

Mincor Resources NL (MCR)

Recommendation: Buy

14 May 2007

Value-adding acquisition of Otter Juan Nickel Mine

- Mincor has announced (14 May) that the transaction with GMM Pty Ltd will include the Otter Juan Nickel Mine. Mincor will now acquire GMM Pty Ltd for \$68.5m in cash (plus adjustments), which includes the \$30m for the McMahon and Durkin Projects. Based on nickel prices below the current LME forward, the payback period is likely to be less than one year.
- There is valuation upside – significantly above our base valuation of \$3.27 per share – from higher forecast nickel prices and mine lives, which are likely to extend beyond 3–4 years (eg the exploration success down plunge from the N08 ore body at the Mariners Mine).
- Our recommendation has been upgraded from Hold to Buy (we had only recently downgraded!) due to the additional value from the GMM acquisition, increased likelihood of sustainable production from a portfolio of mines (Mincor's target: 20ktpa of nickel in ore), further upgrades to nickel price assumptions and consequent upgraded earnings estimates (GMM included).
- The fundamental outlook for nickel remains tight. Total inventories are extremely low and the market is likely to be in a small deficit this year. Hence, the nickel market remains vulnerable to supply disruptions. However, there also remains a risk of further stainless steel de-stocking in the months ahead, which could put downward pressure on nickel prices.
- Risks include lower nickel prices, limited mine life, plus the usual development and production risks.

Share price:	\$4.09					
52 week price range:	\$0.77-\$4.16					
Market capitalisation (\$m):	806					
Year ending 30 June	2004	2005	2006	2007	2008	2009
	Act	Act	Act	Est	Est	Est
Underlying Profit (\$m)	11.3	20.3	24.1	113.3	138.4	141.5
EPS fully diluted (c)	5.9	10.4	12.4	56.4	68.7	70.2
P/E ratio (x)	69.3	39.3	33.0	7.3	6.0	5.8
DPS (c)	1.5	3.0	5.0	12.0	15.0	15.0
Franking (%)	100%	100%	100%	100%	100%	100%
Net Yield (%)	0.4%	0.7%	1.2%	2.9%	3.7%	3.7%
<i>Assumptions</i>						
Nickel in Concentrate (kt)	8.7	10.0	13.5	13.0	15.6	19.0
\$A/US spot	0.714	0.755	0.747	0.780	0.800	0.755
LME spot nickel price (US\$/lb)	5.56	6.65	7.01	16.70	15.25	12.00

Acquisition of Otter Juan

Mincor has just announced (on 14 May) that the existing transaction with GMM Pty Ltd for the acquisition of the McMahon and Durkin Projects is to be expanded to include the operating Otter Juan Nickel Mine (refer to map and presentation slide drafted prior to 14 May announcement, page 2).

Mincor will now acquire GMM Pty Ltd for \$68.5m in cash plus adjustments for working capital; the price includes the \$30m for the McMahon and Durkin Projects as per the original transaction announced in December 2006. The price includes the surrounding exploration ground and all surface and underground equipment and infrastructure. Settlement is scheduled for 1 July 2007.

A royalty of 3% of nickel revenues will be payable to the current shareholders of GMM; no state government royalties are payable on production from either Otter Juan, or McMahon and Durkin, as they are sited on freehold land.

As a private company, GMM has had little incentive to incur the costs of maintaining an extensive Ore Reserve ahead of its mining schedule. Consequently there are currently no publishable (JORC standard) ore reserves for Otter Juan. However Mincor believes, based upon its knowledge of the ore environment, that mining at Otter Juan is likely to continue at a rate of approximately 100ktpa of ore (3,600 tonnes of nickel metal in ore) for the next three to four years, with upside potential beyond that.

Mincor sees the "combined Otter Juan, McMahon and Durkin projects as forming a major new production and exploration centre ... putting within reach our target of 20ktpa of sustainable nickel metal (in ore) production."

The deal provides Mincor with:

- **Potentially strong financial returns.** Based on nickel price forecasts by the Royal Bank of Canada (similar to Holst's forecasts through to 2009CY) and a \$A/US rate of 0.83, the first two years of mining at Otter Juan are estimated to generate a cash flow before tax of \$85m (net of all direct costs and before taking into account the acquisition cost). If the current LME forward curves for nickel are used, estimated cash flow rises to \$135m, with a payback period of less than one year;
- **Operational synergies** with Mincor's potential mine developments at McMahon and Durkin;
- **Strategic upside** through consolidation in Mincor's hands of the northern portion of the Kambalda Dome;
- **Outstanding nickel exploration potential.**

McMAHON-DURKIN PROJECT

- **\$30m transaction u/way**
- **Heart of richly-endowed Kambalda Dome**
- **28,830 tonnes nickel resource already identified**
- **Extensive existing surface and u/g infrastructure**
- **Existing offtake agreement with BHP Billiton**
- **Feasibility studies underway on two new projects – McMahon and Durkin Deeps**

Provisional Scoping Study Results:

- Two Mines;
- Each average 2,500 tonnes nickel pa;
- Each with initial four year mine life;
- Production could commence first half calendar 2008.

