

Compass Resources NL (CMR)

Monster Chinese Funding Package

Recommendation: Buy

09 May 2006

Investment Rating

CMR is focused on development of its 90%, diluting to 45%, owned Browns project in the Batchelor region of the Northern Territory. The company could be cash flow positive by 1Q07 if construction begins at its base metal oxides project in 2Q06. At 9.4Mt and growing (A\$1.5bn in-ground value), oxide resources represent less than 10% of the 84Mt total (~A\$13bn in-ground value). CMR is an opportunity to participate in realisation of considerable value at its advanced projects, royalties and exploration properties. We rate CMR as one of the highest leverage plays to an extended China driven resources boom. CMR has no earnings history, is subject to development risk and low liquidity.

Event

- CMR has signed a letter of Intent (LOI) with Hunan Nonferrous Metals Corp (Hunan) to jointly develop its Browns base metals Oxide and Sulphide resources at Batchelor in the NT. Hunan is the largest integrated producer of nonferrous metals, excluding aluminium, in China. The company will sole fund the Oxide and Sulphide projects, potentially worth \$500-600m in capital expenditure, in return for a 50% interest, reducing CMR equity from 90% to 45%. Uranium exploration and development assets are excluded. Specifically and in one of the most comprehensive deals of its type, Hunan will:-
- Take a placement of 12m CMR shares at A\$2.50ps raising \$30m;
- pay CMR for past exploration expenditure of at least \$10m;
- pay for 70% of exploration expenditure for five years and then 50% thereafter;
- pay \$60m toward capex for the Oxide project including a \$6m overrun facility; and
- subject to satisfactory engineering studies provide all capital required for base metal Sulphide development to a production level up to 4.0Mtpa.

Impact

- CMR is essentially now fully funded for any potential uranium developments and given the share price discount to valuation, remains a free call option on uranium. We retain our Buy recommendation and drop the Speculative qualification given the funding risk is substantially diminished and NT government approval of Oxides is in place.

Recommendation Impact

Unchanged.

Recommendation Trigger Guide

BUY	ACCUM	HOLD	REDUCE	SELL
\$4.00	\$4.50	\$5.85	\$7.20	

Note: Marker indicates price of \$3.35 at publication date.

Snapshot

Last Price	\$3.35
Market Cap.	\$298 million
52 Week High	\$3.47
52 Week Low	\$0.52
Shares on Issue	89.1 million
Sector	GICS - Materials

Valuation

Intrinsic Valuation	\$4.50
Note: NPV at 10% discount	

Risk

Business Risk	High
Pricing Risk	Medium
Company Beta	1.12
Sector Beta	1.39

Investment Fundamentals

Year-end Dec	FY04A	FY05A	FY06E	FY07E
NPAT (\$m)	-0.6	-1.1	1.6	53.1
EPS (¢)	-1.1	-1.7	1.4	44.5
EPS Growth (%)		50.5	-183.8	
PE Ratio (x)	-301.8	-200.6	239.3	7.5
DPS (¢)			0.0	0.0
Dividend Yield (%)	0.0	0.0	0.0	0.0
Franking (%)			0	0

Source: Aspect Huntley analyst estimates. Note: Net profit and EPS are pre-goodwill.

Price Chart



Business Description

Compass Resources NL (CMR) is a base and precious metals exploration and development company based in Australia. The company is focused on the development of the Brown's Project in the Northern Territory and exploration for copper/gold in Central New South Wales.

Event Analysis

The share placement will give Hunan a 10% stake in CMR. Both shareholder and FIRB approval will be required for the transaction overall. CMR will continue to manage the assets on behalf of the parties. The Sulphide project has previously been forecast to cost \$350m at a 2Mtpa rate. A 4.0Mtpa plant would presumably require in the vicinity of \$500m. CMR will remain debt free with respect to all its base metal developments. CMR has not yet committed its share of metal production to any party but Hunan is a very large buyer and expanding user of cobalt, a key metal in the Oxide and Sulphide projects.

The LOI is subject to completion of detailed agreements and documentation. If consummated, this appears a fabulous deal for CMR and comes on the heels of the company announcing a 40% increase in its oxide resource base to 9.4Mt. The expanded resource is close to satisfying the 10 year production target at 1Mtpa and additional oxidised resources are still to come from the Mt Fitch and Browns East deposits. The NT government recently approved development of Browns Oxide, subject to Federal government approval, expected within days. All major items of used capital equipment are secured.

We delay assumed first production from Browns Oxides from 4Q06 to early 1Q07. The delay, dilution from recent and planned capital raisings and reduced project equity lowers our FY06 earnings forecast from 6.7cps to 1.4cps, derived predominantly from interest earned on cash at bank. Dilution also lowers our FY07 forecast from 48cps to 44.5cps. The reduction has been muted by an increase in our FY07 commodity price forecasts to US\$2.45/lb copper, US\$15/lb cobalt and US\$7.26/lb nickel. We lift our CMR valuation 45% to \$4.50ps. The valuation assumes a 50% probability weighting of the Browns Sulphide project advancing to production from mid 2010. Both the Hunan deal and near certainty that the Oxide project will proceed substantially increases the chance of the Sulphide project go ahead; previously we had only applied 10% chance. Applying a 100% probability increases our valuation to \$5.65ps. Long term assumptions are US\$1.25/lb copper, US\$15/lb cobalt, US\$4.50/lb nickel, US\$0.41/lb lead, A\$/US\$ exchange rate of 0.76 and a 10% discount rate. We include \$35m or \$0.30ps for exploration and \$12m or \$0.10ps for the Wyoming royalty and Territory Iron agreement. The valuation includes nearly \$100m or \$0.84ps cash backing.

