

Talking Point

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BRM –The infrastructure stars are aligning, BUY, PT: \$3.20

Brockman Resources' (BRM) Marillana project in W.A. contains 1.4 billion tonnes of iron ore resources virtually located on top of BHP's railway line leading directly to Port Hedland. The results of a Pre-Feasibility Study, to be released in July 09, for the production of 25mtpa for more than 20 years are expected to be very positive. In our view, the infrastructure hurdles are more surmountable than the market is currently giving the company credit for. As such, we think BRM is worth significantly more value than the ~\$60m of Enterprise Value currently being ascribed to the company.

Re-cap on Scoping Study and current status of Marillana project

Completed in March 2008, the original Marillana Scoping Study envisaged a 10mtpa project for 11 years. The Scoping Study considered using both the FMG railway line and the BHP railway line. We understand Option 1, utilising the BHP railway line, is now the preferred option. This Scoping Study had a capital cost of \$714m and an operating cost of \$29.20/t.

However, after extensive positive metallurgical testing of the detrital ore that makes up the bulk of the ore reserves, **the Pre-Feasibility Study currently being completed contemplates producing 15mtpa by 2013 and ramping up to 25mtpa by 2015.** Given the detrital ore requires limited processing, we expect the operating costs will increase above the \$30/t announced in the original feasibility study. Capital costs are also likely to be higher than those announced in the Mar 2008 Scoping Study.

While the original Scoping Study resulted in NPV's around the A\$1bn mark, we expect the Pre-Feasibility results, to be released in late Jul 2009, will enhance the project economics significantly.

Timetable of Marillana project development – 25mtpa by 2015

Milestones and Future Plans	CY 2009		CY 2010		CY 2011		CY 2012		CY 2013	
	H1	H2	H1	H2	H1	H2	H1	H2	H1	H2
Marillana Project - PFS Complete		◆								
Marillana Project - DFS Complete			◆							
EIA (Enviro Impact Assessment) Public Release		◆								
EPA Bulletin Released			◆							
Ministerial Approval				◆						
Marillana Project - Commence Construction				◆						
Marillana Project – Commence Production								◆		
Rail Access Agreement			◆							
NWIOA Port Access HOA	◆									
NWIOA Port Berth DFS Complete			◆							
NWIOA Port Berth Construction Complete										◆

Source: Company

The initial resource announced on 24 Oct 2007 was 43.5mt @ 57.6% Fe. This resource was significantly upgraded to 1.1bt @ 43% - 58% Fe in Mar 2008 and then again to 1.6bt in Aug 2008. This equates to **more than 950mt of final product grading 57 – 60% DSO and beneficiated hematite.**

Infrastructure always the key in bulks

Positive momentum on railway lines opening up continues. Despite what appears to be ongoing resistance by the major iron ore producers, increased momentum on opening up the railway lines to third parties continues.

Potential third party users of the railway lines are approaching the legal and regulatory hurdles on two main fronts. Namely through:

- the National Competition Council and the Australian Competition Tribunal, &
- the provisions of Third Party Haulage Regimes controlled at the State level

At the National level, action through the National Competition Council (NCC) has been ongoing for a number of years, initially being instigated by FMG in 2004. While the railway lines have been declared open to third party access by the Federal Government, the decisions are now subject to appeal and hearings by the Australian Competition Tribunal (ACT).

History of applications and decisions to the National Competition Council (NCC)

	Application date	Decision and date	Current status
Goldsworthy	16/11/07	Declared 27/10/08	Under review
Mt. Newman (BHP)	13/6/04	Deemed 23/5/06	Under review
Hammersley (RIO)	16/11/07	Declared 27/10/08	Under review
Robe (RIO)	18/1/08	Declared 27/10/08	Under review

Source: NCC Website, FSB research

In brief, all four railway lines are subject to a hearing by the ACT which is expected to commence on 28 Sep 2009. The hearing is expected to take 10 – 13 weeks and the ACT could take another 3 months to reach a decision. If the ACT dismisses the appeals, which in our view they will, iron ore export hopefuls have the right to negotiate access agreements. We understand that if the parties cannot reach what are commercially acceptable terms, the ACCC can then intervene. **In our view, third part access on the Pilbara railway lines is inevitable;** and despite the long process, is probably not as far off as the value ascribed to BRM would appear to suggest.

Running in parallel to the NCC course of action is the Pilbara Railways (Third Party Haulage) Regime, which can also be made enforceable under the Trade Practices Act.

