

## MOUNT GIBSON IRON LTD (MGX)

RESEARCH



TOLHURST

Last Price	Price Target	Sector	Risk Rating	Short term <12m	Long Term >12m
\$2.20	\$2.50	Iron Ore	MEDIUM	ACCUMULATE	HOLD

Company update	Initiating coverage
----------------	---------------------

Recommendation Change	n/a
-----------------------	-----

Target Price Change	n/a
---------------------	-----

Forecast Change	n/a
-----------------	-----

## Market Stats

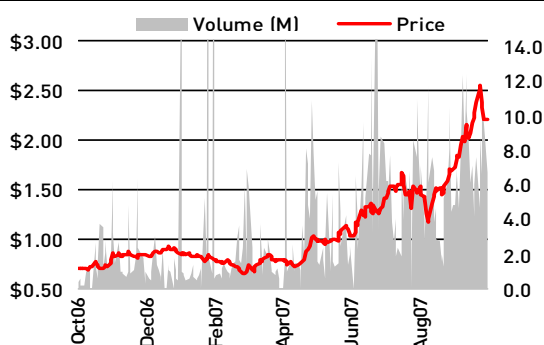
Market Capitalisation	\$m	1,744
12 Month Price Range		\$0.61 - \$2.65
Monthly Turnover	\$m	343
Monthly Volume	#m	161
% of SOI traded per month	%	20.3

Fundamentals		2007A	2008E	2009E	2010E
Net Profit	\$m	27.8	108.4	208.3	353.4
EPS	¢	4.4	13.7	26.3	44.6
EPS Growth	%	-18.0	212.6	92.1	69.7
PE	X	50.3	16.1	8.4	4.9
DPS	¢	0.0	0.0	0.0	0.0
Yield	%	0.0	0.0	0.0	0.0
Franking	%	n/a	n/a	n/a	n/a
P/CF	X	13.3	9.1	4.8	3.3
EV/EBITDA	X	40.4	9.8	5.1	2.6
ROE	%	9.9	23.0	37.1	45.3

## Forecast Returns % Return- 12 months

Forecast Price Appreciation	13.6
Expected Dividend Yield	0.0
Total Forecast Return	13.6

## Share Price Chart 1 Year



## Riding the Iron Rooster

## Thesis

Mount Gibson Iron (MGX) is a Western Australian producer of high grade hematite lump and fines iron ore products. The company has three projects and is forecasting production of 10mtpa by 2010. MGX currently has two operations in production – Talling Peak in the Midwest (3mtpa) and Koolan Island on the northern coast of WA (4mtpa). Over the next two years, it plans to develop another mine in the Midwest - Extension Hill (3mtpa).

The company has a first-mover advantage in the Midwest which provides leverage to the strong iron ore price without relying on substantial infrastructure development. MGX's portfolio of mid-sized projects also gives it a relatively simple organic growth profile and some diversification.

Management has a strong operational background and has demonstrated its ability to execute acquisitions and projects. MGX sees M&A opportunities in the core steel production inputs of iron ore and coking coal. We view this strategy as appropriate (and necessary) as the company will generate strong cash flows in the medium term and needs to extend its relatively limited mine life (each project has an expected minimum mine life of 6 – 8 years).

We also do not rule out the possibility of MGX itself becoming a target with its strong forecast cash flows, substantial development capital in the ground, undemanding pricing multiples and a large foreign shareholding. We note that Russian-backed Gazmetall recently increased its stake to 19.8% (from 17.3%) and Shougang holds 19.4% through APAC Resources.

## Valuation and Recommendation

While down from its recent high of \$2.65, MGX's share price has gained c50% in the past two months. This has been fuelled by the buoyant iron ore sector (and market generally) and increased recognition by larger brokers. **We believe the stock is no longer trading on its fundamentals, but rather on speculation of iron ore price increases, securing an M&A deal, or itself becoming a target.**

**Having said this, apart from an overall market correction, we do not see any obvious catalysts that will derail the stock in the short term.** The next round of iron ore negotiations looks increasingly bullish (especially for Australian producers) which is likely to lead to broker upgrades; we see no significant issues for MGX in stepping up production in the medium term which should provide sufficient cash flow to target M&A opportunities; and MGX's largest shareholder has recently increased its stake to 19.8%.

Our DCF valuation of \$1.68 per share assumes a 30% increase in the next round of iron ore negotiations. This may prove conservative given recent speculation of a 50%+ increase. **Our price target of \$2.50 assumes that MGX will continue to extend its mine life through M&A opportunities. Our price target is also equal to our valuation if we increase our iron ore price profile by 20% ... which is certainly possible.**

**We are initiating coverage of Mount Gibson Iron with a short-term ACCUMULATE / long-term HOLD recommendation. We will look to upgrade our recommendation on a pull-back in the share price.**



# MOUNT GIBSON IRON LTD (MGX)

RESEARCH

TOLHURST

Last Price	Price Target	Sector	Risk Rating	Short term <12m	Long Term >12m
\$2.20	\$2.50	Iron Ore	MEDIUM	ACCUMULATE	HOLD

## Profit and Loss

Y/e June 30	2007a	2008e	2009e	2010e
<b>Total Revenue</b>	<b>165.6</b>	<b>439.3</b>	<b>679.2</b>	<b>968.2</b>
<b>EBITDA</b>	<b>45.5</b>	<b>199.9</b>	<b>357.9</b>	<b>556.9</b>
Depreciation	-4.7	-37.6	-47.6	-54.1
Amortisation *	0.0	0.0	0.0	0.0
<b>EBIT</b>	<b>40.8</b>	<b>162.3</b>	<b>310.2</b>	<b>502.8</b>
Net Interest Expense	0.2	-7.5	-12.7	2.1
<b>Pre-tax profit</b>	<b>41.0</b>	<b>154.8</b>	<b>297.5</b>	<b>504.9</b>
Tax	-13.2	-46.5	-89.3	-151.5
min. int/pref divs	0.0	0.0	0.0	0.0
<b>TNL adj net profit</b>	<b>27.8</b>	<b>108.4</b>	<b>208.3</b>	<b>353.4</b>
Abnormals	20.0	0.0	0.0	0.0
<b>Reported Profit After Tax</b>	<b>47.8</b>	<b>108.4</b>	<b>208.3</b>	<b>353.4</b>

TNL adjusted NPAT from continuing operations and excludes abnormals

\* Excluding goodwill

## Cashflow

Y/e June 30	2007a	2008e	2009e	2010e
<b>Reported pre-tax profit</b>	<b>41.0</b>	<b>154.8</b>	<b>297.5</b>	<b>504.9</b>
Depn and amortisation	63.4	148.0	179.2	201.1
Tax paid	-13.2	-46.5	-89.3	-151.5
(inc)/dec in wk'q cap	13.9	-63.8	-24.0	-28.9
Other	-99.3	0.0	0.0	0.0
<b>Operating cashflow</b>	<b>5.7</b>	<b>192.5</b>	<b>363.5</b>	<b>525.6</b>
Capex	-36.8	-88.0	-80.0	-15.0
Acquisitions/investments	-37.6	0.0	0.0	0.0
Mine Development	0.0	-110.0	-80.0	-70.0
Asset Sales	54.0	0.0	0.0	0.0
Other	-0.5	0.0	0.0	0.0
<b>Investing cashflow</b>	<b>-20.9</b>	<b>-198.0</b>	<b>-160.0</b>	<b>-85.0</b>
Equity raised	2.0	0.0	0.0	0.0
Dividends paid	0.0	0.0	0.0	0.0
Net change in borrowings	0.0	0.0	0.0	0.0
Other	66.6	0.0	0.0	0.0
<b>Financing cashflow</b>	<b>68.6</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>
<b>Net change in cash</b>	<b>53.4</b>	<b>-5.5</b>	<b>203.5</b>	<b>440.6</b>

