

WPG Res Ltd (WPG)

Final Approval For The Knob Is Pending

3 June 2011

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Key Points

- WPA opened up – in a very positive step access to the Woomera Prohibited Area for mining and foreign investment is now more assured.
- Final Approvals - WPG expect the approval process to be completed in July 2011. The final two approvals required are the Development Application (DA) for Port Pirie and the Mine and Rehabilitation Plan (MARP).
- The DA has received recommendation for ministerial approval with only a few modifications to the original application made. The resultant capital increases are covered within the cash reserves held by WPG.

WPG waiting but not stopping

We have revised our model for WPG to now include value from the Hawks Nest magnetite and haematite deposits and have also taken into account the delay to production starting due to permitting delays.

We are encouraged that WPG continues to look beyond their flagship project at Peculiar Knob and develop a pipeline of projects. In addition to the Hawks Nest hematite and magnetite deposits WPG is also evaluating their coal projects and the possibility of a pig iron project on site.

Valuation Adjustments

- Changes to our currency and iron ore price assumptions have slightly reduced the NPV for WPG's main assets by approximately 10%.
- We have reduced our risk weighting for the Hawks Nest Hematite Deposit in line with access to the Woomera Prohibited Area (WPA) looking more promising. Our assumed production profile for the Hawks Nest hematite is for production to commence in FY15. We maintain a high risk weighting for Hawks Nest to reflect the feasibility studies required and also that the Port Pirie shipment facility has received recommendation for 3.5Mtpa at this stage.
- Our valuation for the first time includes a component for the Hawks Nest Magnetite Deposit. Given the early stage of the project we have used a peer comparison to other magnetite companies in the region.

Risks

Post the approval process, which we see as largely running a set course now, we feel that the greatest risks come from delays in construction and cost overruns. The resources industry and in particular the iron ore sector has felt the pinch of rising capital costs and it is not uncommon for 20% overruns to be incurred.

Commodity and currency changes – WPG is a high cost (but high grade) operation and whilst on our long term commodity estimates the operation is profitable our valuation is sensitive to FX and commodity changes

Recommendation

Buy

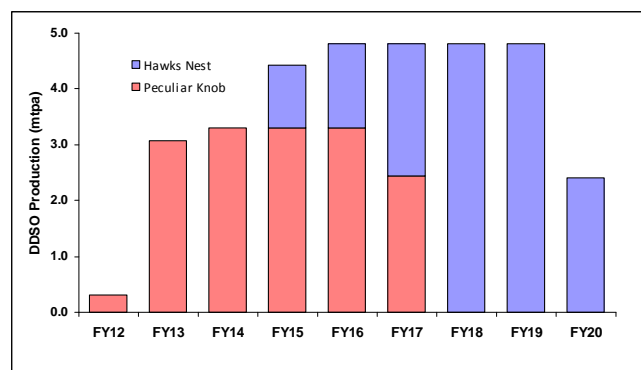
Previous Recommendation	Buy \$1.29/share
Risk Rating	High
Current Share Price	\$0.81
12 Month Price Target	\$1.43
Price Target Methodology	Blended
Total Return (Capital + Yield)	76.8%
NAV / Share	\$1.43
Market capitalisation	\$201m
Liquidity – Daily Value	\$0.7m

Financial Forecasts & Valuation Metrics

Y/e Jun (\$m)	2010A	2011F	2012F	2013F
Revenue	0	0	20	382
NPAT	-2.3	-2.5	-11.8	92.4
EPS (cps)	-1.9	-1.0	-4.8	37.6
EPS Growth	-11%	46%	-365%	880%
DPS (c)	0.0	0.0	0.0	9.4
EV / EBITDA (x)	na	na	na	0.7
PER (x)	-42.1	-78.2	-16.8	2.2
Dividend Yield	0.0%	0.0%	0.0%	11.6%
Gearing	-43%	-51%	21%	-30%
Interest Cover (x)	na	na	na	24.7

Source: Austock Securities estimates

Modelled Production Profile for WPG



Source: Austock Securities estimates

Peculiar Knob Going Forward

Project Funding available and approvals imminent

The South Australian Development Assessment Commission (DAC) has recommended that the iron ore export facility at Port Pirie receive Ministerial approval.

