



Strachan Corporate

February 6th 2007

AFSL 259730

ADVANCED ENGINE COMPONENTS LTD

Major China Play in "Green Energy"

INVESTMENT DRIVERS

- Investment in ACE gives exposure to global markets for an environmentally friendly, low cost alternative fuel technology. Major inroads to the booming Chinese market have been facilitated by its major shareholder the Koo Group, a Taiwanese industrial conglomerate.
- Strachan Corporate estimates that contracts for supply of natural gas vehicle systems with two of China's largest engine manufacturers will boost ACE's sales to over \$1 million per month by June 2007, with potential to move to \$2.7 million per month by early 2008.
- The addition of a third Chinese vehicle manufacturer, Dongfeng Automotive Group to its list of active customers, would lift sales towards \$4 million per month by H2, 2008.
- The company is working to develop markets for gas powered truck and bus operations elsewhere and is advancing several initiatives in Australia, India, Pakistan, Thailand, France the USA and the Netherlands.
- High margin, spare part sales will grow exponentially as the number of vehicles in operation worldwide expands.

CAPITAL STRUCTURE

| | |
|-------------------|---|
| ASX Code | ACE |
| Shares | 121.4 |
| Options | 5.6 20.0 c 06/08 1.3 19.0 c 12/08 20.0 20.0 c 06/08 (1) 5.6 13.5 c 10/07 |
| Con Note | \$ 3.0 @ 40 c 12/09 |
| Cash | \$ 1.2 mil |
| Price | \$ 0.19 per share |
| Market Cap | \$ 23.1 mil |

(1) If 30 day VWAP trades of over 50 cps

OPINION

Advance Engine Components (ACE) has begun to generate significant revenues from the sale of its electronic, natural gas injection and control systems to engine manufacturers in China and elsewhere.

An ongoing search for alternative, less polluting and lower cost fuels, combined with a relative abundance of natural gas, often from otherwise stranded sources, ensures that natural gas will see strong growth in its use as a transport fuel, especially for municipal transport.

ACE budgets to achieve positive operational cash flow mid CY 2007 and is unlikely to require additional equity support to fulfil its current business plan. Major shareholders provide the company with entrée into significant Asian markets.

BOARD

| | |
|--------------------------|------------------|
| Chairman | Graham Keys |
| Managing Director | Antony Middleton |
| Non-Executive | William Lee |
| Non-Executive | Thomas Liu |
| Non-Executive | Albert Pun |

VALUATION SUMMARY

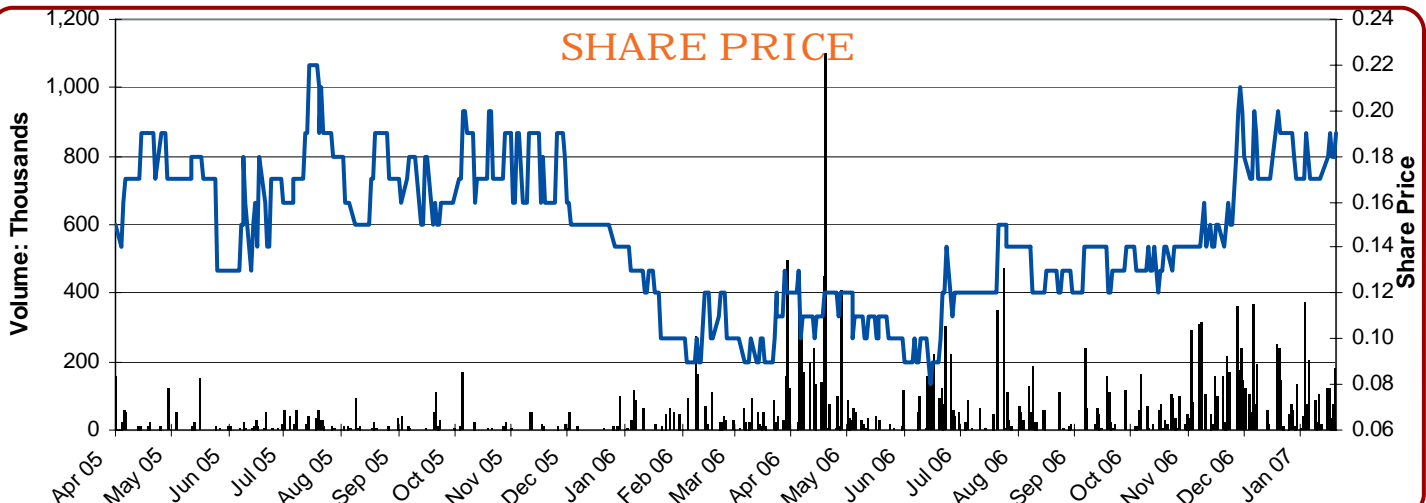
| Method | cps | Comment |
|---------|-----|---------------------------|
| PER | 45 | 8 times FY '08 Projection |
| EV/EBIT | 35 | 6 times FY '08 Projection |
| NPV | 63 | Ke=19.4%; Tg=3% |