The current share price sees CMR on a prospective sub 8 times PE from FY07 on the back of the Browns Oxide project. Earnings could climb to over \$100m for a sub 5 PE from FY10 assuming a 2.0Mtpa Sulphide Project and long term prices. CMR recently dusted off the sulphide pre-feasibility citing a \$350m/2.0Mtpa conventional concentrator generates 78ktpa of lead, 18ktpa of copper, 3.15ktpa of cobalt and 2.25ktpa of nickel.

An increase in Browns Sulphide scale from our assumed 2.0Mtpa to 4.0Mtpa as flagged by CMR would generate upside. It seems a logical step given the +80Mt of resources at Batchelor. Exploration is another potential value adder with a 35,000m drill program kicking off now - three drill rigs have been secured. Most resources are open along strike and at depth. We still add no uranium specific valuation to the total. This is an area that could surprise on the upside when CMR releases its first uranium resource estimate shortly. CMR is essentially now fully funded for any potential uranium developments and given the share price discount to valuation, remains a free call option on uranium. We retain our Buy recommendation and drop the Speculative qualification given the funding risk is substantially diminished and NT government approval of Oxides is in place.

VALUATION	(%)	(\$m)	(A\$ps)
Browns Oxides	45%	244.0	2.05
Browns Sulphides	45%	283.3	1.19
Wyoming & Territory Iron		12.0	0.10
Exploration		35.0	0.29
Cash & Options Ex		102.4	0.86
TOTAL		675.6	4.50

Note: The author personally holds shares in CMR.

Profit & Loss (\$M)

	2001A	2002A	2003A	2004A	2005A
Sales Revenue	0	1	--	0	0
Total Revenue ex. Int.	2	1	0	0	0
EBITDA	0	0	0	0	-2
Depreciation & Amort.	0	0	0	0	0
Goodwill Amortisation	--	--	--	--	--
EBIT	0	0	0	0	-2
Net Interest	0	0	0	0	0
Profit Before Tax	0	0	0	0	-1
Income Tax	--	--	--	--	--
Outside Equity Int.	--	--	--	--	--
Profit after Tax	0	0	0	0	-1
Significant Items after Tax	0	--	0	0	--
Reported Profit after Tax	0	0	0	0	-1
Preferred Dividends	--	--	--	--	--

Ratios and Substantial Shareholders

	2001A	2002A	2003A	2004A	2005A
Profitability Ratios					
EBITDA Margin	% -1,014.21	-18.10	-17,329,900.00	-3,338.70	
EBIT Margin	% -1,152.33	-21.75	-17,837,376.00	-3,371.79	
Net Profit Margin	% 492.64	-7.24	-15,254,975.00	-2,535.79	
Return on Equity	% 0.28	-0.25	-0.22	-2.72	-3.16
Return on Assets	% 0.27	-0.23	-0.21	-2.64	-3.07

Debt/Safety Ratios

Net Debt/Equity	% -20.77	-6.27	-11.98	-22.38	-42.60
Interest Cover	x -297.76	-49.86	-567.07	-13,990.10	

Top 5 Substantial Shareholders

Cairnglen Investments Pty Ltd	8.6%
Wythenshawe Pty Ltd	6.8%
HMC Investors LLC	6.2%
Citadel Investment Group LLC	6.2%

Previous Research

07/03/2006	A Month to Oxides Funding?
30/11/2005	Drilling Points to Oxide Expansion
04/10/2005	Avalanche of Oxide Data and More to Come
12/08/2005	More Drill Results and Flexibility Highlighted
28/06/2005	NT Drilling Starts
05/04/2005	What's it Worth?
12/01/2005	Fresh Cash and Resources Lifted

Cash Flow (\$M)

	2001A	2002A	2003A	2004A	2005A
Receipts from Customers	0	--	--	--	--
Funds from Operations	-1	-1	0	0	0
Net Operating Cashflow	1	0	0	0	0
Capex	-4	-3	0	-1	-4
Acquisitions & Investments	0	0	--	--	0
Sale of Invest. & Subsid.	0	0	0	0	--
Net Investing Cashflow	-3	-2	0	0	-4
Proceeds from Issues	4	0	2	4	14
Dividends Paid	--	--	--	--	--
Net Financing Cashflow	4	0	2	4	14
Net Increase Cash	1	-3	1	3	10
Cash at Beginning	3	4	1	2	5
Exchange Rate Adjust.	0	0	0	0	--
Cash at End	4	1	2	5	15

Balance Sheet (\$M)

	2001A	2002A	2003A	2004A	2005A
Cash & Equivalent	4	1	2	5	15
Receivables	0	1	0	0	0
Inventories	--	--	--	--	--
Other Current Assets	0	0	0	0	0
Current Assets	4	2	2	5	16
Prop. Plant & Equipment	14	16	0	0	1
Intangibles	--	--	--	--	--
Other Non-Current Assets	0	0	0	0	0
Non-Current Assets	14	16	17	18	22
Total Assets	18	18	20	23	37
Interest Bearing Debt	0	0	0	0	0
Other Liabilities	1	1	0	1	1
Total Liabilities	1	1	0	1	1
Net Assets	17	17	19	22	36
Share Capital	22	22	24	28	42
Reserves	--	--	--	--	0
Retained Earnings	-5	-5	-5	-5	-6
Outside Equity Int.	--	--	--	--	--
Total Shareholders Equity	17	17	19	22	36

Principals & Directors**Principals**

Chairman	Mr Gordon L Toll
Company Secretary	Mr Philip Cohen

Directors

Dr John Chappell(Non-Executive Director)
Mr Philip Cohen(Director, Company Secretary, Manager, Corporate, Legal Services)
Mr Rodney David Elvish(Technical Director)
Mr Gordon L Toll(Chairman)

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