

Compass Resources NL (CMR)

Ownership Simplification Welcome

Recommendation: Buy

16 June 2006

Investment Rating

CMR is focused on development of its 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

- Simplification of Rum Jungle Project area ownership is good news. CMR will issue private company, Guardian Resources, 8.25m shares in exchange for its 10% equity in the projects. CMR will own 100% of its NT properties for the first time. The deal is value accretive with CMR paying out 6.5% of its issued capital for 10% of assets that comprise the vast majority of our valuation. Assuming the deal with Hunan Nonferrous Metals (Hunan) goes ahead, as we expect, CMR's sell down of the projects will leave it with 50%, not 45% as before.
- CMR is also more attractive to predators. In the short term a would-be acquirer may want to get in prior to consummation of the Hunan deal. In the longer term CMR will now own 100% of the uranium excluded projects. Simplification from a project management point of view is positive. The prior requirement to free carry Guardian on some exploration programs and assist in arranging its share of project finance is now removed.
- Guardian will no longer fund its share of the Oxide - \$6m and Sulphide - \$30-50m projects in addition to exploration spend. Guardian's owner, Josh Pitt, is already a major CMR shareholder. By switching into CMR he ends up with a larger stake in the company's other prospects in central and western NSW and in Peru. Whether Pitt ends up on the CMR board remains to be seen. He has highly regarded exploration and investor credentials. Throwing his lot in with CMR is already a seal of approval. CMR has flagged the possibility of further non-exec additions to the board given the rapid growth in the company.

Impact

- Our valuation increases 6% to \$5.25ps due to a combination of the value accretive Guardian transaction and an increase in assumed Sulphide mine life. Long term assumptions are US\$1.75/lb copper, US\$15/lb cobalt, US\$5.00/lb nickel, US\$0.41/lb lead, A\$/US\$ exchange rate of 0.76 and a 10% discount rate. We include \$0.27ps for exploration and \$0.10ps for the Wyoming royalty and Territory Iron agreement. We retain our Buy recommendation.

Recommendation Impact

Unchanged.

Recommendation Trigger Guide

BUY	ACCUM	HOLD	REDUCE	SELL
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\$4.75 \$5.25 \$6.85 \$8.45

Note: Marker indicates price of \$2.72 at publication date.

Snapshot

Last Price	\$2.72
Market Cap.	\$279 million
52 Week High	\$4.38
52 Week Low	\$0.69
Shares on Issue	102.4 million
Sector	GICS - Materials

Valuation

Intrinsic Valuation	\$5.25
Note: NPV at 10% discount	

Risk

Business Risk	High
Pricing Risk	Medium
Company Beta	1.09
Sector Beta	1.39

Investment Fundamentals

Year-end Dec	FY04A	FY05A	FY06E	FY07E
NPAT (\$m)	-0.6	-1.1	1.6	39.3
EPS (¢)	-1.1	-1.7	1.4	30.8
EPS Growth (%)		50.5	-183.8	
PE Ratio (x)	-245.1	-162.9	194.3	8.8
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 first of three drill rigs for the NT exploration campaign is already working at Browns East, to be followed within a week or so by a rig to target Browns Deepes. The third rig scheduled for testing uranium targets is expected in July. This

will see four rigs drilling simultaneously including one in NSW. NSW exploration is expected to begin in three weeks including drilling at Croakers, Bogan East and then Cobar look-alikes in western NSW. The NT campaign is a substantial 35,000m program. Management was highly optimistic for its potential at the recent AGM. Browns East drilling will target sulphide mineralisation above the existing resource of 30.5Mt @ 1.3%Cu, 1.3%Pb, 0.13%Co and 0.13%Ni. The second rig will initially drill three deep holes beneath the Browns deposit, about 60m deeper than the deepest mineralised hole which returned about 62m @ 12% lead. The holes will chase this higher grade core.

Federal Government approval for the Browns Oxide project, FIRB approval for the \$30m placement to Hunan, and the preliminary resource estimate Mt Fitch uranium are imminently awaited. The first uranium resource is likely to be only the start of a growing resource position. Drill results should flow aplenty given the busy exploration program.

Recent market volatility has seen CMR's price fall heavily. Panic and sentiment seem to have overridden fundamentals. Our valuation is predicated on commodity prices lower than spot. We only credit CMR with 50% of the potential value for its Sulphide project. We estimate CMR will have cash approaching \$100m or \$0.78ps after the Hunan placement and assume repayment of \$10m for past exploration expenditure. CMR will remain debt free with respect to all its base metal developments with Hunan to pay \$60m for the Oxide project, all capital for the sulphide project up to 4.0Mtpa throughput rates and 70% of exploration expenditure for five years. The strong cash balance underwrites Oxide project development independent of Hunan's involvement and affords CMR the luxury to take advantage of opportunities should they present and/or pay dividends.

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

HMC Investors LLC	11.6%
Citadel Investment Group LLC	10.0%
Cairnglen Investments Pty Ltd	8.6%
Wythenshawe Pty Ltd	6.8%

Previous Research

29/05/2006	Upgrade to Long Term Commodity Price Forecasts
09/05/2006	Monster Chinese Funding Package
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)
Dr Malcom Humphreys(Executive Director)
Mr Gordon L Toll(Chairman)

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