Source: Strachan Corporate Pty Ltd

SUBSTANTIAL SHAREHOLDERS

| | |
|--------------|-------|
| 698 Capital | 45.6% |
| Lim Asia | 16.4% |
| Westpac Noms | 6.6% |

SHARE PRICE



INTRODUCTION

Diesel to natural gas engine conversion technology

ACE designs, assembles and markets natural gas (methane) vehicle systems (NGVS), along with associated spare parts and technical services to original equipment manufacturers (OEM) involved in vehicle assembly and engine manufacturing. Systems are either retrofitted to diesel engines or preferably, designed for OEM assembly lines, enabling engines to run on natural gas, which is supplied as compressed natural gas (CNG) or liquid natural gas (LNG).

Cheaper to run...

Vehicles powered by methane are cheaper to run and emit significantly lower levels of pollution than those which are diesel powered. ACE is initially targeting the market for municipal buses, which can be refuelled from central depots. Sales of NGVS's are expected to grow as refuelling infrastructure expands in target markets, enabling long haul and regional truck companies to take advantage of this lower cost, less polluting technology. For example, the Indian Capital, Delhi presently has about 250,000 vehicles using natural gas engines and it has over 200 depots selling compressed natural gas.

low emission...

well proven.

Sales rising swiftly

ACE raised \$1.95 million via a share placement and \$0.56 million via an SPP at 12 cps during November and December 2005, providing adequate working capital to meet inventory build up requirements as it supplies its current order load. In the December 2006 quarter, sales exceeded \$1.5 million and the company reported its first positive quarterly EBITDA result. Sales are expected to lift sharply during CY 2007 as ACE's customers ramp up their sales and marketing efforts for new, natural gas engines.

