

Compass Resources NL (CMR)

Oxide's All Go

Recommendation: Buy

17 October 2006

Investment Rating

CMR is focused on development of its Browns project in the Batchelor region of the Northern Territory. Construction of the base metal oxides project is underway for first production by 1H07. At 9.4Mt and growing (A\$1.5bn in-ground value), oxide resources represent just over 10% of the 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 underway. CMR is an opportunity to participate in realisation of considerable value at 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. The balance sheet is strong with exploration and development well funded.

Event

- At a time of near record prices for key Browns metals including US\$20/lb cobalt and US\$0.70/lb lead, market focus has been on the recent share price pull-back, director selling and the paucity of drill results. Is this an opportunity? We have stressed in previous reports that CMR is thinly traded and volatility can feature. Still the 20% share price retrace from \$4.99ps highs at the end of September is intriguing. It is worth remembering previous price falls including 39% to \$1.00ps in November 2005 and 47% to \$2.14ps in June of this year. On both occasions there was no apparent reason for the retrace. The current decline is once again likely a function of sentiment and profit-taking rather than the health of the company.
- Many subscribers questioned director selling from Malcolm Humphreys. He has sold another small portion of his substantial holdings and this is not the first time. He has made no secret of the fact he is reducing responsibilities to the company, increasingly taking a back seat; hence his handover of the Chairmanship to Gordon Toll and Managing Director responsibilities to Richard Swan. We see nothing particularly new or significant in this.

Impact

- Expect reporting on NT assays not yet returned. Five drill rigs are reportedly working on site in the NT and should generate considerable news flow. In a general sense there is ongoing cause for optimism with new base metals and uranium zones encountered.
- Our CMR valuation is unchanged at \$5.75ps and conservatively only credits 50% of our calculated value for the sulphide project. Applying 100% increases our valuation to \$8.60ps. We retain the Buy recommendation. CMR finished the quarter with \$75m in cash excluding an expected \$11m refund from HNC for past exploration expenditure.

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 \$4.13 at publication date.

Snapshot

Last Price	\$4.13
Market Cap.	\$510 million
52 Week High	\$4.99
52 Week Low	\$1.00
Shares on Issue	123.4 million
Sector	GICS - Materials

Valuation

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

Risk

Business Risk	High
Pricing Risk	Medium
Company Beta	0.96
Sector Beta	1.22

Investment Fundamentals

Year-end Dec	FY04A	FY05A	FY06E	FY07E
NPAT (\$m)	-0.6	-1.1	0.0	29.6
EPS (¢)	-1.1	-1.7	0.0	23.1
EPS Growth (%)	1,133.3	50.5		
PE Ratio (x)	-372.1	-247.3		17.9
DPS (¢)			0.0	0.0
Dividend Yield (%)	0.0	0.0		0.0
Franking (%)			0	0

Source: Aspect Huntley analyst estimates. Note: Actuals before 12/05 are AGAAP 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

Drill results are being held up at testing laboratories. Some drilling has been delayed. The September quarter did not include results from areas that were of particular interest, ie Browns Deeps and Browns East. Expectation for these results could explain some of the weakness.

Much of what CMR reported in its September 2006 quarterly report was covered in our August update. Since then, the Browns Oxide project has been given official go-ahead by the NT Government's Minister for Mines. Concrete pouring began early this month and relocation of second hand equipment including the ball mill and processing plant is underway. An access agreement with the NT Power and Water Corporation and the 50% JV Co-operation Agreement with Hunan Nonferrous Metals (HNC) were signed. CMR shareholders will vote on the HNC JV at a General Meeting on October 30. Foreign Investment Review Board approval is still required. Genuine progress is being made to deliver the 1.3Mtpa mine by mid 2007. Long term assumptions for our \$210m or \$1.65ps Oxide project valuation include US\$1.75/lb copper, US\$15/lb cobalt, US\$5.00/lb nickel, an A\$/US\$ exchange rate of 0.76 and a 10% discount rate. Using spot prices markedly increases the Oxide valuation to \$4.05ps.

We continue to await key exploration news. At Browns East where an excellent intercept of 52m @ 2.3%Cu, 0.5%Pb, 0.27%Co, 0.2%Ni and 65g/tAg was previously reported, follow-up RC holes could not be completed due to high water flows from cyclonic rains. The suspended holes, often just entering mineralisation, are expected to be finished later this year. A program to test mineralisation 175m below surface is also underway. Drilling was delayed at Browns Deeps due to hole deflection. One hole eventually intersected the target zone between 395m and 445m but assays aren't available yet. We keenly await results from Browns East and Browns Deeps.

Drilling at the Browns Western Extension (Zinc zone) confirmed the continuity of lower grade lead/zinc mineralisation including a best result of 65m @ 2.76%Zn, 0.7%Pb and 15g/tAg from 103m terminating in 5.9% zinc. Extensions will be tested with follow-up drilling. Results of the first 12 of 31 holes to extend the 14.5Mlb Mt Fitch uranium resource yielded a best result of 14m @ 1.3lb/t from 32m. The deposit remains open and further drilling is planned.

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	% -20.76	-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	12.9%
Human Nonferrous Metals Corporation Limited	9.7%
Merrill Lynch & Co Inc	8.9%
Citadel Investment Group LLC	8.3%
Wythenshawe Pty Ltd	8.1%

Previous Research

21/08/2006	Progress on Multiple Fronts, Timetable Slips
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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