## Balance sheet

Y/e June 30	2007a	2008e	2009e	2010e
Cash	60.8	15.3	138.8	509.4
Receivables	9.8	65.9	67.9	96.8
Inventories	34.6	65.9	101.9	145.2
Other	6.1	6.1	6.1	6.1
<b>Current assets</b>	<b>111.3</b>	<b>153.2</b>	<b>314.7</b>	<b>757.6</b>
Receivables	0.0	0.0	0.0	0.0
PPE	187.8	238.2	270.6	231.5
Mine Properties	370.7	425.3	413.7	371.7
Intangibles	0.0	0.0	0.0	0.0
Other	22.7	22.7	22.7	22.7
<b>Non-current assets</b>	<b>581.2</b>	<b>686.2</b>	<b>707.0</b>	<b>625.8</b>
<b>Total assets</b>	<b>692.5</b>	<b>839.4</b>	<b>1021.7</b>	<b>1383.4</b>
Current acc. Payable	64.3	87.9	101.9	145.2
Current borrowings	98.8	98.8	98.8	98.8
Other current liabilities	1.2	4.4	6.8	9.7
<b>Total current liabilities</b>	<b>164.2</b>	<b>191.0</b>	<b>207.4</b>	<b>253.7</b>
NC borrowings	55.5	125.4	125.4	125.4
Other nc liabilities	18.5	35.1	54.3	77.5
<b>Total nc. Liabilities</b>	<b>74.0</b>	<b>160.6</b>	<b>179.8</b>	<b>202.9</b>
<b>Total Liabilities</b>	<b>238.2</b>	<b>351.6</b>	<b>387.2</b>	<b>456.5</b>
Shareholders funds	454.3	487.8	634.5	926.9

## Valuation data

Y/e June 30	2007a	2008e	2009e	2010e
Net profit adj (\$m)	27.8	108.4	208.3	353.4
EPS (c)	4.4	13.7	26.3	44.6
EPS growth (%)	-18.0	212.6	92.1	69.7
<b>P/E ratio (x)</b>	<b>50.3</b>	<b>16.1</b>	<b>8.4</b>	<b>4.9</b>
PEG ratio	-2.8	0.1	0.1	0.1
Lynch ratio	-0.4	13.2	11.0	14.1
CFPS (c)	16.5	24.3	45.9	66.3
Price/CF (x)	13.3	9.1	4.8	3.3
DPS (c) ordinary	0.0	0.0	0.0	0.0
Franking (%)	n/a	n/a	n/a	n/a
<b>Yield (%)</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>
EV/EBITDA (x)	40.4	9.8	5.1	2.6
EV/EBIT (x)	45.1	12.0	5.9	2.9
Net Debt/Equity (%)	20.6	42.8	13.5	-30.8
Tax Rate (%)	32.2	30.0	30.0	30.0

## Profitability ratios

Y/e June 30	2007a	2008e	2009e	2010e
EBITDA/Net sales (%)	29.2	45.5	52.7	57.5
EBIT/Net sales (%)	26.1	47.6	53.3	49.2
Return on assets (%)	6.6	14.2	22.4	29.4
Return on equity (%)	9.9	23.0	37.1	45.3

## Scenario Analysis

		Iron Ore Price Scenario					
		\$A	-20%	-10%	Base	10%	20%
AUD/USD Scenario	-20%	1.72	2.23	2.74	3.25	3.76	
	-10%	1.24	1.70	2.15	2.60	3.06	
	Base	0.87	1.27	<b>1.68</b>	2.09	2.50	
	10%	0.56	0.93	1.30	1.67	2.04	
	20%	0.30	0.64	0.98	1.32	1.66	

		Iron Ore Price Scenario					
		\$A	-20%	-10%	Base	10%	20%
WACC	8.5%	0.96	1.40	1.83	2.27	2.71	
	9.5%	0.91	1.33	1.75	2.17	2.60	
	10.5%	0.87	1.27	<b>1.68</b>	2.09	2.50	
	11.5%	0.82	1.21	1.61	2.00	2.39	
	12.5%	0.78	1.16	1.54	1.92	2.30	

## Key Assumptions

Y/e June 30	2007a	2008e	2009e	2010e
<b>Ore Shipped</b>				
Lump (wmt)	1,449	2,790	3,560	4,650
Fines (wmt)	1,013	3,010	4,140	5,350
<b>Total (wmt)</b>	<b>2,462</b>	<b>5,800</b>	<b>7,700</b>	<b>10,000</b>
Lump Iron Ore Price (US\$/t)	95.0	109.3	126.7	133.1
Fines Iron Ore Price (US\$/t)	78.0	87.0	98.4	104.4
AUD/USD	0.787	0.850	0.790	0.750

## Reserves / Resources

Reserves	Tonnes (mt)	Grade (%)
Tallering Peak	20.7	61.5%
Koolan IsaInd	24.8	65.0%
Extension Hill	12.1	60.7%
<b>Total</b>	<b>57.6</b>	<b>62.8%</b>
Resources	Tonnes (mt)	Grade (%)
Tallering Peak	22.1	61.7%
Koolan IsaInd	57.8	64.3%
Extension Hill	19.5	59.9%
<b>Total</b>	<b>99.4</b>	<b>62.9%</b>

## MOUNT GIBSON IRON LTD (MGX)

RESEARCH



TOLHURST

Last Price	Price Target	Sector	Risk Rating	Short term <12m	Long Term >12m
\$2.20	\$2.50	Iron Ore	<b>MEDIUM</b>	<b>ACCUMULATE</b>	<b>HOLD</b>

**Drivers / Catalysts****First Mover Advantage**

MGX has been producing Direct Shipping Ore (DSO) in the Midwest since 2004 and has established access agreements for the existing road, rail and port infrastructure. While some upgrade of Geraldton Port is required before Extension Hill commences production in 2009, MGX has few infrastructure constraints in the medium term. Given that DSO production is essentially an exercise in logistics, we view this as a key consideration.

Another advantage is early production is benefiting from the current strong iron ore prices. The majority of MGX's Midwest peers do not expect to begin meaningful production until at least 2010, making them reliant on the prevailing iron ore environment at the time. In contrast, MGX can step-up its production and take advantage of the forecast strength in the iron ore market over the medium term. The strong operating cash flows it generates can be used to develop resources, pursue acquisitions or return to shareholders.

**Mergers & Acquisitions**

MGX has indicated that it sees M&A opportunities in the core steel production inputs of iron ore and coking coal. Given the current high asset prices and MGX's strategic focus on steel production inputs, we view a merger as the most likely scenario. This would require a partner with a similar strategic view and preferably a tight register to help facilitate the deal.

Following the successful acquisition of Aztec Resources (Koolan Island) in 2006, we believe MGX has sufficient management capabilities and funding options to take on another project in the later stages of feasibility or in construction. Management has also demonstrated its commitment to low capital intensity, premium products with its sale of the Extension Hill Magnetite Project (MGX sold its 73% stake to Sinom Holdings for \$52.5 million). We believe any corporate development will be in keeping with this strategy.