PRODUCTS

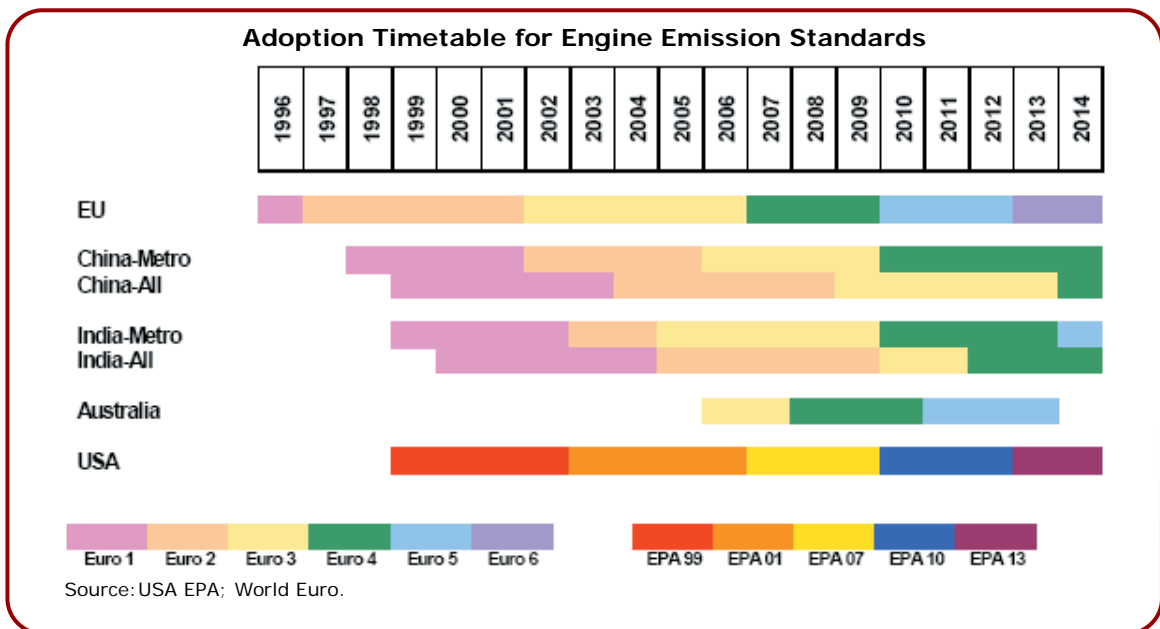
Electronic, drive by wire vs mechanical system

ACE is commercialising an electronic fuel injection and engine control system. While competitors use mechanical alternatives, ACE's inherently simple "drive-by-wire" electronics system, ensures optimal engine performance at all times, cutting back fuel consumption when not required and adding to fuel economy and further reducing emissions by switching to three cylinder operation (for a 6 cylinder engine) when the engine is idling. The technology is applicable to all forms of gas fuel, such as natural gas and Hythanetm.

ACE designs, assembles & services

The key to ACE's leading edge NGVS is its patented electronic control unit (ECU). The ECU monitors each cylinder to ensure the same air/fuel mix, enabling the engine to operate at higher power outputs with minimal additional wiring or piping. ACE's on-line, precision NGVS ensures efficient fuel burning which cuts emissions, meeting Euro 4 standards for carbon monoxide, nitrogen oxides and non-methane hydrocarbons while meeting or exceeding power and torque outputs of the original, base diesel engine.

