

20 February 2009

## Buy

**Important:** The above recommendation has been made on a 12 month view and may not suit your investment needs or timeframe. The basis it is prepared on is summarised on the last page of this report. **PLEASE CONTACT YOUR ADVISER TO DISCUSS THIS GENERAL RECOMMENDATION BEFORE ACTING ON IT.**

### High Volatility

#### Target price

A\$0.30 (from A\$1.00)

#### Price

A\$0.10

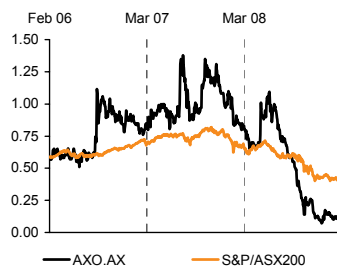
#### Short term (0-60 days)

n/a

AXO90220

### Price performance

	(1M)	(3M)	(12M)
Price (A\$)	0.15	0.13	0.80
Absolute (%)	-33.3	-20.0	-87.5
Rel market (%)	-30.6	-18.8	-79.6
Rel sector (%)	-31.8	-27.5	-68.2



#### Market capitalisation

A\$15.12m (US\$9.71m)

#### Average (12M) daily turnover

A\$0.15m (US\$0.13m)

RIC: AXO.AX, AXO AU  
 Priced at close of business 20 Feb 2009.  
 Source: Bloomberg

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# Aurox Resources

## RockCheck now just under 15%

**AXO has increased its reserve base to 207Mt and there's no doubt about the quality of Balla Balla iron ore, with RockCheck Steel (AXO's major offtaker) increasing to a 14.6% equity interest. In the current debt/equity market regime AXO is looking to optimise the value of the project and conserve its A\$28m cash.**

### Key forecasts

	FY07A	FY08A	FY09F	FY10F	FY11F
EBITDA (A\$m)	-0.76	-1.98	0.00	0.00	105.4 ▼
Reported net profit (A\$m)	-9.06	1.45	0.00 ▲	0.00 ▼	89.40 ▼
Normalised net profit (A\$m) <sup>1</sup>	-9.06	1.45	0.00 ▲	0.00 ▼	89.40 ▼
Normalised EPS (c) <sup>1</sup>	-4.50	0.71	0.00 ▲	0.00 ▼	43.60 ▼
Normalised EPS growth (%)	n/a	n/a	n/a	n/a	349.4
Dividend per share (c)	0.00	0.00	0.00	0.00	0.00
Dividend yield (%)	0.00	0.00	0.00	0.00	0.00
Normalised PE (x)	n/m	14.10	n/m	0.40	0.23
EV/EBITDA (x)	n/m	6.91	n/a	n/a	2.58
Price/net oper. CF (x)	-3.27	-1.58	-0.43	0.40	0.19 ▲
ROIC (%)	0.00	-91.6	0.00	0.00	13.60

Use of ▲ ▼ indicates that the line item has changed by at least 5%.

year to Jun, fully diluted

1. Pre non-recurring items and post preference dividends

Accounting standard: IFRS

Source: Company data, ABN AMRO Morgans forecasts

### Balla Balla magnetite – sales contract with specialty steel makers

Aurox has two 15-year sales contracts for a combined 6Mtpy of magnetite ore from 2010, increasing to a total of 10Mtpy within five years of commissioning. One of the two Chinese-based specialty steel makers, RockCheck Steel, increased its holding in AXO from 8.9% to 14.6% in the December-quarter 2008. For these specialty steelmakers, the relatively high vanadium content at Balla Balla is an important market differentiator, as they can recover the valuable vanadium from the slag. Pricing is on terms equivalent to Hamersley Premium Fines prices.

### A major reserve upgrade – but it's about finance

Reserves at Balla Balla were upgraded by 33% from 155Mt to 207.3Mt at 45.2% Fe, 0.63% V<sub>2</sub>O<sub>5</sub>, and 14.0% TiO<sub>2</sub>. The reserves are more than adequate to meet the two initial sales contracts over 15 years, and we expect the resource (downgraded from 502Mt to 437.5Mt with the increased data) to support production beyond that. Aurox will pre-pay a Port Facility Charge to export an initial 6Mtpy over the Utah Point berth, Port Hedland, with a subsequent expansion to 10Mtpy. Financing the mine development, slurry pipeline and port infrastructure is currently the greatest challenge we see for Aurox.