**Strong Industry Dynamics**

The medium term outlook for iron ore is robust with China's rise as an industrial superpower creating a prolonged commodity growth cycle. China's influence on growth in iron ore consumption is illustrated in Figure 1.

The broadening gap between Chinese supply and demand, and time lag for the big three to ramp up production, looks set to support increasing or stable iron ore prices until at least 2009. We are forecasting increasing prices out to 2010 at which point we anticipate additional volume from the major producers. This is illustrated in Figure 2.

The company has agreements in place for 100% of life of mine production at Talling Peak and Koolan Island and 30% of forecast production for Extension Hill. Off-take agreements are based on Hamersley benchmark prices. MGX' off-take agreements are listed in the table below:

**Few infrastructure constraints in medium term**

**Currently benefiting from record high iron ore prices**

**M&A opportunities in iron ore and coking coal**

**Management capabilities and funding capacity to pursue M&A**

**China driving global iron ore consumption**

**Robust iron ore prices in medium term**

**100% of current production contracted**

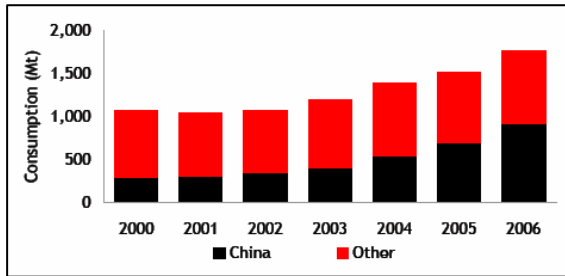
# MOUNT GIBSON IRON LTD (MGX)

RESEARCH



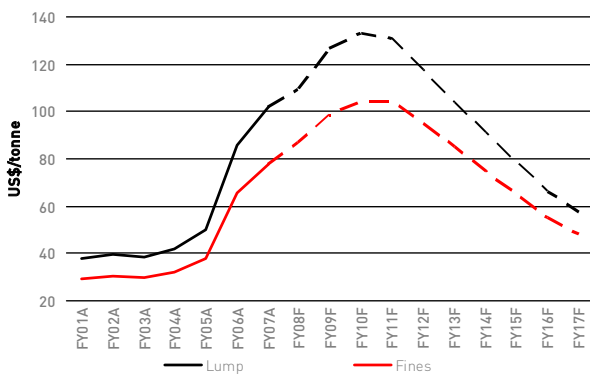
Last Price	Price Target	Sector	Risk Rating	Short term <12m	Long Term >12m
\$2.20	\$2.50	Iron Ore	<b>MEDIUM</b>	<b>ACCUMULATE</b>	<b>HOLD</b>

Figure 1: Growth in global iron ore consumption



Source: MGX

Figure 2: TNL forecast iron ore price



Source: TNL estimates

Project	Est. %	Customer	Type
Tallering Peak	25%	Rizhao Steel	steel mill
	25%	Pioneer	steel mill
	25%	Stemcor	trading company
	25%	Sinom	trading company
Koolan Island	40%	Rizhao Steel	steel mill
	40%	CITIC	trading company
	20%	Marubeni	trading company
Extension Hill	30%	Sinom	trading company

As a producer, MGX has the most leverage to this period of strong prices in the medium term. We also like management's focus on developing deposits while prices are high, which will allow lower cost production in future years and help insulate the company from any weakness in the iron ore price post 2009.

### Bulls Say

- Benefiting from current high iron ore prices
- Strong cash flows forecast for medium term
- Funding capacity and management capability to grow via M&A
- Potential takeover target

### Bears Say

- Limited mine life with expected minimum mine life of each project 6 – 8 years
- Small scale of projects makes it a high-cost producer
- Continued operating and capital cost pressures
- Share price has already run a long way

Last Price	Price Target	Sector	Risk Rating	Short term <12m	Long Term >12m
\$2.20	\$2.50	Iron Ore	<b>MEDIUM</b>	<b>ACCUMULATE</b>	<b>HOLD</b>

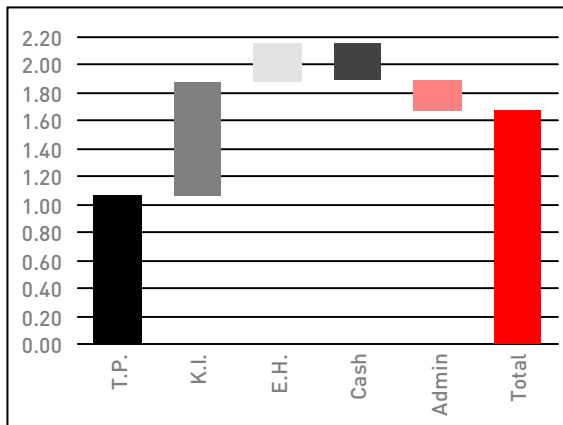
## Valuation

### DCF Method

Our DCF valuation is \$1.68 per share and assumes a WACC of 10.5%. It helps illustrate where we see the value in MGX's assets. Our DCF methodology takes into account each project's different production profile, both in terms of volume and timing.

### DCF valuation of \$1.68 per share

Figure 3: DCF valuation



Source: TNL estimates

Component	(\$ per share)
Tallering Peak	1.07
Koolan Island	0.82
Extension Hill	0.28
Net Cash	-0.26
Admin	-0.23
<b>Total</b>	<b>1.68</b>

A breakdown of our DCF valuation is illustrated in Figure 3. It is worth noting that while Tallering Peak and Extension Hill are relatively similar operations, our valuation is almost four times as much for Tallering Peak as it is currently in production and benefiting from record high iron ore prices. In contrast, Extension Hill is not forecast to reach full production until FY10, at which time we expect iron ore prices to start to decline.

### Scenario Analysis

We have included several scenarios for our iron ore price, AUD/USD and WACC assumptions. We note that some of the key iron ore price drivers are also drivers of the AUD. As such, we would expect the two variables to trend in the same direction.

	\$A	Iron Ore Price Scenario				
		-20%	-10%	Base	10%	20%
AUD/USD Scenario	-20%	1.72	2.23	2.74	3.25	3.76
	-10%	1.24	1.70	2.15	2.60	3.06
	Base	0.87	1.27	<b>1.68</b>	2.09	2.50
	10%	0.56	0.93	1.30	1.67	2.04
	20%	0.30	0.64	0.98	1.32	1.66

	\$A	Iron Ore Price Scenario				
		-20%	-10%	Base	10%	20%
WACC	8.5%	0.96	1.40	1.83	2.27	2.71
	9.5%	0.91	1.33	1.75	2.17	2.60
	10.5%	0.87	1.27	<b>1.68</b>	2.09	2.50
	11.5%	0.82	1.21	1.61	2.00	2.39
	12.5%	0.78	1.16	1.54	1.92	2.30

### Relative Value Method

#### Relative value metrics have limited use

Relative value metrics have limited use in this case as the global iron ore industry is dominated by diversified mining companies and there are no directly comparable Australian companies. However, we have included a comparison table below for completeness. As expected, MGX trades on a higher multiple than its peers as it is in production, has a high proportion of reserves relative to resources, and is the subject of corporate speculation.