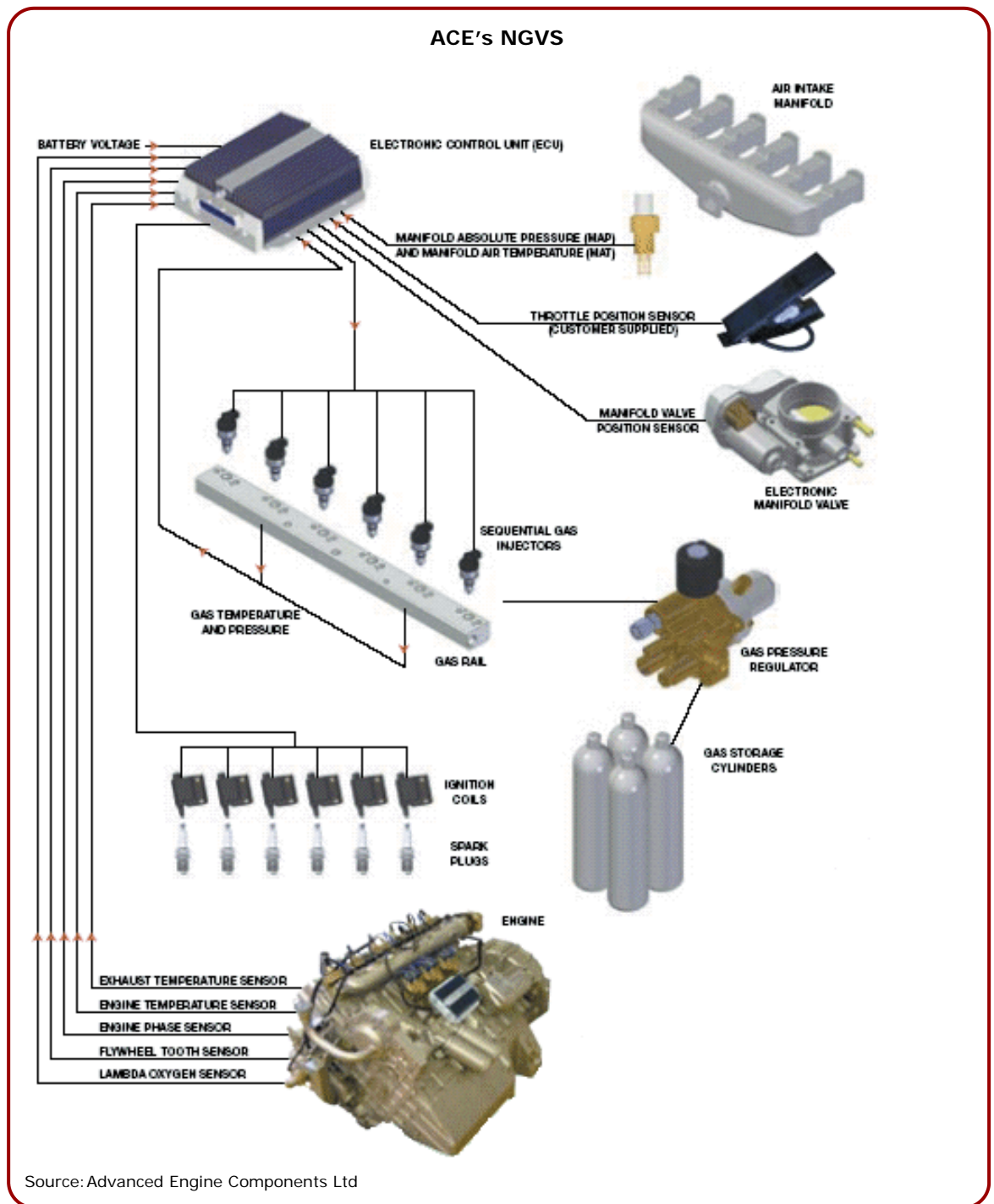
ACE's NGVS enables engines to meet Euro 4 emission standards, well ahead of requirements which currently stipulate Euro 2 or 3 emission standards.



Cost to fall as volume rises & assembly moves to China

Component parts of the NGVS are manufactured by third parties and are currently assembled at ACE's facility in Perth, where existing orders and outlook for up to 320 NGVS's per month can be met. The company has recently established an office in China and plans to commence NGVS assemblage in China for that market, which is expected to demand 1,000 units per month by late 2007 and up to 1,500 units per month by late 2008.

Production costs are expected to fall substantially as a five fold volume increase pushes down supplier production costs and the main assembly centre shifts to China. While unit prices will also reduce, margins should be more than maintained.



ACE's advantage
using electronic
system

High level
environmental
performance

COMPETITORS

Many motor vehicle component makers such as Bosch make mechanical systems for NG engines, while other engine manufacturers have invested in their own, in-house technology. However, ACE is unaware of any similar electronic system on the market which can deliver the efficiency and performance of ACE's NGVS to meet Euro 4 emission standards.

The complexity of the technology underlying ACE's NGVS makes it difficult to copy, even though ACE's patent protection outlines the basic operating principle. ACE's partners rely on its technical support to commercialise NG engines and since ACE's components make up less than 10% of the cost of a new engine, it is unlikely that its large customers would act to disrupt ACE's position in the market. Existing and new customers make a significant investment in ACE's technology creating a long term market for spare parts and service. Strachan Corporate believes that engine manufacturers are unlikely to change supplier, having completed due diligence on ACE's costs and performance and invested in that technology.

SHAREHOLDERS AND PARTNERS

Strong partners...