Gaining of the final approvals will be a key milestone and catalyst

WPG has advised that they expect ministerial approval to be granted in July 2011 at about the same time as the MARP approval.

The current estimate by WPG is that site works will commence in July. To this end WPG has started to order and receive materials associated with the construction, such as rail and points to be used at the rail siding. These have been delivered to site.

Changes to DA recommended

We have reviewed the Development Assessment Commission recommendations and most are in line with standard assessment recommendations. The recommendations around noise abating at the storage facility and traffic control will add ~\$5m to the capital costs. The capital increases fall within the contingency planning done by WPG and do not affect our valuation.

Approved tonnage rate

The Commission recommended that the Port Pirie facility be approved for 3.5Mtpa of iron ore. In our modelling we have assumed that once Hawks Nest is approved it will be brought on line at an initial rate of 1.5Mtpa. Once the Port Pirie facility is operating WPG will be seeking to increase the approved tonnage rate. We view the probability of increasing the tonnage rate as reasonable given that the number of train movements already approved will support the increased tonnage. We have modelled a worst case scenario and our risked valuation is only impacted by ~10%.

Contracts awarded

Contract	Awarded to
Rail haulage (3.3Mtpa)	Genesse and Wyoming
Mining Services (70 month drill and blast, loading and haulage of ore and waste)	MACA Limited
Catering contract for village	
Construction and installation of village	Ausco Modular
Road haulage from Peculiar Knob Mine to rail siding	
Port Pirie Facility Management	
Design and construction of Port Pirie iron ore receival storage and load out facility	Kerman Contracting
Yet to be awarded – civil site works and haul road construction	

Hawks Nest the next story

In May 2011 the Federal Government announced that they had accepted the recommendations put forward by the Hawke Review into shared access by mining and the Defence Department in the Woomera Prohibited Area (WPA). The recommendations will be put into practice over the next 6 months with a joint Federal and State Government group implementing the changes.

The main outcome of the review will be some clarity on where resources activities can take place and what restrictions will be placed on operations

For WPG the key outcomes are that the Hawks Nest deposits are now accessible also that the path to potential foreign ownership is possible. This allows WPG to restart the stalled work on the hematite deposit (100% WPG) and also the 50/50 JV with the Chinese company Wuhan Iron and Steel (Group) WISCO on the magnetite deposit.

WISCO JV Explained

WPG entered into a JV agreement with WISCO in May 2009, then in September 2009 the Defence Department indicated they would not support the FIRB application made by WPG and WISCO as part of the JV.

Since then the JV has been placed on hold. Now activities can resume. This is a positive step for WPG as it provides them with an extended project pipeline.

Terms of the WISCO JV

As part of the original JV terms WISCO will sole fund expenditure of \$45m to earn a 50% JV interest in

the Hawks Nest tenement (excluding DSO resources), with a minimum commitment of \$25m. The funding is to be spent on completing feasibility studies and exploration. Additionally WISCO will assist WPG in raising their share of the capital costs and will have a right to purchase WPG's share of the concentrate.

This is a similar structured arrangement that Gindalbie (ASX:GBG) has with the Chinese company AnSteel for the development of the Karara magnetite project located in the Mid West of WA. The Karara JV has successfully brought the project to construction phase within a relatively short time period.