Company 8-Oct-07	Price (\$)	Mkt Cap (Dil)	EV (Dil)	Current Resource		Production Targets		Stake	Resource		Reserve	
				Dil Mkt Cap / t	Dil EV / t	Start Date	Volume (mtpa)		mt	Fe%	mt	Fe%
Fortescue (FMG)	53.56	15,110	16,339	10.8	11.6	2008	60	100%	2,400	58.5%	1,053	58.5%
Midwest Corporation (MIS)	3.22	688	650	9.7	9.1	2006	2	73%	10	57.6%	8	57.7%
<b>Mount Gibson Iron (MGX)</b>	<b>2.20</b>	<b>1,771</b>	<b>1,864</b>	<b>28.4</b>	<b>29.9</b>	<b>2007</b>	<b>10</b>	<b>100%</b>	<b>99</b>	<b>62.8%</b>	<b>58</b>	<b>63.0%</b>
Murchison Metals (MMX)	4.95	2,143	2,136	18.2	18.1	2006	2	50%	380	62.0%	9	63.0%
Portman (PMM)	11.59	2,087	2,021	22.2	21.5	2005	5	100%	152	62.0%	92	62.0%
Sundance Resources (SDL)	0.78	1,503	1,479	12.8	12.6	2011	35	90%	218	60.0%		

Source: company announcements; company websites; TNL estimates; IRESS



Last Price	Price Target	Sector	Risk Rating	Short term <12m	Long Term >12m
\$2.20	\$2.50	Iron Ore	<b>MEDIUM</b>	<b>ACCUMULATE</b>	<b>HOLD</b>

**Limited mine life is the main issue**

Figure 4: Koolan Island deposits



Source: MGX

**Risks / Challenges**

**Mine Life**

The main issue for MGX in the short term is its limited mine life. We believe this is the primary driver behind management pursuing M&A opportunities in the core steel production inputs of iron ore and coking coal.

The ore bodies at Talling Peak and Extension Hill are essentially fully defined and we do not expect any significant upgrade to the resource base. There is potential to extend the Koolan Island resource through exploration of the western side of the island. This is illustrated in Figure 4. However, this region is currently subject to Native Title claims and we have not factored it into our numbers.

Based on our forecasts, which assume some conversion of resources to reserves at Koolan Island (65% conversion) and Extension Hill (90% conversion), our estimated mine life of each project is:

	Talling Peak	Koolan Island	Extension Hill
First Production	FY04	FY08	FY09
Final Production	FY13	FY17	FY15
Mine Life (years)	6	10	7

Source: TNL estimates

**Geraldton Port has been undercapitalised**

The main operational issue we see for MGX is potential bottlenecks at the Geraldton Port. Historically, lower iron ore prices required the discovery of massive resources to warrant the substantial investment infrastructure. This has been to the detriment of areas such as the Midwest where significant resources exist but not of the same magnitude of those in the Pilbara. This has resulted in Geraldton Port being undercapitalised.

**Inefficiencies at Berth 4 are being rectified**

Figure 5: Upgrade to rail unloader at Berth 4



Source: TNL

The main issue in the short-term is inefficiencies at Berth 4, which caused Talling Peak operating below capacity in FY07 and into 1H08 (annualised rate c2.3mtpa). Following a site visit, the main issue noted was the use of Berth 4 as a multi-user, multi-commodity port. This system becomes very inefficient when volume approaches capacity, as the 4.7mtpa ship loader must be changed over to accommodate different commodities such as mineral sands – this can take up to a day and a half.

This problem looks to be rectified in the short term with the Geraldton Port Authority (GPA) currently installing a new ship loader at Berth 5 which will provide 10mtpa of capacity dedicated to iron ore. This is scheduled to be operational in early 2008. In addition, the rail unloader at Berth 4 is being expanded from 4mtpa to 10mtpa as illustrated in Figure 5.

We expect MGX to increase production to above its targeted annual rate during 2H08 to help it work through its 0.3mt in excess stockpiles. The company has secured a number of rail wagons to allow for the expected increase in haulage requirements associated with the 3.5mtpa rate.

An overhead view of the Geraldton Port is shown in Figure 6.

Last Price	Price Target	Sector	Risk Rating	Short term <12m	Long Term >12m
\$2.20	\$2.50	Iron Ore	<b>MEDIUM</b>	<b>ACCUMULATE</b>	<b>HOLD</b>

Figure 6: Geraldton Port



Source: Gindalbie Metals presentation

**High cost projects and skilled labour shortages**

**Leveraged to a single commodity**

**Cost Pressures**

MGX's projects are relatively small scale at 3 – 4mtpa which makes them high cost. We expect operating costs to be an ongoing issue with the skilled labour shortage continuing to place pressure on wages. MGX is also subject to the industry-wide pressure on capex costs, although to a lesser extent than new project developers.

**Iron Ore Prices**

MGX is a pure iron ore producer and therefore leveraged to a single commodity, which carries an inherent level of risk. Major supply or demand shocks have potential to significantly alter iron ore prices over the long term. Another component of this is the AUD/USD exchange rate with benchmark prices denominated in USD.

# MOUNT GIBSON IRON LTD (MGX)

RESEARCH



Last Price	Price Target	Sector	Risk Rating	Short term <12m	Long Term >12m
\$2.20	\$2.50	Iron Ore	<b>MEDIUM</b>	<b>ACCUMULATE</b>	<b>HOLD</b>

## Major producers undertaking massive expansion programs in coming years

We believe this will become an even bigger focus as additional volume comes on stream from 2010. This is expected to be driven by the big three producers (CVRD, Rio Tinto and BHP) who are undertaking massive expansion of their hematite projects at marginal costs compared to new players. Current expansion estimates are shown in the table below:

Producer	Short Term	Long Term
CVRD	Increase to 300mtpa in 2007	Increase to 450mtpa in 2011
RIO	Increase to 220mtpa in medium term	Increase to 320mtpa in long term
BHP	Increase to 135mt in 2007	Increase to 300mtpa in long term
FMG	Targeting 45mtpa rate in 2008	Aspirations of 200mtpa in long term

