

Metals & Mining

DMC Mining

BUY

Initiation – Low-ball Bid from CLIO

25 March 2010

Upcoming events

First results from drilling campaign (2Q10)
Ongoing drilling results (2010)

Price (A\$)	0.39
Target price (A\$)	0.94
Ticker (ASX)	DMM
Market cap (A\$m)	33.1
Cash (A\$m)	3.0
Debt (A\$m)	-
Attrib resource (Mt Fe)	26.5
Attrib reserve (Mt Fe)	-
EV/Resource (US\$/t Fe)	1.15
EV/Reserve (US\$/t Fe)	-
52-week price high (A\$)	0.39
52-week price low (A\$)	0.07
3M-avg daily vol (000)	255
3M-avg daily val (A\$000)	0.86
Shares basic (m)	78.9
Shares fully diluted (m)	90.2
Top shareholders (%)	
Cape Lambert Iron Ore	36.3
Project vendors	9.5
Directors and management	7.3
Total	53.1

Share Price Performance (A\$)



Source: Bloomberg

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DMC is a small-cap that we are confident will outperform on the basis of a major JORC resource upgrade this year. *We expect a maiden itabarite resource of over 250Mt, potentially this year, with the investment case further underpinned by access to existing rail for a DSO operation. A bid of A\$0.40 from Cape Lambert Resources is a testament to asset quality, but massively undervalues the company.*

Table 25: DMC Mining’s Resources

Asset	Resource	Interest	CY10 production
Mayoko, Republic of Congo	33.1Mt at 55.5% Fe	80%	-

Source: Ambrian estimates

DMC’s core asset is an 80% interest in the Mayoko Iron Ore Project in the Republic of Congo (ROC). Historic drilling has identified an inferred resource of 33.1Mt at 55.5% Fe within the licence area. Based on a high-resolution geophysical survey and field mapping, the company has released a target of 0.9-1.3Bt itabirite iron ore at 35-45% Fe, and we think over 250Mt could be reached in 12-18 months.

Having recently visited the site, we are confident the highly-anticipated results from the company’s first drilling campaign will impress and validate the iron ore target identified by geophysics. The drilling campaign commenced in December 2009, with 2,500m of drilling planned across the 7km Mt Lekoumou-Mipoundi magnetic anomaly. Initial results are expected in 2Q10 and should enable a JORC resource later in the year.

The main reason we like the project (in addition to its potential size) is its excellent access to existing infrastructure, something most of its African (and Australian) peers do not have. An existing railway line capable of transporting 11Mtpa passes within 3km of the deposit, which connects to the deepwater port of Pointe Noire. This should enable faster and cheaper development of the project vs. junior peers.

Recommendation – BUY; Target Price A\$0.94

A scoping-study was released in 2008 based on a 3Mtpa DSO operation rising to an 11Mtpa expansion scenario. We base our valuation on this, applying a 0.25x NAV multiple to the DSO operation to reflect the early-stage nature of the project and 0.10x NAV to the expansion case. This results in a risked NAV of A\$74.14m, or A\$0.94/share, over 2x the current share price. On this basis we initiate coverage with a BUY recommendation and a A\$0.94 target price.

Table 26: Financial Forecasts

Yr to Jun	2010E	2011E	2012E	2013E	2014E
Iron ore sold (000t)	-	-	-	530	2,100
Sales (A\$m)	-	-	-	55.94	208.69
EBITDA (A\$m)	(3.20)	(3.20)	(3.20)	35.13	134.83
Income (A\$m)	(3.15)	(3.32)	(4.94)	(4.44)	43.40
EPS (A¢)	(0.04)	(0.04)	(0.06)	(0.06)	0.55
P/E (x)	-	-	-	-	0.7
EV/EBITDA (x)	-	-	-	8.1	1.5

Source: Company data, Ambrian estimates

Figure 33: Rail Access



Source: DMC Mining

Figure 34: Existing Rail



Source: Ambrian, March 2010

Asset Summary

DMC Mining is essentially a one-asset company, entirely focused on drilling out the Mayoko iron ore deposit in Congo Brazzaville. The company released an initial JORC resource for the hematite cap only based on historic drilling, and is now focusing on drilling to define a much larger resource on the underlying iron ore. Lying only 3km from an existing rail line, the intention is to start up with a DSO operation, followed by a larger hard-rock operation.

Takeover offer – On 23 March 2010 Cape Lambert announced a takeover offer of A\$0.40/share. This comes weeks after initial drilling has tested the geophysical target, but before the company has had a chance to release assay results. In our view, the bid is clearly opportunistic, and we see immediate value in the company, some 30% in excess of the last bid price.