### Valuing Balla Balla and valuing AXO

The sales contracts and pricing confirm the attractiveness of Balla Balla magnetite project and the iron ore. Aurox has a 100% equity interest, and reports A\$28m in cash at 31 December 2008. A value for AXO is problematic, given the current debt and equity markets and sentiment. Valuing the project on an NPV basis generates A\$2.00 per share, but funding and JV options remain open, and we have set a value of A\$1.00 per share. Our target price of A\$0.30 reflects about one-third of this, with the discount a function of sentiment and uncertainty over the effects of a Rio Tinto/Chinalco tie-up.

## Company profile

Aurox has finalised two 15-year sales contracts for a combined 6Mtpy from 2010, increasing to a total of 10Mtpy within five years of commissioning, with two Chinese-based specialty steel makers, Chengde Iron and Steel and RockCheck Steel. RockCheck now holds a 14.6% interest in AXO, which is evaluating the Balla Balla magnetite iron project 110km from Port Hedland in the west Pilbara mineral field of WA. Balla Balla is a tabular body of massive vanadiferous (vanadium-bearing) titanomagnetite. It is the highest grade of its kind known in Australia and is also high grade in a world context. The resource (defined to JORC Code standards) is now 437.5Mt at 44.5% Fe and 0.65% V<sub>2</sub>O<sub>5</sub> (vanadium pentoxide).

Proved and probable ore reserves in two conceptual pit shells, defined over a 7km portion of the resource base, are 207.3Mt at 45.2% Fe and 0.63% V<sub>2</sub>O<sub>5</sub>, more than adequate to meet the two initial sales contracts. The company has secured an agreement with the Port Hedland Port Authority to export an initial 6Mtpy of magnetite ore through the Utah Point multi-user facility from 2010. The mine, plant and export infrastructure will be constructed to accommodate expansion to 10Mtpy of exports, and AXO has secured a linear stockpile at Port Hedland capable of servicing a 10Mtpy shipping operation.

## Valuation and risks

We initiated coverage of AXO with a valuation of A\$2.00 per share based on a value of a\$2.00/t of iron ore in reserves, and a target of A\$1.00 per share. We see substantial potential upside from the current AXO share price as project funding is advanced and there are ongoing increases to both resources and reserves. A current cash position of about A\$28m (January 2009) places the company in an adequate position to progress project development in the short term. We have now modelled a valuation for AXO's interest in Balla Balla based on a hypothetical joint-venture structure with a Chinese offtaker. Our discounted NPV-based valuation is A\$1.00 per share. Our target price is about one-third of our valuation, reflecting current market sentiment to the junior iron ore explorers/developers. We doubt that sentiment will change until there are at least embryonic signs of economic stability, and until the resolution of Rio Tinto's current status, with its implications for other iron ore miners.

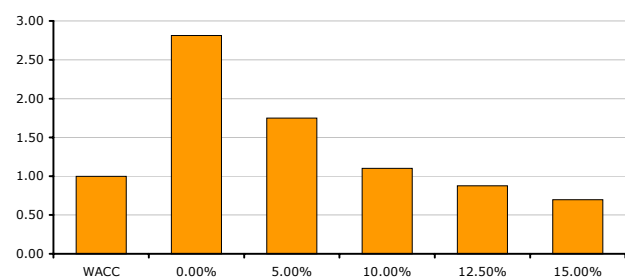
The greatest risks to our target price are largely related to achieving project financing. While the environmental approval for the slurry pipeline is yet to be finalised, the application has received the EPA chairman's sign-off and is in the final stages of departmental approval. The slurry pipeline from Balla Balla to Port Hedland is co-aligned with the DBNGP and has mitigated the risks associated with the approval of the pipeline.

As with all developments, there will be construction risk, both in terms of time and price. Longer term the project will be exposed to iron ore prices and the AUD/USD exchange rate. We see only limited resource risk and limited operational risk. Expanding capacity to the 10Mtpy case in the medium term is subject to securing the additional port capacity at Port Hedland. Indications are that this will be available at Utah Point, and the company anticipates access will be secured, but the commercial terms, structure and timing of an agreement remain uncertain and will prove critical to the realisation of longer-term value.

