

COMPASS RESOURCES (CMR) \$0.20

Resource Junior

Recommendation: Speculative Buy

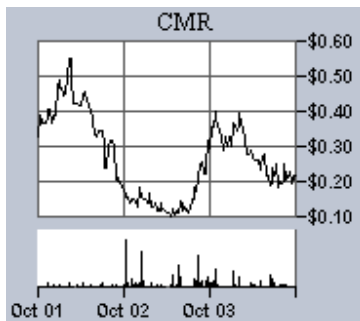
No. Shares: 54.1m* Avg. Monthly t/o: 0.6m

Mkt Cap: \$10m Initial Review

Rolling Year High: \$0.44 Low: \$0.18

Business Risk: High Price Risk: High

* Includes 0.826m partly paid shares, excludes 1m options.



Is the Perfect Storm Brewing for CMR?

In the past when writing stories on highly speculative stocks, this analyst has stressed that to be worthwhile, there must be very evident and substantial upside to justify the obvious risk. This means finding companies where order of magnitude valuation increases are a possibility. This philosophy stems from the fact that the "perfect storm" is such a rarity. In the case of resource specs, the potential for order of magnitude valuation increases must necessarily stem from geology; and the essential "perfect storm" ingredient is that rare gathering of rising commodity prices, a receptive market and positive announcements with respect to exploration and development.

CMR might have just such an order of magnitude valuation asset that one would require of a "perfect storm" investment. Largely due to lack of promotion, the company's huge Browns deposit in the Northern Territory hasn't made many headlines, but it could represent a sleeping giant. Located approximately 100km south of Darwin near Batchelor, CMR's 90% owned resources comprise 82 million tonnes of copper, lead, cobalt and nickel rich ore, the in-ground value of which at current spot prices is over A\$14 billion. If one was to ignore the obvious capital and operating cost disparity, this is equivalent in gold terms to a 25Moz orebody of 9.0g/t average grade.

Browns Resource on a 100% Basis

Resource1	Mt	%Cu	%Pb	%Co	%Ni	(US\$/t) ²
Browns	39	0.44	3.61	0.11	0.09	123
Browns East	31	1.29	1.28	0.13	0.13	144
Area 55	12	0.49	0.56	0.14	0.14	117
TOTAL	82	0.77	2.28	0.12	0.11	128

Total Metal	Kt	630	1870	98	90	\$10.5bn

1. Measured, Indicated and Inferred Resources

2. Based on spot prices for Cu - US\$1.49/lb, Pb - US\$0.46/lb, Co - US\$23.25/lb, Ni - US\$7.64/lb and gold - US\$423/oz.

The problem is that polymetallic sulphide orebodies like Browns are notoriously difficult to treat. Further, the likely ~US\$150m capital cost to develop a mine on the scale required has to date been viewed as prohibitive for a company with a market cap of around A\$10 million. There in lies the opportunity. CMR has spent over A\$12m on pre-feasibility test work including a \$4.8m R&D grant from the Commonwealth. A bulk sample pit was established in 1999 and the company successfully demonstrated cost effective high metal recoveries to a bulk sulphide concentrate followed by fluoboric acid leaching. Italian company Engitec SPA has licenced CMR to use the Flubor® technology at Browns. However, the departure in late 2002 of US partner Doe Run due to financial difficulties has seen the Browns project on hold.

Efforts have recently focused on obtaining a new JV partner and a number of international companies have reportedly expressed interest; not surprising given the current commodity price environment. CMR is working to conclude an agreement in the current quarter but has been waiting for incumbent partner, US copper major Phelps Dodge (PD), to formally withdraw. That company had a deal to target deep ore beneath the 350m deep base of the current Browns resource. A single 1.2km deep PD hole drilled last year failed to intersect economic mineralisation and the company is now expected to withdraw. CMR believes the mineralisation may have been offset by faulting and with the orebody open at depth, the potential remains to increase the resource.