Powerful customers in China

| | |
|--|---|
| <p>Alliance Partners ACP – Pakistan AFT – Melbourne Brehon Energy – UK Dalian Diesel (FAW) – China Dongfeng Nanchong – China FAW – China IBH - Bangladesh Irisbus – France Motive Energy – Perth VAFS – India Vialle – Netherlands Weichai Weifang – China</p> <p>AEC Alliance Customers AFT – Petronas, Malaysia FAW, Monika – Thailand FAW – Myanmar Weichai – Iran Weichai – Thailand</p> <p>Shareholders 698 Capital (Koo Gp) - Taiwan Lim Asia – Hong Kong Chemco - Perth (Coogee) CIM Special fund – UK Key Special Fund - UK</p> | <p>ACE's largest shareholder is Hong Kong based, venture capital company 698 Capital International Ltd, which is part of the Koo group, a Taiwan based pan Asian business encompassing over 80 companies employing more than 20,000 people worldwide with total assets of over US\$25 billion. Other shareholders in the UK and in Australia are supportive; however, new investors may find that a lack of market information ahead of expected significant improvement in quarterly revenue outcomes could provide some liquidity at around 20 cents in this otherwise illiquid stock.</p> <p>The company now employs about 40 people worldwide and has recently established a sales and technical support office in China where it also plans to establish an assembly facility capable of supporting local sales of up to 1,500 units per month.</p> <p>ACE is working with partners not only to sell NGVSs but also to establish refuelling and service networks which will support and enhance its marketing efforts.</p> |
|--|---|

Source: Advanced Engine Components Ltd

MARKETS

Truck and bus engines in Australia, China, India, Thailand plus...

ACE's NGVS is presently in everyday operation on 645 busses in Europe and Australia, providing a substantial operational data database covering over 120 million kilometres of route services. ACE has established strategic partnerships with two of China's five main heavy duty engine manufactures and is testing its system with a third, ahead of an expected sales contract during 2007.

The Chinese Central Government has arranged a consolidation of its vehicle manufacturing industry and mandates cleaner fuel systems. This clean air policy should result in construction of at least 24K new busses each year which are adapted for either LPG or natural gas. First Auto Works (FAW) is commercialising 3 different NG engines, using ACE's components. ACE is now delivering into orders for about 200 units per month from just one customer, FAW and volumes are expected to increase from to 500 per month during 2007 as FAW sells more NG buses and trucks.

At Weichai Wiefang Peterson Gas Engine Co, ACE has designed an NGVS for 3 new engine models and marketing is underway at an initial rate of about 120 per month. Volumes are also set to lift toward 500 per month by late 2007 or early 2008.

In mid 2006, ACE commenced design of NGVS's for China's third Auto maker, Dongfeng Nanchong Automobile Co Ltd, which has a dominant market position in the south of China. Dongfeng is already China's largest manufacturer of natural gas engines, but has engaged ACE's multi point NGVS so as to meet more stringent Euro 3 certification. New orders from Dongfeng are expected to ramp up from mid 2007, again moving towards 500 per month by late 2008.

In Australia, ACE will earn an 8.3% interest in Motive Energy, owned by a consortium, including Alinta and aiLimited. Motive is integrating the supply of NG vehicles with the supply of compressed natural gas infrastructure and services to commercial fleet owners.

In India, ACE is working with Vialle Alternative Fuel Systems to promote NGVS's to Swaraj Mazda and other manufacturers. Another of ACE's partners Eden Energy is promoting its alternative methane hydrogen fuel, Hythane to the Indian market where ACE's NGVS's can be adapted for use with this fuel. Five manufacturers have been identified and at least one of these is likely to choose the ACE technology over its competitors.

In Pakistan, ACE and FAW are working to export engines into this market where NG engines and the infrastructure to support them is already common. One initial trial engine has been supplied for testing during early CY2007.

In Europe, ACE's 600 Renault buses continue to generate revenue from the supply of spare parts. While the new owner of these buses has developed an in-house NGVS, the bus maker is not marketing the system and may yet return to ACE for its components.

S W O T Analysis

Strengths

STRONG MARKET GROWTH: Alternative fuels such as natural gas and Hythane™ will continue to attract interest from motor vehicle manufacturers.