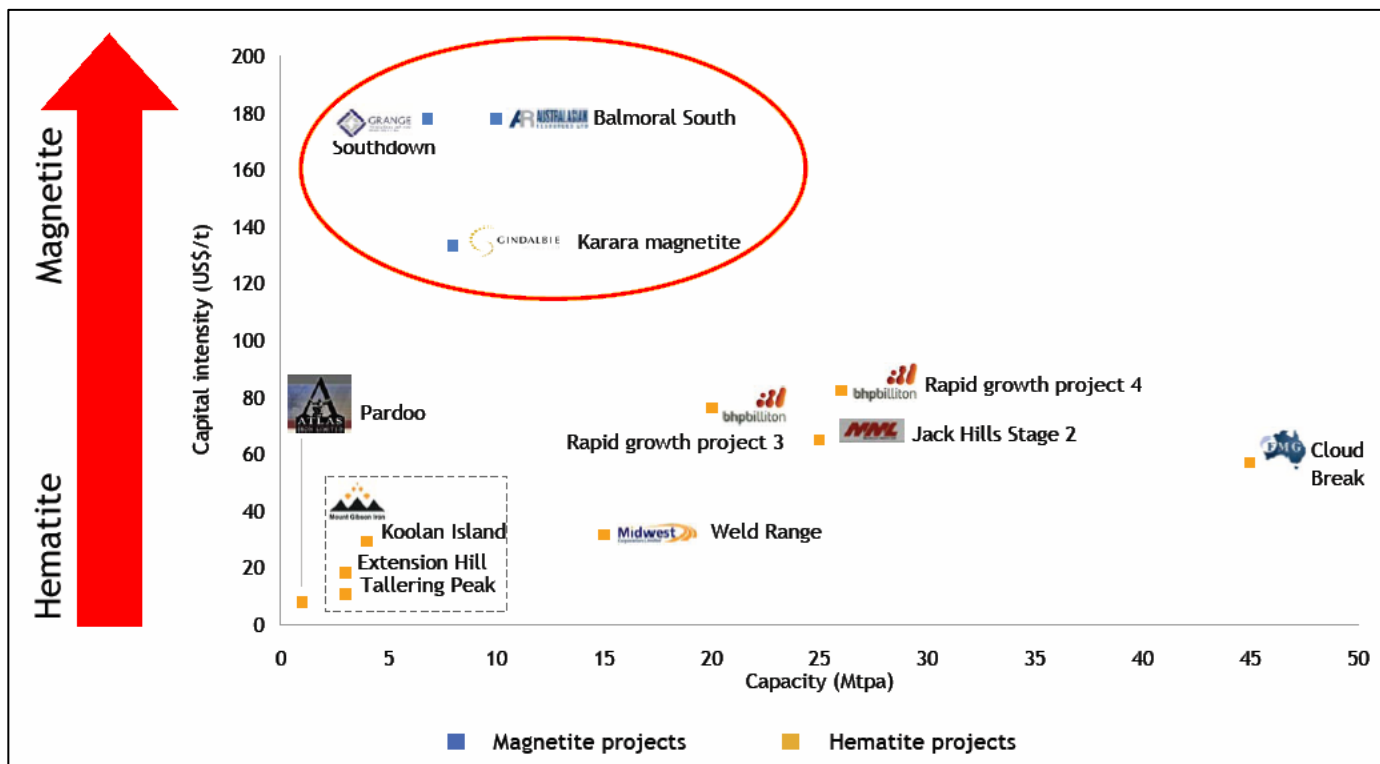
Source: AJM; company presentations

## Small scale making operating costs high

In addition, the relatively small scale of the company's projects makes the operations high cost. While this is not an issue in the current buoyant iron ore environment, if prices fall margins are likely to come under pressure as costs such as labour do not appear to be readily compressible. However, management's focus on developing deposits while prices are high is expected to allow lower cost production in future years and help insulate it from any weakness in the iron ore price post 2009.

We view this as an even bigger issue for companies developing magnetite projects which are a lot more capital intensive. This is illustrated in Figure 7.

Figure 7: Capital intensity



Source: MGX



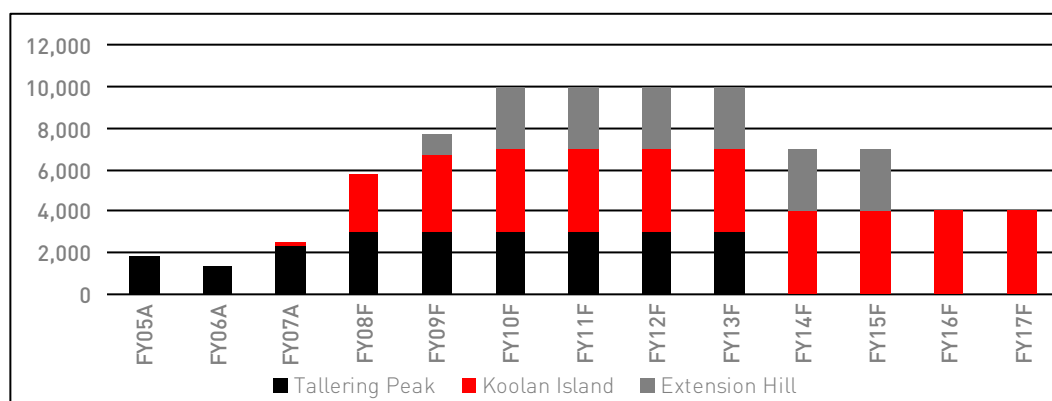
Last Price	Price Target	Sector	Risk Rating	Short term <12m	Long Term >12m
\$2.20	\$2.50	Iron Ore	<b>MEDIUM</b>	<b>ACCUMULATE</b>	<b>HOLD</b>

### Model Assumptions

Our key medium term assumptions are summarised in the table below:

	Tallering Peak			Koolan Island			Extension Hill		
	FY08	FY09	FY10	FY08	FY09	FY10	FY08	FY09	FY10
Ore Shipped (mt)	3.0	3.0	3.0	2.8	3.7	4.0	0.0	1.0	3.0
Realised Selling Price (\$/t)	73.9	91.5	101.3	76.9	84.9	94.4	n/a	86.1	95.5
Total Cost (\$/t)	44.0	44.0	44.0	44.0	44.0	44.0	n/a	45.0	40.0
Total Cost (\$/t)	44.0	44.0	44.0	44.0	44.0	44.0	n/a	45.0	40.0
Capex (\$m)	8.0	5.0	5.0	40.0	30.0	6.0	40.0	45.0	4.0
Development Capex (\$m)	0.0	0.0	0.0	50.0	50.0	50.0	60.0	30.0	20.0
Reserves (mt)	19.9 @ 61.5%			24.9 @ 65.0%			12.1 @ 60.7%		
Resource (mt)	22.1 @ 61.7%			57.8 @ 64.3%			19.5 @ 59.9%		
Resource Conversion (%)	n/a			65%			90%		
First Production	FY04			FY08			FY09		
Final Production	FY13			FY17			FY15		
Remaining Mine Life (years)	6			10			7		
Lump / Fines Split	65 / 35			30 / 70			50 / 50		
Lump Grade (%)	63.5%			65.5%			62.5%		
Fines Grade (%)	61.0%			63.0%			60.0%		
Strip Ratio (Life of Mine)	6:1			6:1			1:1		

### TNL Forecast Production Profile





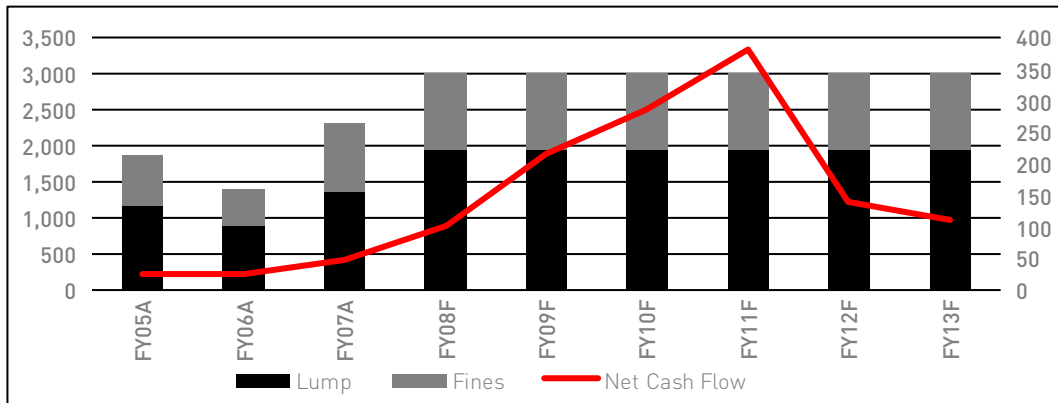
# MOUNT GIBSON IRON LTD (MGX)