Table 27: Key Assets

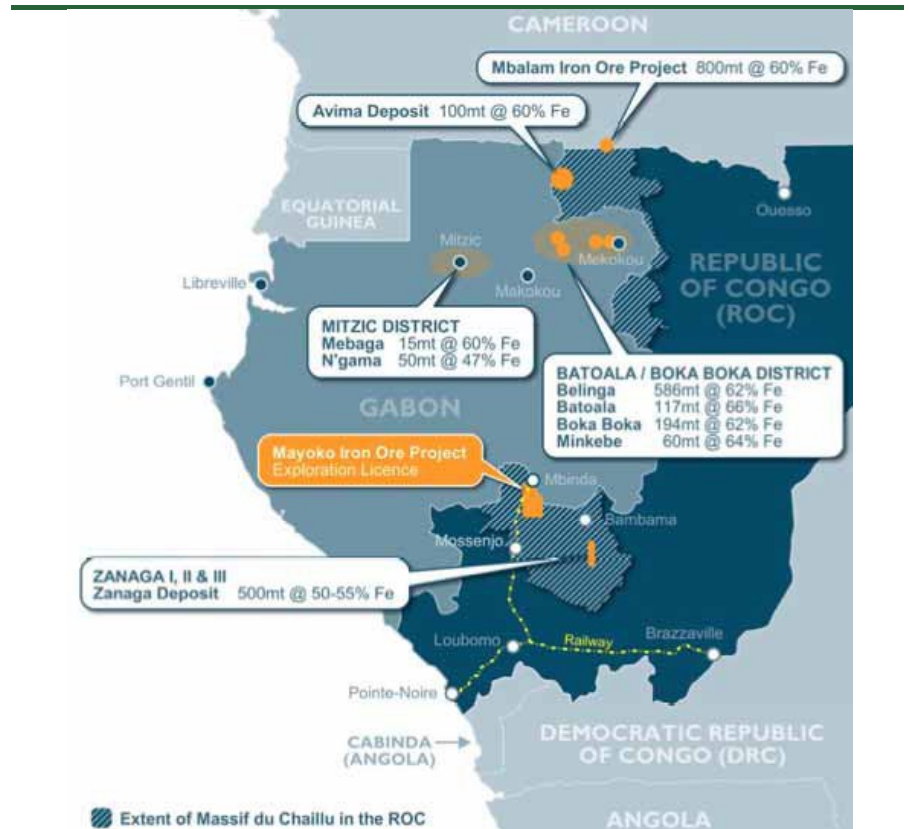
Project	Equity	Comment
Pre-BFS		
Mayoko, Republic of Congo	80%	Resource drilling underway

Source: Ambrian

Mayoko, Republic of Congo (80%)

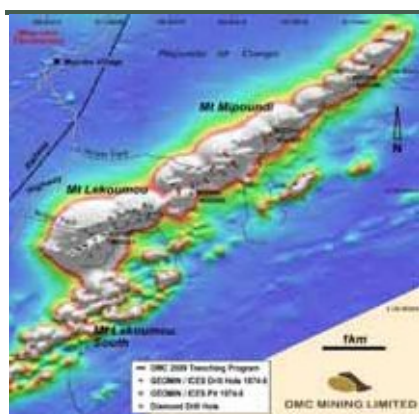
DMC acquired an 80% interest in the Mayoko Iron Ore Project in December 2007. The licence area is located approximately 300km NE of the country’s main port – Pointe Noire – and sits at the southern end of the Massif du Chaillu Formation, an iron ore belt running approximately N-S from Cameroon, through Gabon and the ROC.

Figure 35: Iron Ore Assets in Republic of Congo



Source: Ambrian

Figure 36: Mayoko Geophysics



Source: DMC Mining

Figure 37: Point Noire



Source: Google Maps, DMC Mining

Geology and Resources – Historic drilling in the licence area during the 1970s highlighted an inferred hematite resource of 33.1Mt at 55.5% Fe. DMC undertook a high-resolution airborne geophysical survey covering 220km² of its 1,000km² licence area during 2009. The results of the survey show a major 7km long magnetic anomaly at the Mt Lekoumou and Mt Mipoundi prospects along with three other anomalies within the area.

Modelling of these anomalies, constrained by trenching results and historic drilling, has identified an exploration target of 0.9-1.3Bt of predominantly itabirite iron mineralisation grading 35-45% Fe.

A 2,000m drilling campaign was launched in December 2009 aimed at drilling four traverses across the 7km Mt Lekoumou-Mt Mipoundi anomaly to validate the geophysical modelling and confirm the presence of iron mineralisation along strike and at depth. The results of this drilling programme are eagerly anticipated – they are due in April-May 2010.

Infrastructure – One of the key factors we like about the Mayoko project is its great access to infrastructure, one of the major considerations in any iron ore project. A railway line runs within 3km of the deposit, connecting to the deepwater port of Pointe Noire. The line was originally constructed by Comilog to transport manganese from Gabon and carried 3.1Mtpa at its peak. It is now under-utilised and has an estimated capacity of 11Mtpa with minor upgrade work. DMC has signed an agreement with the government to access the railway during the exploration phase, and also has a MOU with the Port Authority of Pointe Noire to study the feasibility of iron ore export options.