M I N C O R

Valuation

Our base valuation has increased to \$3.27 per share after including the GMM transaction (acknowledging that it remains subject to a number of conditions) and increasing our nickel

price assumptions (long term pricing from June half 2010 at US\$7.00/lb). There is valuation upside from higher forecast nickel prices and mine lives, which are likely to extend beyond 3-4 years - based on continuity and repetitions of ore trends.

If average nickel prices were 10% above our base case assumptions, our base case valuation would increase to \$3.84 per share.

Mincor has a relatively high sensitivity to movements in the nickel price compared to Independence Group (IGO, \$3.89, Buy) due to higher production (15ktpa nickel in ore, potentially >20ktpa; IGO: 9ktpa nickel in ore) and less hedging from 2007-08.

As at 31 March 2007, MCR had, on average, 27% of production hedged over the next two years at an average price of around A\$24,242/t (A\$11.00/lb). Currently, every US\$1.00/lb move in the average nickel price will change Mincor's revenue by \$16m (after hedging), based on production of 13kt of nickel in concentrate.

Valuation ¹ at 31/12/06	A\$m NPV/share (c)	
Operations / Projects (10% disc.)	613	305
Cash & liquid assets	87	44
Debt	-4	-2
GMM Pty Ltd acquisition cost	-69	-34
Capitalised corporate costs	-20	-10
Appraisal/Exploration assets	50	25
Valuation	658	327

¹ Pro forma valuation, assuming acquisition of GMM Pty Ltd on 31 December 2006.

Growth Strategy

Mincor's exploration and acquisition growth strategy has been focused on:

- **Near mine nickel exploration;**
- **Kambalda nickel exploration** - The terms of Mincor's long-term off-take agreement with BHP applies to any future nickel operation. BHP toll-treats the ore at its Kambalda concentrator and purchases the resulting concentrate;
- **Australian gold and base metals** - Mincor has recently secured tenements with drill ready targets for tungsten and zinc/lead in WA, copper in NSW and gold in WA, south of the Widgiemooltha Dome.
- **Global project/corporate opportunities.**

At Carnilya Hill (MCR earning 70% from View Resources), Mincor's March Quarterly Report indicated that the feasibility study is "advancing rapidly". Production is likely to commence in the March quarter 2008.

Mincor's total ore reserves as at 30 June 2006 were 1.7mt at 2.7% nickel containing 44,695 tonnes of nickel metal - 81% of nickel mined in 2005-06 was replaced from extensions to known ore bodies (up from 45% for 2004-05). Total

resources (including reserves) at 30 June 2006 were 2.0mt at 3.8% nickel for 75,831t of nickel metal (2005: 68,109t of nickel metal).

Nickel Supply/Demand Outlook (April, '07)

Extremely high spot nickel prices (now US\$23/lb) are being underpinned by strong nickel demand from the Chinese stainless-steel industry (2007 growth estimates: +20-30%), continuing limited supply growth, very low LME nickel inventories and fund activity. **A trigger for falling nickel prices would be de-stocking by stainless-steel mills, given the recent build in stainless-steel inventories in North America and Europe.** High nickel prices are also triggering a range of customer responses, including thrifting, substitution through the development of no-nickel or low-nickel stainless steels, higher stainless steel scrap supply and, in China, the use of nickel pig iron (from laterite ore sources; long term, likely to be high cost and marginal supply) to make stainless steel.

Standard & Poor's suggests that "to date, however, nickel substitution and demand destruction have been fleeting because of the technical constraints of stainless steel mills and because of end-users' limited tolerance for lower grade stainless steels. Nevertheless, current nickel prices are proving a strong incentive for customers to explore alternatives."

LME nickel stocks remain very low at around 4,200t, of which only about 3,000t is currently available for delivery given cancelled warrants are at about 30%.

Supply disruptions have been ongoing. Eramet SA, operator of the world's largest ferronickel plant, reported on 11 January that it had reduced sales to customers and used inventories to cope with a three-month-old strike that has cut its production in New Caledonia by 27% since 25 September 2006.

Stainless-steel output rose 14% in 2006 to 27.8mt, according to industry consulting company MEPS (International) Ltd. **In addition to the stronger than anticipated western world demand, rising nickel demand from Chinese stainless-steel makers is likely to remain a key driver in 2007.** Beijing based Antaika Information Development Co estimates Chinese stainless steel production rose more than 25% to 4.7mt in 2006. The growth in Chinese nickel consumption in 2006 (35kt) is likely to account for about 50% of the projected increase in global demand.

The nickel supply/demand outlook over the next two years is also likely to be tighter than previously

expected due to the delays on the two largest nickel development projects globally:

- BHP Billiton expects first metal production from the **Ravensthorpe Nickel Project** in the first quarter 2008 (originally: mid 2007);
- CVRD's announcement (24 November) that first production from the **Goro Project** will be "postponed" to 2008, rather than 2007.

Longer term, there are many potential new applications, including the further development and production of hybrid cars, each of which reportedly require about 60-70kg of nickel.

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