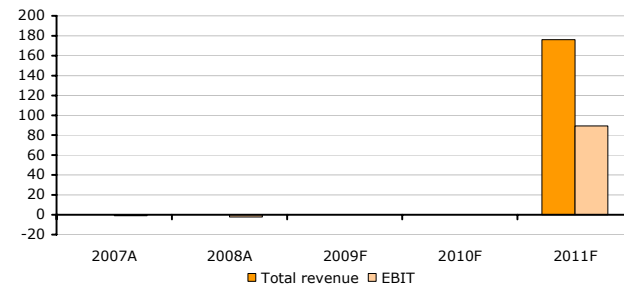
**AXO – financial summary**

Year to Jun 30	AIFRS 2007A	AIFRS 2008A	AIFRS 2009F	AIFRS 2010F	AIFRS 2011F	Price target (A\$)	0.30
<b>Income statement</b>						Valuation (A\$)	\$ 1.00
Divisional sales	0.0	0.0	0.0	0.0	176.1		
Total revenue	0.0	0.1	0.0	0.0	176.1	<b>Valuation summary</b>	<b>A\$m</b> <b>A\$ps</b> <b>DCF valuation inputs</b>
EBITDA	-0.8	-2.0	0.0	0.0	105.4	Balla Balla	197.1 0.96 Rf 6.50%
Depreciation & amortisation	-0.1	-0.1	0.0	0.0	-16.0	Exploration	19.7 0.10 Rm-Rf 4.50%
EBIT	-0.9	-2.1	0.0	0.0	89.4	Net cash	28.0 0.14 Beta 1.85
Net interest expense	0.1	1.7	0.0	0.0	0.0	Corporate	-40.0 -0.20 CAPM (Rf+Be) 14.8%
Pre-tax profit	-9.1	1.0	0.0	0.0	89.4	<b>Total valuation</b>	<b>204.8 1.00</b> Tax rate (t) 30.0%
Income tax expense	0.0	0.4	0.0	0.0	0.0		<b>WACC</b> 13.05%
After-tax profit	-9.1	1.5	0.0	0.0	89.4		Shares 205.1
Minority interests	0.0	0.0	0.0	0.0	0.0		
NPAT	-9.1	1.5	0.0	0.0	89.4	<b>Production (kt)</b>	<b>2008A 2009F 2010F 2011F</b>
Significant items	0.0	0.0	0.0	0.0	0.0	Lump sales kt	0.0 0.0 0.0 0.0
NPAT post abnormal	-9.1	1.5	0.0	0.0	89.4	Fines Sales kt	0.0 0.0 0.0 0.0
						Magnetite Sales kt conc	0.0 0.0 0.0 0.0
<b>Growth ratios</b>	<b>2007A</b>	<b>2008A</b>	<b>2009F</b>	<b>2010F</b>	<b>2011F</b>		
Sales growth	n.m	n.m	n.m	n.m	n.m	<b>Key assumptions</b>	<b>2008A 2009F 2010F 2011F</b>
Operating cost growth	n.m	n.m	n.m	n.m	n.m	USD / AUD exchange rate	0.79 0.90 0.75 0.72
						Iron ore - lump (USD/dltu)	97.51 129.46 192.13 155.63
						Iron ore - Hammersley fines (USD/dltu)	76.41 98.04 137.80 111.62
						IOC pellet price (USD/dltu)	119.27 151.07 220.86 185.98
<b>Cash flow statement</b>	<b>2007A</b>	<b>2008A</b>	<b>2009F</b>	<b>2010F</b>	<b>2011F</b>	<b>Per share data</b>	<b>2008A 2009F 2010F 2011F</b>
EBITDA	-0.8	-2.0	0.0	0.0	105.4	No. shares	205.1 205.1 205.1 205.1
Cash flow from ops (1)	-6.2	-13.0	0.0	0.0	105.4	EPS (cps)	0.7 0.0 0.0 43.6
Capex (2)	-0.2	-37.6	-75.0	-350.0	0.0	EPS (normalised) (c)	0.7 0.0 0.0 43.6
Disposals/(acquisitions)	-0.1	-1.1	0.0	0.0	0.0	Dividend per share (c)	0.0 0.0 0.0 0.0
Cash flow from invest (3)	-0.2	-38.6	-75.0	-350.0	0.0	Dividend payout ratio (%)	0.0 0.0 0.0 0.0
Incr/(decr) in equity	9.5	58.5	50.0	0.0	0.0	Dividend yield (%)	0.0 0.0 0.0 0.0
Incr/(decr) in debt	0.0	45.1	0.0	350.0	0.0		
Ordinary dividend paid	0.0	0.0	0.0	0.0	0.0	<b>Operating performance</b>	<b>2008A 2009F 2010F 2011F</b>
Other financing cash flow	-0.2	-2.4	0.0	0.0	0.0	EBIT growth	138% n.m. n.m. n.m.
