

Talking Point

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Iron ore partnerships – deal or no deal?

We view the corporate activity amongst iron ore juniors over the last few months as reflecting a number of positive factors that are likely to continue in the short term. In particular;

- It is abundantly clear that China's interest in steel making raw materials is a long term strategic imperative and the GFC related collapse in equity markets has, in most cases, made essential investments in raw material companies more attractive than would have been otherwise; &
- On the infrastructure front, there is growing confidence that, despite the long hard slog by iron ore juniors (trail blazed by FMG), RIO and BHP will ultimately haul other people's ore on their railway lines. We discussed this issue in more detail in a Talking Point dated 2 July 2009 which is available on our website.

The table below shows the various partnerships formed over the last couple of years in Western Australia based iron ore companies.

W.A. based iron ore companies – deal or no deal

Company	Code	Partner	Date	Key relationship/deal
Deal				
Feraus	FRS	China - China Railway Materials	Sep-09	\$12.6m for 12%
United Minerals	UMC	China - China Railway Materials	Sep-09	\$27.2m for 11.4% & off-take
Aquila Resources	AQA	China - Baosteel	Aug-09	\$285m for ~15%
Gindalbie Metals	GBG	China - Ansteel	Jun-09	\$162m raising. Ansteel - 36%
Fortescue Metals	FMG	China - Hunan Valin	Feb-09	\$644m for 17%
Mt Gibson	MGX	China - APAC and Shougang	Nov-08	\$162.5m for ~40% & offtake
Midwest	MIS	China - Sinosteel	late 07	Taken over by Sinosteel
Murchison Metals	MMX	Japan - Mitsubishi	Jun-07	Mitsubishi 50% project int.
Aurox	AXO	China - Hebei Iron & Steel	Mar-07	15 year off-take with two cos.
BC Iron	BCI	Deal with FMG	Jun-09	FMG earning 50% of Nullagin
No deal				
Largest shareholders				
Atlas Iron	AGO	IMC Group - 16.7%. Off-take agreements in place for 3 years.		
Australasian Res.	ARH	Clive Palmer - 59%		
Brockman Res.	BRM	Wu Nam Int. - 13.44%		
Giralia Resources	GIR	AMCI - 9.8%		
Iron Ore Holdings	IOH	Kerry Stokes - 52%		

Source: Company reports, FSB research

Of those companies without a strategic partner, we view BRM as the most likely in obtaining a partner in the short term. BRM has a 1.4bt resource right next to BHP's railway line and will require between \$705m and \$1.35b in upfront capital to construct the project according to a Pre-feasibility study completed by the company in Aug 2009.

As part of the North West Iron Ore Alliance (NWIOA), BRM is bargaining on ultimately getting its ore on either the FMG or BHP railway line to Port Hedland where the NWIOA

has been allocated 50mt of capacity. The NWIOA need to build unloading and port facilities at an estimated cost of ~\$2b. However, the recent investment of \$285m in AQA by Baosteel is sending some of the strongest signals yet that capital for ports and railways are not insurmountable hurdles for Chinese investors. **We recommend BRM as a Buy with a price target of \$3.20/share.**

IOH's landmark deal with RIO in July 2008 to sell 1.5mtpa for 6 years from its Phil's Creek project, while small, indicates the working relationship IOH has with RIO. IOH has slowly been increasing the size of its Iron Valley haematite resource, now totalling 160mt @ 59% Fe, located ~15km from RIO's Yandicoogina mine and ~15km south of BHP's railway line. **We expect negotiations between the WA State Government, RIO and BHP over State Access Agreements will result in some form of third party access.** Leading from that, we view IOH as in a box seat for negotiations given it has already established a relationship with RIO. **We recommend IOH as a Speculative Buy with a price target of \$1.40/share.** In our view, the short term catalyst for IOH is the signing of the formal sales and purchase agreement with RIO which we expect within weeks.

FRS is the latest junior to form a strategic relationship with a Chinese partner. **We view China's Railway and Materials (CRM) investment in FRS, while small in absolute terms, as very symbolic and probably the thin end of the wedge.** China's Railway and Materials is a state owned enterprise, which potentially has very deep pockets. On a non-binding basis, CRM will assist FRS in rail and infrastructure solutions as well as finance. FRS's 167mt @ 58.6% Fe haematite resources are located in the Mt. Newman region. **We recommend FRS as a Speculative Buy with a price target of \$1.00/share.**

Iron ore juniors with big plans or big partners

		BRM	IOH	FRS
Shares on issue (fully diluted)	m	140.9	135.0	168.2
Share price (close 10/9/09)	\$	1.67	0.74	0.61
Price Target	\$	3.20	1.40	1.00
Upside		92%	89%	65%
Mkt Cap	\$m	235.3	99.9	101.8
Cash	\$m	100.0	14.5	14.5
EV	\$m	135.3	85.4	87.3
Resources	Mt	1,400	173	160
EV/t	\$/t	0.10	0.49	0.55

Source: Iress, Company reports, FSB research

The short term catalyst for all three stocks is positive news on rail access developments at both a state and federal level. Additionally for BRM we see a major strategic partnership as a potential catalyst for the stock over the next six months.

While at the federal level, we don't expect to hear the results of the Australian Competition Tribunal hearing regarding access until early 2010, we may hear something from the Western Australian government regarding State Access Agreements before the end of 2009.

**Recommendation. BUY BRM, Price: \$1.67; PT: \$3.20.
BUY IOH, Price: \$0.74; PT: \$1.40.
BUY FRS, Price: \$0.605; PT: \$1.00.**

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