Preference is for a new partner with extensive ore treatment experience. Potential for construction of concentrate handling facilities overseas could lower the capital cost and reduce operating costs. CMR reports that a 1mtpa Australian project utilising only 20% of the area's presently identified resources has an NPV of A\$220m (IRR 38%) at 7.5% discount rate whilst the project with offshore treatment of concentrate showed an NPV improvement of A\$138m. Both models use long term metal price assumptions of US\$1.10/lb Cu, US\$0.35/lb Pb, US\$12.50/lb Co and US\$4.50/lb Ni, much lower than current spot prices.

With commodities running its amazing how 'minor' details such as metallurgy and funding can miraculously vanish. If these favourable conditions persist, how long can a base metal resource of the scale of Browns be ignored, particularly against a backdrop of voracious Chinese demand for commodities?

Browns will likely have a low strip ratio due to the orebody rolling over near surface. There should also be flexibility in treatment due to metal zonation. Excellent potential exists to add additional high grade ore to the resource down dip and at new discoveries such as Mt Fitch South, 8km to the north. Latest drilling has confirmed both near surface and deep continuity of the orebody at higher grades than forecast by the resource model. At this stage, consideration is being given to a number of circuits in addition to the Flubor leach which CMR favours for the all Australian based project.

Significantly, in parallel with seeking a major strategic partner, CMR has announced it has been evaluating a low capex start-up project. If this is based on previously reported oxide resources at Browns and Area 55, then a 1mtpa operation would be expected to be sustained over a mine life of three to five years. This would be a more straight forward leach operation than that required to treat sulphide concentrates. The near surface oxide component of the orebody has an approximate in-ground value of over A\$1 billion using current spot prices but is less than 10% of the total resource. This scenario would see CMR as master of its own destiny and could lend comfort to those potential investors for whom the risks of getting a polymetallic sulphide orebody into production seem too great.

Other Projects

CMR is progressing its active gold and base metals exploration projects in NSW. In partnership with AKD, the company has also acquired the high potential Nangali gold project from Newmont in Peru. Nangali (CMR

70%, AKD 30%) is a high grade epithermal vein system which has yielded surface assays of 98.2g/t Au and 814g/t Ag. Targets are already defined with the potential believed to be 0.5-2.0Moz.

CMR has an interest, diluting to 40%, in the 160koz World Beater gold project in California with MBA Gold Corp funding feasibility work. The company also has a royalty interest in Alkane's ~500koz Wyoming project in NSW. CMR's royalty interest comprises 75 cents per dry tonne for the first 500,000 tonnes, followed by 3% of gold and other minerals recovered until 150,000oz, and 5% of gold and other minerals thereafter.

Valuation

CMR's projects in a best case 'perfect storm' scenario could deliver a share price that is many multiples of the current 20c. We have not completed a formal valuation for the company suffice it to say we are comfortable paying up to A\$27m or 50cps. This can be justified by conservatively applying an approximate value of A\$16m for Browns and its environs, A\$4m for World Beater and other projects in the Americas, A\$4.0m for the Wyoming royalty, and A\$3m for NSW exploration areas.

Conclusion

As with most resource juniors with no earnings, CMR is highly speculative and not for conservative investors. The Browns sulphide project has metallurgical complexity and must pass a feasibility study prior to meeting the next hurdle of funding. Ore grades with respect to the more heavily traded commodities of copper, lead and nickel are relatively low and the more volatile commodity cobalt is a main stay at Browns. If the wind changes and storm conditions subside, investors could find themselves marooned in what is an illiquid stock.

On the positive side, Browns is a massive resource, open for expansion, and definitely a 'perfect storm' contender. The project is well positioned with respect to ports and infrastructure and the majority of the resource is located on granted mining leases. A large amount of work has already been completed. Any fast tracking of a separate low capex start up project such as a less complex oxide project could reduce the risk. Examples of what could spur the share price into action include commitment to an early start up project, continued commodity price strength and/or the arrival of a credible sulphide JV partner. It is well known that Chinese interests are buying in to and looking for new Australian resource projects ala WPL's North West Shelf. Browns certainly has the scale to be of interest. CMR has a modest A\$1.2m in cash, but no debt and conservative management. We rate the company a 'Speculative Buy'.