

Compass Resources NL (CMR)

Progress on Multiple Fronts, Timetable Slips

Recommendation: Buy

21 August 2006

Investment Rating

CMR is focused on development of its Browns project in the Batchelor region of the Northern Territory. Site clearing has begun at the base metal oxides project. First production is expected by 1H07. At 9.4Mt and growing (A\$1.5bn in-ground value), oxide resources represent just over 10% of the growing 84Mt total (~A\$13bn in-ground value). A feasibility study for a sulphide follow-up project, up to 4.0Mtpa, begins shortly. A preliminary development study on the adjacent Mt Fitch uranium project is also underway. CMR is an opportunity to participate in realisation of considerable value at its advanced projects and exploration properties. We rate the company 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 made substantial progress since our June update when it acquired Guardian's 10% stake in the NT JV properties. Environmental approvals for the Browns oxide project are in place. The project has been awarded Federal government Major Project Facilitation status. Site clearing has started and plant construction is due to begin shortly. Richard Swan, a 38 year mine engineering veteran has been appointed MD. His experience includes Vice President Operations at the Alumbreira copper/gold mine in Argentina. He will be based in Darwin to drive development and operation of the Batchelor mines. All pre wet season work necessary to avoid potential for delays should be finished in time.
- Oxide capacity has been increased 30% to 1.3Mtpa. The final capital expenditure estimate has increased to \$69m. This is largely academic for CMR given that Hunan Nonferrous Metals (Hunan) is funding. The cost to CMR, if any, is the six month slip to first production, now mid 2007. Hunan acquired a ~10% stake in CMR for \$30m after receiving FIRB approval in July. This cash is in the door. The cooperation agreement fleshing out the letter of intent for Hunan to take its 50% interest in CMR's NT base metal projects is expected to be finalised shortly.

Impact

- Assays from NSW drilling and additional uranium and copper results from the NT are expected within a couple of weeks. Any continuation of the high quality Browns East results would continue to enhance sulphide project value. Our FY07 earnings forecast declines 27% to 22.5cps on the slip in first oxide production. Our CMR valuation increases 10% to \$5.75ps and conservatively only credits 50% of our calculated value for the sulphide project. We retain the Buy recommendation. CMR has over \$80m in cash excluding past expenditure repayments and no debt.

Recommendation Impact

Unchanged.

Recommendation Trigger Guide

BUY	ACCUM	HOLD	REDUCE	SELL
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\$5.15 \$5.75 \$7.45 \$9.20

Note: Marker indicates price of \$3.72 at publication date.

Snapshot

Last Price	\$3.72
Market Cap.	\$459 million
52 Week High	\$4.38
52 Week Low	\$1.00
Shares on Issue	123.3 million
Sector	GICS - Materials

Valuation

Intrinsic Valuation \$5.75
 Note: NPV at 10% discount

Risk

Business Risk	High
Pricing Risk	Medium
Company Beta	0.90
Sector Beta	1.15

Investment Fundamentals

Year-end	FY	FY	FY	FY
NPAT (\$m)				
EPS (¢)				
EPS Growth (%)				
PE Ratio (x)				
DPS (¢)				
Dividend Yield (%)				
Franking (%)				

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

We remind readers that for its 50% interest, Hunan will refund around \$10m of past CMR expenditure, pay 70% of future base metal exploration for five years and 50% thereafter, pay up A\$72m (previously \$60m) towards oxide project capex and fund the sulphide project capex up to a throughput rate of 4.0Mtpa. As one of the largest producers of value added cemented carbides, ie tungsten tip drill bits, Hunan is a natural buyer for CMR's share of any cobalt production. We note with interest that cobalt prices are again nudging US\$20/lb on Zambian supply concerns. Timing for the sulphide feasibility study will also be decided shortly.

Exploration drilling for the 2006 field season has started - two rigs are currently operating in NT and one in NSW. Better than expected drill results to date at Browns East include 53m @ 2.25%Cu, 64g/tAg and 0.27%Co and 0.19%Ni or almost 4.0% copper equivalent. The intercept includes 15m @ 5.15%Cu. This very wide, high grade result occurs above the existing Brown East resource of 30.5Mt @ 1.3%Cu, 1.3%Pb, 0.13%Co and 0.13%Ni and to our mind reinforces the likelihood of a larger 4.0Mtpa open cut sulphide operation rather than 2.0Mtpa. High grade copper results are not new at Batchelor with past intercepts including 26m @ 5.9%Cu at 300m, beneath the old Whites open cut. CMR is waiting on a second rig to complete diamond extensions to existing Browns East holes cut short by excessive water flows. Average copper grades are likely to be higher than for Browns.

Drilling at Browns West has returned encouraging intercepts including 65m @ 2.76%Zn and 15g/tAg. It will be intriguing to see if the three zinc lenses of 5-10m thickness coalesce and increase in grade at depth, as appears to be happening. Deeper drilling beneath the Browns orebody itself has taken longer than expected, currently only at 130m depth. Results that would determine if the orebody continues to depth are keenly awaited. Shallower Mt Fitch copper oxide drilling is chasing mineralisation in a southerly direction. Any significant extensions to oxide mineralisation could be more quickly capitalised upon than for sulphides.

A preliminary uranium resource has been delineated at the Mt Fitch prospect. The indicated and inferred resource is 8.9Mt @ 1.01lb/tonne for 8.9Mlbs or 18.3Mt @ 0.79lb/tonne for 14.5Mlbs at a lower cut-off grade. Drilling in August will chase the mineralisation to the north, west and at depth. A high grade intercept of 19m @ 4.6lb/tonne occurs along the northern edge of the resource. Mt Fitch is only one of several promising prospects and has not been closed off. A preliminary development study and cost estimate for Mt Fitch uranium has begun. Processing rates up to 2Mtpa feed will be investigated with a full feasibility study likely to follow. A new uranium prospect has also been identified at Area 55 West. Previous results include 3.7m @ 2.58lb/tonne U3O8. Area 55 West validates the concept of a central uranium processing plant serving multiple orebodies in the region. That said, CMR's primary target at Rum Jungle is a Ranger type deposit (50 to 100Mlbs U3O8).

Our CMR valuation increases 10% to \$5.75ps and conservatively only credits 50% of our calculated value for the sulphide project. Applying 100% for the sulphide project increases our valuation to \$8.60ps. 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 excluding uranium and \$0.10ps for the Wyoming royalty and Territory Iron agreement. We now apply a separate \$0.40ps value for the uranium assets equivalent to \$5.00/lb of resource at the higher cut-off, in line with the market average. This value could increase rapidly given high uranium prospectivity. CMR has drilled only two prospects and has ore grade intercepts on many more. The uranium prospects represent very considerable blue sky.

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

Merrill Lynch & Co Inc	13.9%
HMC Investors LLC	11.6%
Human Nonferrous Metals Corporation Limited	9.7%
Citadel Investment Group LLC	8.3%
Wythenshawe Pty Ltd	8.1%

Previous Research

16/06/2006	Ownership Simplification Welcome
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
CEO/MD	Mr. Richard Swann
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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