Mining and Processing – GRD Minproc completed a scoping study on the Mayoko project in June 2008. The study looked at the feasibility of a direct shipping ore (DSO) operation and was based on the existing hematite resource of 33.1Mt @ 55.5% Fe and an expansion scenario based on an estimated potential hematite resource of 110-135Mt from geological mapping. Production rates were modelled at 3Mtpa on the base case scenario and 11Mtpa for the expansion scenario, to match the 11Mtpa estimated capacity of the rail line. The results of scoping study are shown below.

Table 28: Scoping Study Results

Description	3Mtpa	11Mtpa
Resource Mined	33Mt	110-135Mt
Mining Capex (A\$m)	8.9	51.1
Plant Capex (A\$m)	75.6	100.6
Infrastructure Capex (A\$m)	9.0	9.0
Rail and Port Capex (A\$m)	61.5	182.1
Miscellaneous Capex (A\$m)	6.4	10.6
Total Direct Costs (A\$m)	161.4	353.4
EPCM (A\$m)	30.1	74.3
Total Direct and Indirect Costs (A\$m)	192.0	428.0
Provisional Costs (A\$m)	6.0	58.0
Total Capex (A\$m)	198.0	486.0
Mining Cost (US\$/t)		6.00
Processing Cost (US\$/t)		1.35
Transport Cost (US\$/t)		14.40
Port and Royalty Cost (US\$/t)		0.50
Total Operating Cost (US\$/t)		22.25

Source: Company data

Figure 38: Drilling



Source: Ambrian, March 2010

Investment Case and Opinion

We believe our positive view on DMC is reflected in the results of the scoping study above. The benefit of access to existing infrastructure is shown in the relatively low capital intensity of the project vs. junior peers. For example, a 300km railway line probably represents a US\$300-500m capex saving vs. a similar project without rail. This lower capex hurdle enables even the relatively small 3Mtpa DSO operation (based on known resources of 33Mt) to be economically robust.

We model: (a) the results of the scoping study for the base case 3Mtpa operation, with production from 1Q13; and (b) an expansion scenario to 11Mtpa from 3Q16. We increased the production cost estimate slightly to reflect some additional processing of the DSO product to upgrade the iron content from 55.5% to 62.9% Fe. This results in production of 2.1Mtpa and 7.7Mtpa of upgraded product vs. the 3Mtpa and 11Mtpa outlined in the scoping study, with a production cost of US\$30.71/t. We calculate an NPV_{10%} of A\$191.90m for the 3Mt pa operation and an incremental NPV of A\$409.47m for the expansion scenario.

Table 29: DMC Mining NAV

Asset	NPV (A\$m)	Interest	NAV	NAV (A\$m)	NAV (A\$/sh)
Base Case 3Mt	191.90	80%	0.25x	38.38	0.49
Expansion 11Mt	409.47	80%	0.10x	32.76	0.42
Net Cash	3.00	100%	1.00x	3.00	0.04
Total	604.37			74.14	0.94

Source: Company data, Ambrian estimates

Figure 39: BIF in Drill Core



Source: DMC

This modelling places no value on the full 0.9-1.3Bt exploration target that DMC has outlined based on its geophysical work and geological mapping. We await the results of the current drilling campaign that we anticipate will validate the target and will be a ‘game changing’ event.

Recommendation – BUY; Target Price A\$0.94

DMC’s current market cap of A\$26m equates to 13% of our NPV value of the base case scenario (modelled on known resources of 33Mt) and 5% of the expansion scenario. This includes no value for the 0.9-1.3Bt exploration target, giving a free option on drilling success. We apply a 0.25x NAV multiple to the base case NPV to reflect the early-stage nature of the project and assign a 10% probability/0.10x NAV to the expansion scenario. This results in a risked NAV of A\$74.14m, or A\$0.94/share, nearly 3x the current share price. As such, we initiate coverage with a BUY recommendation and a A\$0.94 target price.

Table 30: Abbreviated Operational and Financial Forecasts

Yr to Jun	10E	11E	12E	13E	14E
Mayoko Production (000t)	-	-	-	530	2,100
EBITDA (A\$m)	(3.20)	(3.20)	(3.20)	35.13	134.83
Profit (A\$m)	(3.15)	(3.32)	(4.94)	(4.44)	43.40
Cash cost (US\$/t con)	-	-	-	26.84	26.92
Average Iron Ore price (US\$/t)	-	-	-	85.24	79.50
Cashflow from operations (A\$m)	(3.15)	(3.32)	(4.94)	12.41	89.42
Cashflow from investing (A\$m)	(5.00)	(4.00)	(111.76)	(137.50)	(2.14)
Cashflow from financing (A\$m)	4.76	-	150.00	50.00	(40.00)
CFO + CFI (US\$m)	(8.15)	(7.32)	(116.70)	(125.09)	87.28

Source: Company data, Ambrian estimates