STRONG PARTNERS & CUSTOMERS: ACE is working with three of China's largest engine and auto manufacturers as well as significant partners elsewhere in Asia and Europe.

MANAGEMENT AND SHAREHOLDER BACKING: ACE has strong backing from its Asian shareholders and management has recently subscribed additional funds.

TIMELY PRODUCT: The use of natural gas engines is set to rise dramatically.

PATENT PROTECTION: While the company's IP is patent protected, its customer service support and the technical complexity of its solution provides the best protection.

GROWING MARKET FOR SPARE PARTS: ACE's operational NG engines require new injectors each year.

Weaknesses

SMALL COMPANY: ACE is a small component supplier in a very big industry, which is however characterised by a wide spread of component suppliers. Once a customer makes the decision to use ACE's technology there is a considerable investment of time and money required to change supplier.

LIMITED TRACK RECORD: After several years of product design and testing, involving at least 120 million kilometres of use by Irisbus, sales are only now beginning to ramp up.

RELIANT ON SMALL CUSTOMER BASE: ACE has a small number of large customers, so failure of one could have a large impact.

Opportunities

HIGHER DIESEL COSTS: Rising fuel costs should improve the market outlook natural gas engines since gas is widely available and cheaper than diesel.

NEW APPLICATIONS: Application of natural gas for transport fuel will expand beyond use in mine vehicles and municipal bus services to general transport as refuelling infrastructure expands.

Threats

COMPETITION: There will always be competitors, however, existing NGVS's are seldom able to produce Euro 4 emission performance.

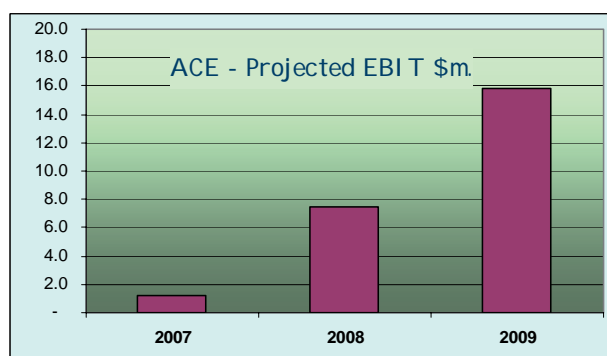
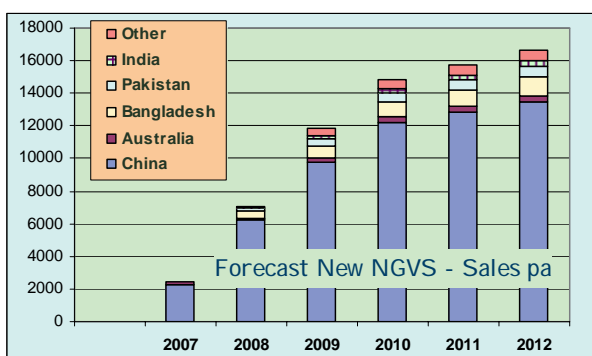
DELAYS & COST OVERRUNS: Dealing with customers in Asia can be frustrating and progress is always slower than expected.

FINANCIAL PROJECTIONS & VALUATION

ACE is presently tracking towards monthly sales of between \$500,000 and \$550,000. The company aims to achieve positive cash flow during H1, CY2007. Unit sales to FAW and Weichai are building towards a combined 350 per month by the end of FY2007. Addition of Dongfeng to the customer list during H1, CY2007 should further boost sales into FY 2008, while additional near-term prospects are being generated with partners in India, Pakistan Thailand, Myanmar, Iran, and Bangladesh and the Netherlands, which could begin to produce first sales in CY2008.

In Australia, ACE's involvement with Motive Energy is likely to result in modest sales in FY2008 with potential for firm sales post FY2009.