RESEARCH

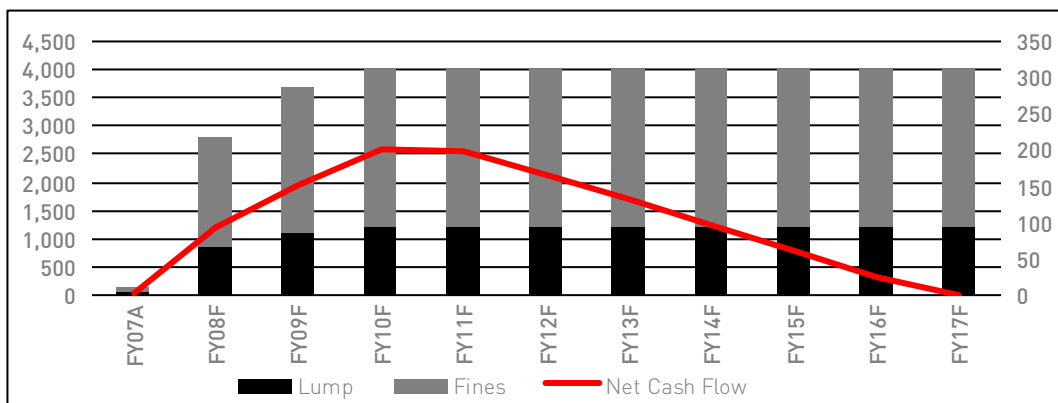
TOLHURST

Last Price	Price Target	Sector	Risk Rating	Short term <12m	Long Term >12m
\$2.20	\$2.50	Iron Ore	<b>MEDIUM</b>	<b>ACCUMULATE</b>	<b>HOLD</b>

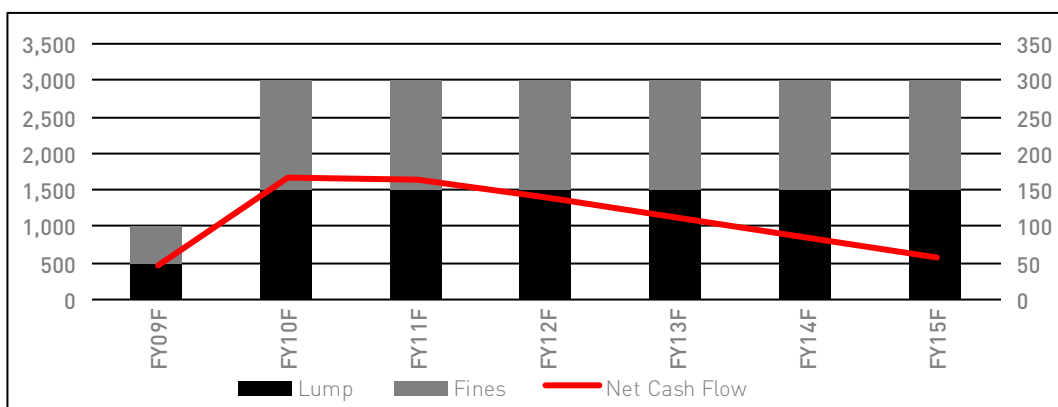
Tallering Peak – TNL Forecast Production Profile and Net Cash Flow



Koolan Island – TNL Forecast Production Profile and Net Cash Flow

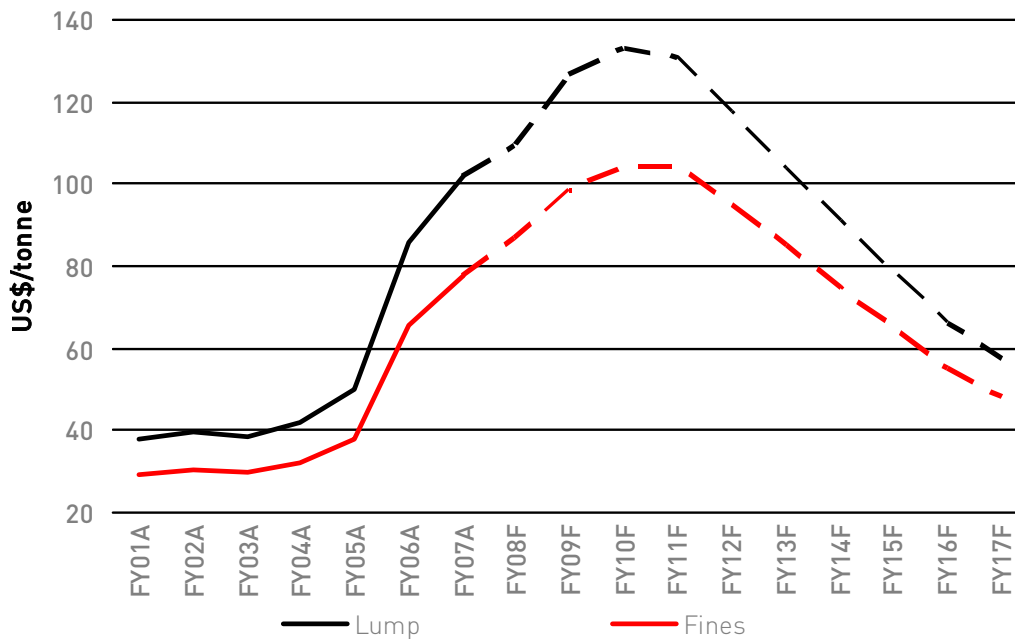


Extension Hill – TNL Forecast Production Profile and Net Cash Flow



Last Price	Price Target	Sector	Risk Rating	Short term <12m	Long Term >12m
\$2.20	\$2.50	Iron Ore	<b>MEDIUM</b>	<b>ACCUMULATE</b>	<b>HOLD</b>

## TNL Iron Ore Price Assumptions



## Valuation &amp; Recommendation

## Stock trading above fundamental valuation

While down from its recent high of \$2.65, MGX's share price has gained c50% in the past two months. This has been fuelled by the buoyant iron ore sector (and market generally) and increased recognition by larger brokers. We believe the stock is no longer trading on its fundamentals, but rather on speculation of iron ore price increases, securing an M&A deal, or itself becoming a target.

## No obvious catalysts to derail share price

Having said this, apart from an overall market correction, we do not see any obvious catalysts that will derail the stock in the short term. The next round of iron ore negotiations looks increasingly bullish (especially for Australian producers) which is likely to lead to broker upgrades; we see no significant issues for MGX in stepping up production in the medium term which should provide sufficient cash flow to target M&A opportunities; and MGX's largest shareholder has recently increased its stake to 19.8%.

## Price target \$2.50 per share

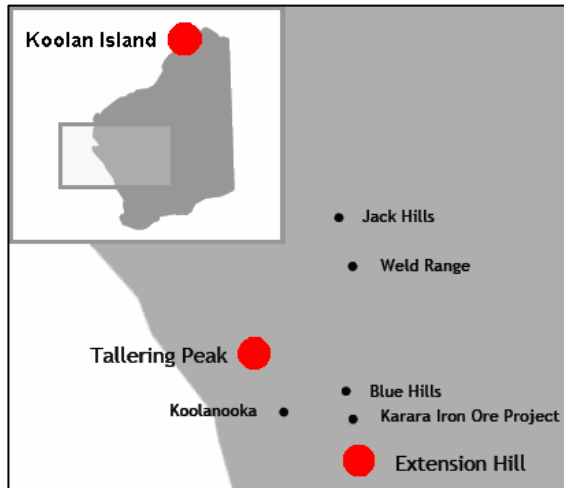
Our DCF valuation of \$1.68 per share assumes a 30% increase in the next round of iron ore negotiations. This may prove conservative given recent speculation of a 50%+ increase. Our price target of \$2.50 assumes that MGX will continue to extend its mine life through M&A opportunities. Our price target is also equal to our valuation if we increase our iron ore price profile by 20% ... which is certainly possible.

