fuels Limited, Earth Biofuels, Inc., Natural Fuel Limited, Tree Oils India Ltd and numerous other alternative energy players.

## Risks

An excellent highly informative article on Mission NewEnergy in the May 2009 issue of Biodiesel Magazine noted that jatropha, while very promising, was only one of ten trees being considered by Tree Oils India Ltd. and domesticating a wild plant involved "Unknown unknowns." Plants take three years to bear fruit and managing 126,000 uneducated subsistence Indian farmers is bound to be a learning experience. Crop yield will depend upon using technology successfully. Like other crops, Mission's jatropha nurseries will be exposed to the risk of damage from climatic changes, diseases, fires and other natural disasters.

Management has established environmental policies and procedures aimed at compliance with local environmental and other laws. It also performs regular reviews to identify environmental risks and to ensure that the systems in place are adequate to manage those risks. In addition, Mission is subject to laws and regulations in various countries in which it operates. As a result, operations could be impacted by any sudden changes. Such risks accompany ambitious start-ups and management must have the ability to deal with the unexpected when it arises.

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