Strachan Corporate Estimated Sales and Projected Earning



Source: Strachan Corporate Pty Ltd

Aims for 2,200 unit sales FY'07 & ~7,000 in FY'08

Valuing a business whose projected earnings are uncertain and projected to grow swiftly, requires the comparison of several approaches. So far the company has spent over \$25 million to develop and commercialise its products. This investment would be valueless if no sales were on the basis of the products developed. So far, the company has reported sales growth, with over \$1.5 million of actual sales in the December 2006 quarter and strong expressions of interest from several customers to lift their requirements as CY2007 unfolds. If all goes to plan for the company, Strachan Corporate estimates that ACE will report a profit after tax this financial year of around \$1 million or 0.7 cps. NGVS unit sales are projected to rise substantially in FY2008 and beyond, but actual sales numbers are highly uncertain. Based on the best information available and making certain assumptions about the rate of vehicle take-up, Strachan Corporate estimates that unit sales will rise to around 7,000 in FY2008 and 12,000 in FY2009.

Based on these volume assumptions and allowing for sales of spare and replacement parts, Strachan Corporate estimates that sales should rise from around \$10 million this year to \$27 million in FY2008.

EBIT set to grow to \$7.5m FY'08

Share value estimated at 35 to 45 cps

Based on Strachan Corporate's projections and estimates for profitability, capitalising FY2008 and estimated after tax earnings by applying a multiplier of 8 times and an EV/EBIT multiple 6 times, produces value targets of between 45 and 35 cents per share respectively. Running a DCF model for the company, applying a cost of equity (discount) of 19.4% and a terminal growth, post 2012 of just 3% pa to projected free cash flow generates an NPV target share price of 63 cps.

Valuation Summary

| Method | cps | Comment |
|---------|-----|---------------------------|
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BOARD & MANAGEMENT

Non-Executive Chairman: Graham Keys

Mr Keys is a former corporate finance partner of Ernst & Young. He has experience as an Executive and Non executive Director of a number of publicly listed companies.

Managing Director: Tony Middleton

Tony has a Bachelor of Engineering and Master of Business Administration from the University of Western Australia, and a Company Directors Diploma from the University of New England. He has held senior management positions with government agencies including Chairman and Chief Executive Officer of WA transport logistics company, Transperth and also on various international engineering projects.

Non-Executive Director: Albert Pun

Albert holds a M Sc and Bachelor of Social Sciences degree from the University of Hong Kong and is a Director of Hong Kong based financial advisory company Sage Capital Limited. He is also the Chief Advisor of Hong Kong based regional investment bank, KGI Asia Limited.

Mr Pun previously worked at Morgan Stanley Asia Limited as Vice President.

Non-Executive Director: Thomas Liu

Thomas holds an MBA from the Kellogg School of Management and also dual B Sc degrees from Boston University. He is an Executive Director with a subsidiary of China Development Industrial Bank in Taiwan.

Mr Liu was previously Managing Director of 698 Capital Holdings Limited.

Non-Executive Director: William Lee

William is a Chartered Financial Analyst and Chartered Certified Accountant who holds an MBA from the Hong Kong University of Science and Technology and a Master of International and Public Affairs from the University of Hong Kong. He is a Vice President with CDIB Capital Limited, a subsidiary of China Development Industrial Bank in Taiwan.

William is previously a Director and Chief Financial Officer of 698 Capital Holdings Limited.

Chief Financial Officer: Eric Parry

Eric has over 20 years financial management experience in manufacturing, engineering and technology companies

Engine Development Manager: Barry Neumann

Barry is an engineer who has been instrumental in developing the control system, at the heart of ACE's NGVS.

Electronics Division Manager: Nathan McLaren

Nathan is a computer systems engineer who has guided the development and commercialisation of ACE's ECU.

GM AEC China: David Wang

David is a Canadian trained engineer based in Beijing. David manages the Chinese customer relations, Chinese components procurement and the Beijing office and assembly facility.

Senior Mechanical Engineer :Mike McKay

Mike is an engineer who has specialised for 30 years in the design, development and commercialisation of automotive systems and components.

Disclaimer

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