## Wait for pullback to upgrade short-term Accumulate recommendation

We are initiating coverage of Mount Gibson Iron with a short-term ACCUMULATE / long-term HOLD recommendation. We will look to upgrade our recommendation on a pull-back in the share price.

Last Price	Price Target	Sector	Risk Rating	Short term <12m	Long Term >12m
\$2.20	\$2.50	Iron Ore	<b>MEDIUM</b>	<b>ACCUMULATE</b>	<b>HOLD</b>

Figure 8: Location of projects



Source: MGX

## Company Overview

### Profile

Mount Gibson Iron (MGX) is an independent Western Australian producer of high grade hematite lump and fines iron ore products. The company has three projects and is forecasting production of 10mtpa by 2010. The location of projects is illustrated in Figure 8.

MGX currently has two operations in production – Talling Peak in the Midwest (3mtpa) and Koolan Island on the northern coast of WA (4mtpa). Over the next two years, it plans to develop another mine in the Midwest - Extension Hill (3mtpa).

The key statistics of each project are shown in the table below.

	Talling Peak	Koolan Island	Extension Hill
<b>Mining Operations</b>			
Reserves (mt)	19.9 @ 61.5%	24.8 @ 65.0%	12.1 @ 60.7%
Resource (mt)	22.1 @ 61.7%	57.8 @ 64.3%	19.5 @ 59.9%
Annual Production Target (mtpa)	3	4	3
TNL Forecast Mine Life (years)	6	10	7
MGX Expected Minimum Mine Life (years)	6	8	6
<b>Logistics</b>			
Road (km)	65	-	85
Railhead	Mullewa		Perenjori
Rail (km)	107	-	240
Port	Geraldton	Koolan Island	Geraldton

Figure 9: Talling Peak DSO mine operation including crushing and screening plant (centre)



Source: TNL

### Talling Peak

#### Assets

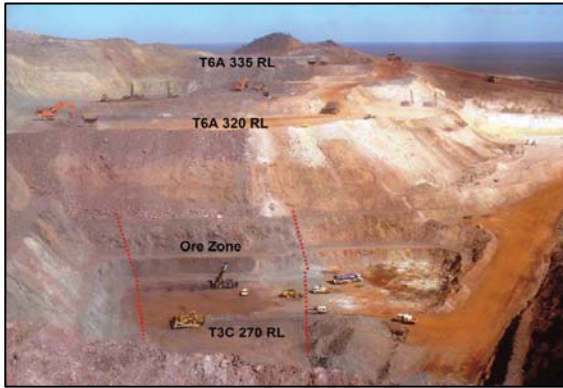
- Talling Peak DSO mine
- crushing and screening plant
- rail loading facility at Mullewa
- ore storage and loading facilities at Geraldton

The Talling Peak DSO mine operation including crushing and screening plant are illustrated in Figure 9.



Last Price	Price Target	Sector	Risk Rating	Short term <12m	Long Term >12m
\$2.20	\$2.50	Iron Ore	<b>MEDIUM</b>	<b>ACCUMULATE</b>	<b>HOLD</b>

Figure 10: Main range pits looking west (June 2007)



Source: MGX

Figure 11: Koolan Island DSO mine operation including crushing and screening plant



Source: MGX

Figure 12: Eastern pit (August 2007)



Source: MGX

### Operations

The Tallering Peak operation involves mining from several open pits (See Figure 10), which have a life of mine strip ratio of 6:1 (although the current strip ratio is 12:1). Ore is crushed and screened onsite before being loaded onto trucks for a 65km journey to Mullewa. At Mullewa the ore is transferred to wagons at a purpose-built rail loading facility then railed 107km to Geraldton. The ore is stored in a large 160,000t storage shed at Berth 4 for loading onto panamax-sized carriers for export.

### Comments

The Tallering Peak operation has ramped up to 3Mtpa production following the delivery of a new mining fleet with larger earthmoving equipment. MGX has also recently purchased an onsite crushing and screening plant from a third party contractor, which has seen a 30% improvement in throughput.

### Koolan Island

#### Assets

- Koolan Island DSO mine
- crushing and screening plant
- port loading facilities
- sea wall to isolate main mine pit and jetty

The Koolan Island DSO mine operation including crushing and screening plant are illustrated in Figure 11.

### Operations

The Koolan Island operation will initially involve mining from several outer open pits (estimated to contain 12 – 14mt of ore) while the flooded main pit is brought back into production over the next 18 months. Figure 12 illustrates the eastern pit. The life of mine strip ratio is 6:1. Ore is crushed and screened onsite before being directly loaded onto panamax-sized ships for export. No road or rail transport is required.

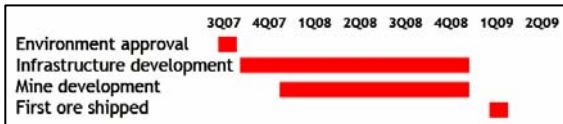
### Comments

MGX completed its 1 for 3 scrip takeover of Aztec Resources in February 2007. The main asset acquired was the high-grade Koolan Island hematite deposit which was in its final stages of development. The mine was earlier operated by BHP from 1965 – 1993 and produced almost 70mt of ore. MGX shipped its first ore in June 2007.

The installed infrastructure has a capacity of 6mtpa. MGX has identified a number of exploration targets on the unexplored western side of KI. Prior to the commencement of exploration MGX will need to reach an agreement with the traditional landowners. If MGX can gain access and increase its reserve base, production could be increased to 6mtpa without significant cost.

Last Price	Price Target	Sector	Risk Rating	Short term <12m	Long Term >12m
\$2.20	\$2.50	Iron Ore	<b>MEDIUM</b>	<b>ACCUMULATE</b>	<b>HOLD</b>

Figure 13: Extension Hill development timeline



Source: MGX

Figure 14: Rail track approaching Berth 4



Source: MGX

Figure 15: MGX's storage shed at Berth 4



Source: MGX

### Extension Hill

The development timeline for Extension Hill is outlined in Figure 13.

#### Expected Operations

The operation is expected to be very similar to Talling Peak. It will involve mining from several open pits, which have a life of mine strip ratio of 1:1 (this is lower than Talling Peak as the ore body is on the crest of a hill). Ore will be crushed and screened onsite before being loaded onto trucks for an 85km journey to Perenjori. At Perenjori the ore will be transferred to wagons at a purpose-built rail loading facility then railed 240km to Geraldton. The ore will be stored in a 260,000t storage shed at Berth 5 for loading onto panamax-sized carriers for export.

#### Comments

The planned mining tenements received approval from the Environment Minister in August 2007. MGX is currently finalising its feasibility study for Extension Hill to develop a 3mtpa DSO mine. The company is considering two project scenarios with the final choice determined by rail unloading capacity at Geraldton Port. As previously mentioned, the additional capacity is expected to be available by June 2008 if the existing unloader is upgraded or by January 2009 if a new unloader is installed. We have chosen to be conservative and have factored in the latter.

The operation has relatively low development requirements with the refurbishment of an 85km haul road to the railhead at Perenjori, construction of storage facilities at Geraldton port, and mine development the major capex items.