Part IIIA of the Trade Practices Act sets out a number of mechanisms by which access can be obtained to infrastructure services including: (1) declaration and arbitration, (2) access undertakings and (3) certification of effective state access regimes. In W.A., the government has drafted the Pilbara Railways (Third Party Haulage) Regime with a view to having it certified under (3) above. We understand, **the purpose of the Haulage Regime is to give practical effect to the policy intent of haulage obligations that have existed with both BHP and RIO since the 1960's.** The W.A. Department of Treasury and Finance has reviewed the submissions and we understand the final copy is now in the hands of the relevant W.A Ministers for their consideration.

The State Agreements BHP and RIO have with the W.A. government date back to the 1960's. These agreements contain provisions for third party haulage of iron ore at competitive rates. In our view, **it is highly likely that such State Agreements will have to be re-written in light of the proposed BHP/RIO iron ore JV.** This will enable the W.A government to re-write the provisions of third party access into these agreements taking into consideration the interests of junior hopefuls and the prospect of higher royalties and taxes that are likely if third party rail access is freed up allowing junior producer hopefuls to get off the ground.

As to the question of whether there is actual physical capacity on the Newman railway line, most studies show there is ample capacity, especially when the line is duplicated.

As part of Rapid Growth Project 5 (RGP 5) BHP is duplicating 220km of the Newman railway line. Currently the railway line is largely single carriageway with a number of sidings and is limited to ~150mtpa. BHP's RGP 4 and 5 are expected to increase iron railed on this railway line to ~200mtpa by 2013. Studies to increase BHP's iron ore capacity to ~350 mtpa are ongoing.

Duplicating the railway line will make a step change in the capacity the line can handle from ~150mtpa to ~400mtpa (or one ~45kt train every hour of the year), not taking into account loading or unloading capacities. This still leaves 50mtpa on the railway line if BHP increased its capacity to 350mtpa. One of the key advantages for BHP in the proposed BHP/RIO iron ore JV, is that RIO's export ports are considered more amenable to expansion than Port Hedland and therefore, in our view, it is highly unlikely BHP will utilise the Newman line for future conceptual expansions to 350mtpa. **This potentially leaves significant latent capacity for third party users.** While loading and unloading capacities are currently limited, these can be overcome by new rail spurs, loops and associated materials handling facilities, albeit at a cost.

BRM is making headway on port developments at Port Hedland. **The North West Iron Ore Alliance (NWIOA) has completed a Scoping Study for two multi-user berths and associated materials handling infrastructure at Port Hedland capable of accommodating 50mtpa by 2013.** We estimate the capital cost for the NWIOA port development to be in the order of \$40 - \$50/t of capacity or \$2 - \$2.5b, and will be funded in a separate vehicle, which will be partially financed by the NWIOA members. While we concede such a large capital development and the associated required financing does pose a risk to the viability of BRM's Marillana project, we suspect BRM's new substantial shareholder, the Hong Kong based Wu Nam International Holdings Ltd, which holds 14.33% of BRM, does not believe this to be a show stopper.

Location of proposed multi-user berths for the NWIOA



Source: Company

Valuation

We have modelled BRM ramping up to 25mtpa by 2015 and assumed capital cost and operating costs of \$1.2b and \$40/tonne FOB respectively. Using long term prices of \$0.95/Fe unit and \$0.82/Fe unit for lump and fines respectively and an AUD/USD exchange rate of 0.75, **the Marillana project potentially generates an annual EBITDA of close to \$650m, has a current valuation of ~\$12.00/share, and an IRR of greater than 30%.** The capital cost of the port is not included in the analysis above, but is included as part of the operating cost of the port handling fees.

While the project is in the early stages of development, the progress to date BRM has made on rail access and port development is very positive. **We expect to hear further encouraging announcements on rail access early next year.** In anticipation of positive news on this front, **a nearer term catalyst for the stock could be further corporate activity, either at the parent level or a sale in a minority stake in the**

project. Encouraging Pre-Feasibility Study results in July 09 may also act as a short term catalyst for the stock.

BRM has ~\$100m in cash, no debt and a Market Capitalisation of ~ \$160m. Despite the risks, we don't believe the risk/reward profile reflects the current progress and position of the Marillana project and believe the company will significantly re-rate over the next 12 months. **We have set our 12 month price target to \$3.20/share, reflecting a 75% discount to our one year forward DCF based valuation.**

Recommendation. BUY BRM (Price: \$1.20; SPT: \$3.20)

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