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The Mining Investment Experts

OZEQUITIES COMMENTARY
On Presentation

5th November, 2004 *Analyst : Warwick Grigor*

Compass Resources NL ("CMR")

"High Profit Margin Copper/Cobalt Project Approaching Commitment"

There is More to a Story Than Numbers

Sitting at this desk, I receive presentations on many projects. You would be surprised (or maybe you wouldn't) how many spivs show me projects with PEs of 1x, but these usually come with many warning bells. Compass is different however, due to the conservative nature of the directors and their high level of integrity. Whilst I have confidence in their numbers, there can be a negative side to this credibility rating. They are not particularly good share spruikers. There are many punters around that look for promotional ability as the key motivator for buying shares, but if you are actually looking for substance then CMR would be worth a closer look.

Background

Compass has been around a long time, but it has been so quiet one would be excused for having forgotten it. Its portfolio comprises a number of gold interests of varying merit, including a royalty over Alkane's 500,000 oz gold discovery in NSW, but the main asset is the lead/copper/cobalt/nickel project just south of Darwin. Lead has never been very sexy so it has been difficult to attract attention over the years. However, with the increase in demand and prices for base metals, and the acknowledgement that Browns comprises two distinct projects – oxide and sulphide – means that there is good reason to become at least a little more excited.

Oxide Resource – Copper/Cobalt/Nickel

CMR has 5.8 mill. tonnes in the top 15m overlaying the deeper sulphide ore, in three locations at Browns (measured), Area 55 (indicated) and Mt Fitch (indicated). The total in-situ resource is 55,000 t Cu, 9,300 t Co and 7,200 t Ni. Work will continue over the next four months to firm up the resource estimates and possibly add to it.

Project Parameters

A 500,000 to 1,000,000 tpa operation is being considered, but we assume the larger figure will be preferred. This is estimated to costs about $40m if there is a combination of new and second hand equipment. If the commitment is made by mid 2005, initial production could commence in the first half of 2006. Mining should be straight forward with free digging most likely in the soft oxide ore.

Heap and tank leaching operations are being assessed, but the agitated tank leach will give much better cobalt recovery, so we have assumed this is the preferred route. A conventional sulphuric acid leach process (i.e. low technical risk) is expected to achieve copper recoveries of 92% into solution, and the addition of sodium meta-bisulphate could boost cobalt recoveries towards 90%.

The SX-EW process will enable the recovery of LME deliverable copper at a rate of 10,000 tpa, while cobalt and nickel production of 1,000 tpa and 700 tpa respectively, into an hydroxide product. Payment terms for this chemical product are likely to be 70% of the contained metal value.

Favourable Profit Margins

CMR ran the numbers on copper prices of US$1.10/lb (compared with recent prices of US$1.35/lb), cobalt prices of US$12.50/lb and nickel at US$5.50/lb. Using an operating cost figure of about $25 pt, the internal numbers show a cash margin of $50m p.a. or 94¢ a share. The classic rule of thumb, that a project is very worthwhile if the payback period is less than twelve months, applies here.

Before we get too excited we need to consider capital charges and dilution from financing, as well as taxation. We need to run our own numbers to fine tune the estimated EPS, but it doesn't take much imagination to suggest that it should be in excess of 30¢ a share. Thus the prospective PE ratio may be less than 1x.

Sulphide Project The Second Leg

Beneath the oxide zone is an 82 mt resource at 0.75% Cu, 2.28% Pb, 0.12% Co and 0.11% Ni. There is the potential for a large scale, $270m development that could operate for 18 years and more at mill feed grades of 6.2% Pb, 0.7% Cu, 0.18% Co and 0.11% Ni. However, this should be seen as a separate project that needs to stand on its own merits.

We need to take the time to properly model CMR, but on a first pass view the $16m market capitalisation looks cheap. It is worthwhile following.

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