### Infrastructure

#### Narrow Gauge Railway

MGX is using a narrow gauge railway to transport its 3mtpa of ore from Talling Peak. The track has capacity of 14mtpa, which is expected to be sufficient for MGX's needs and all other users until the northern standard gauge railway comes online in CY11. Figure 14 illustrates the narrow gauge track approaching Berth 4 at the Geraldton Port.

#### The Geraldton Port

Berth 4 - operational

- The rail unloader adjacent to Berth 4 has capacity of 4mtpa (currently being expanded to 10mtpa) and is used by MGX and Midwest Corporation (Murchison Metals uses road haulage)
- MGX has a 160,000t storage shed to house production from Talling Peak (See Figure 15)
- The ship loader at Berth 4 has capacity 4.7mtpa and is used by MGX, Midwest and Murchison

# MOUNT GIBSON IRON LTD (MGX)

RESEARCH



<b>Last Price</b> \$2.20	<b>Price Target</b> \$2.50	<b>Sector</b> Iron Ore	<b>Risk Rating</b> <b>MEDIUM</b>	<b>Short term &lt;12m</b> <b>ACCUMULATE</b>	<b>Long Term &gt;12m</b> <b>HOLD</b>
-----------------------------	-------------------------------	---------------------------	-------------------------------------	--	---

Figure 16: Position of Berth 5 at Geraldton Port



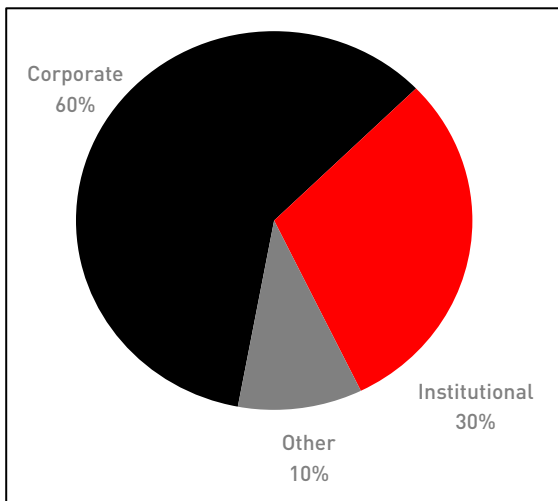
Source: Gindalbie Metals presentation

Figure 17: Berth 5 under construction



Source: TNL

Figure 18: Structure of Top 50 shareholders



Source: MGX

Berth 5 – under construction (See Figures 16 and 17)

- The WA government has committed \$35 million to upgrade Berth 5
- MGX has secured access to land behind Berth 5 for a 260,000t storage shed to house production from Extension Hill
- Geraldton Port Authority (GPA) currently installing a new ship loader at Berth 5 which will provide 10mtpa of capacity dedicated to iron ore
- This is scheduled to be operational in early 2008

### Proposed Regional Infrastructure

- Northern standard gauge railway available from beginning of CY11
- This new railway is key to the aspirations of Murchison and Midwest
- New deepwater port at Oakajee available from beginning of CY11

### Capital Structure

Cash	\$61m (as at September 2007)
Issued Capital	Shares: 792.8m Options: 12.0m

### Shareholders

MGX has a tight share register with significant Russian and Chinese interests. The Top 50 shareholders represent 70% of the total register, the majority of which is held by corporate or institutional investors. This is illustrated in Figure 18.

Russia's Gazmetall has increased its interest from 17.2% to 19.8%. Gazmetall is a steel-making enterprise with an estimated value in excess of \$20 billion. There is also significant Chinese interest on the register with APAC Resources holding 19.4%. APAC is a group of Chinese trading houses including Shougang.

### Management

Management has a strong operational background and has demonstrated its ability to execute acquisitions (Koolan Island) and projects (Extension Hill). Management has been disciplined in its development of resources and has shown a commitment to low capital intensity, premium products.

#### Luke Tonkin – MD (Appointed in Oct 05)

- 22 years experience, with management and executive roles with WMC (KNO, St Ives, Leinster, CNGC) and Sons of Gwalia.
- Multi commodity executive and operational experience

#### Alan Rule – CFO (Appointed CFO in Jun 07)

- Finance Director Jul 05 – Jun 07
- Extensive experience in financial roles and international financing of mining projects
- CFO Western Metals and St Barbara Mines

#### Neil Hamilton – Chairman (Appointed Non-Exec Chairman in April 07)

- 23 years experience as a director of publicly listed companies
- Chairman of IRESS, Integrated Group and Non-Exec of IAL
- Former Chairman of Western Power and SOG



## MOUNT GIBSON IRON LTD (MGX)

RESEARCH



Last Price	Price Target	Sector	Risk Rating	Short term <12m	Long Term >12m
\$2.20	\$2.50	Iron Ore	<b>MEDIUM</b>	<b>ACCUMULATE</b>	<b>HOLD</b>

### Tolhurst's Recommendation and Risk Rating system:

Recommendations are assessments of each Tolhurst Analyst's view of potential total returns over Short Term and/or Long Term time horizons. A Short Term time horizon is less than 12 months; a Long Term time horizon is greater than 12 months.

Expected total Return is measured as (capital gain (or loss) + dividend)/purchase price

We have divided our recommendations into four main categories:

**Buy:** Expected Total Return more than 20%

**Accumulate:** Expected Total Return between 5% - 20%

**Hold:** Expected Total Return between -5% and 5%

**Sell:** Expected Total Return less than -5%

### Risk Ratings:

Risk is a subjective assessment of overall risk within a company including price volatility and earnings variability, external liquidity, and size.

We divide our risk into three categories:

**High:** Company typically has high price volatility and earnings variability, low external liquidity and has a small market capitalisation.

**Medium:** Company typically has moderate price volatility and earnings variability, external liquidity and a medium size market capitalisation.

**Low:** Company typically has low price volatility and earnings variability, high external liquidity and is a large size market capitalisation.

### Disclosure of Interest:

Tolhurst Ltd ('Tolhurst') and/or entities and persons connected with it may have an interest in the securities the subject of the recommendations set out in this report. In addition, Tolhurst and/or its agents will receive brokerage on any transaction involving the relevant securities.

Tolhurst may seek from the company subject to this Research Report and/or their shareholders, advisory mandates or mandates for dealings in securities, and therefore may receive commissions or fees from the companies, and/or their shareholders, at some time in the future.

### Disclaimer

The information and opinions contained in this report have been obtained from sources Tolhurst believed to be reliable, but no representation or warranty, express or implied, is made that such information is accurate or complete and it should not be relied upon as such. Information and opinions contained in the report are published for the assistance of recipients, but are not relied upon as authoritative and may be subject to change without notice. Except to the extent that liability cannot be excluded, no Tolhurst Group company accepts any liability for any direct or consequential loss arising from any use of material contained in this report.

### General Advice Warning

This report is intended to provide general advice. In preparing this advice, Tolhurst did not take into account the investment objective, the financial situation and particular needs of any particular person. Before making an investment decision on the basis of this advice, you need to consider, with or without the assistance of a securities adviser, whether the advice is appropriate in light of your particular investment needs, objectives and financial circumstances.

### Analyst verification

We verify that we, Ben Kakoschke and Naji Aoukar, have prepared this research report accurately and that any financial forecasts and recommendations that are expressed are solely our own personal opinions. In addition, we certify that no part of our compensation is or will be directly or indirectly tied to the specific recommendation or financial forecasts expressed in this report.

This report has been reviewed by peers within the research department.