Cash flow from fin (5)	9.2	101.3	50.0	350.0	0.0	NPAT growth	-116% -100% #DIV/0! #DIV/0!
Forex and disc ops (6)	0.0	0.0	0.0	0.0	0.0	Normalised EPS growth	n.m. n.m. n.m. n.m.
Incr/(decr) cash (1+3+5+6)	2.8	49.6	-25.0	0.0	105.4	Asset turnover (%)	0.0 0.0 0.0 7.7
Equity FCF (1+2)	-6.3	-50.6	-75.0	-350.0	105.4	EBITDA margin (%)	n.m. n.m. n.m. n.m.
						EBIT margin (%)	n.m. n.m. n.m. n.m.
<b>Balance sheet</b>	<b>2007A</b>	<b>2008A</b>	<b>2009F</b>	<b>2010F</b>	<b>2011F</b>	Net profit margin (%)	n.m. n.m. n.m. n.m.
Cash & deposits	4.9	54.5	29.5	29.5	118.9	Return on net assets (%)	-3.2 0.0 0.0 43.9
Trade debtors	0.1	2.0	2.0	2.0	2.0	Net debt (A\$m)	-54.4 -29.4 670.6 581.3
Inventory	0.0	0.0	0.0	0.0	0.0	Net debt/equity (%)	-84.7 -25.7 587.5 285.6
Investments	0.0	0.0	0.0	0.0	0.0	Net interest/EBIT cover (x)	1.2 n.m n.m n.m
Other intangible assets	0.0	0.0	0.0	0.0	0.0	ROIC (%)	-91.6 0.0 0.0 13.6
Fixed assets	0.3	37.1	112.1	462.1	462.1		
Other assets	1.7	32.5	32.5	32.5	32.5	<b>Comparable multiples (x)</b>	<b>2008A 2009F 2010F 2011F</b>
Total assets	6.9	126.0	176.0	526.0	615.4	Aurox Resources	EV/EBITDA
Interest bearing debt	0.2	0.1	0.1	350.1	350.1	Year to 30 Jun	PE -0.4 0.4 0.1
Trade payables	0.5	18.7	18.7	18.7	18.7	FerrAus	EV/EBITDA
Long-term borrowings	0.1	0.0	0.0	350.0	350.0	Year to 30 Jun	PE -4.2 -5.2 -0.6
Provisions	0.0	0.1	0.1	0.1	0.1	Year to 30 Jun	PE -7.4 -7.4 0.5
Other liabilities	-0.1	42.9	42.9	-307.1	-307.1	Iluka Resources	EV/EBITDA
Total liabilities	0.7	61.9	61.9	411.9	411.9	Year to 31 Dec	PE 4.5 3.4 2.3
Share capital	20.3	79.1	129.1	129.1	129.1		
Other reserves	0.0	0.0	0.0	0.0	0.0		
Retained earnings	-18.5	-20.0	-20.0	-20.0	69.4		
Total equity	6.3	64.2	114.2	114.2	203.5		
Minority interest	0.0	0.0	0.0	0.0	0.0		
Total shareholders' equity	6.3	64.2	114.2	114.2	203.5		
Total liabilities & SE	6.9	126.0	176.0	526.0	615.4		

Valuation sensitivity to discount rate (A\$/share)



Total revenues and EBIT (A\$m)



Source: Company data, ABN AMRO Morgans forecasts

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For listed property trusts (LPTs) the recommendation is based upon the target price plus the dividend yield, ie total return. A Buy implies a total return of 10% or more; a Hold 5-10%; and a Sell less than 5%.

Absolute performance, short-term (trading) recommendation: The Trading Buy/Sell recommendation implies upside/downside of 3% or more. The trading recommendation time horizon is 0-60 days.

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Subject companies: AXO.AX.

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