Hawks Nest potential

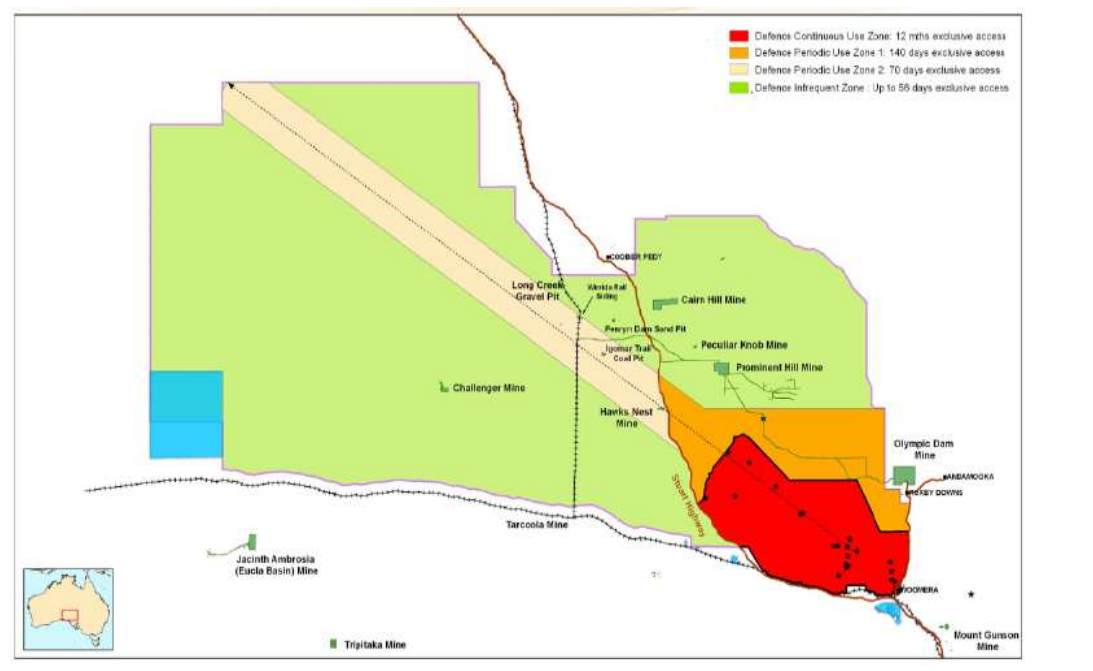
WPG has defined a 569Mt resource (@36% Fe) at Hawks Nest, in addition an Exploration Target of 2.19 to 2.57bnt @ 22-43% Fe has been estimated in accordance with the JORC guidelines.

When the Woomera access guidelines with respect to foreign ownership are in place we would expect the JV to recommence work on the project.

A scoping study completed in 2009 was based on concentrate production of 6Mtpa over a 30 year mine life.

Woomera Access Zones

WPG's Hawks Nest Deposits lie outside of the no-go zone. Maximum restrictions on activities are defined



Source: Company Report

Valuation

FX and commodity assumptions

We have revised our model for changes to the Austock assumptions for iron ore price and AUD:USD exchange rates. We have lifted both our assumed iron ore and exchange rate assumptions which has resulted in a reduction of our valuation for both the Peculiar Knob and Hawks Nest Deposits.

WPA Access becoming more open

With the Federal and Government accepting all of the recommendations of the Hawke Review into the Woomera Prohibited Area we have accordingly reduced our risk weighting for the Hawks Nest hematite project from 90% to 70%. We still maintain a high risk weighting as the development work on the project still needs to be completed and the exact framework for access within the WPA has to be legislated.

Hawks Nest hematite assumptions

At present we have assumed that the total capital required to bring Hawks Nest hematite on line will be ~\$50m (haul road and pre-strip), this will be funded from cash flow from Peculiar Knob. Production will initially be at a rate of 1.5Mtpa and then ramping up to 4.8Mtpa as Peculiar Knob production trails off in 2017.

Hawks Nest magnetite valuation

Valuing the Hawks Nest magnetite project is speculative at this stage given that all work stopped on the project sometime ago when access to the WPA become increasingly difficult. WPG have defined a significant resource (569mt @ 36% Fe) at the project and have a target range of greater than 2bnt (2.19-2.57bnt @ 22-43% Fe). In valuing this asset we have looked at the comparable magnetite stories in the region and have concluded that the market is currently valuing comparable assets at an enterprise value between \$40 and \$50m we therefore have taken the mid point of this range.

Scope for magnetite to contribute more to WPG

We see this as being a very modest value attributed to a resource that has potential to grow significantly. We will revisit the valuation as the future of the WISCO JV becomes clearer and more work is undertaken on the project.

Upside Catalysts

WISCO JV is ratified and proceeds.

Upon the WISCO JV agreement being formalised WPG will have the benefit of being free funded in a \$45m exploration program.

Increased production from Peculiar Knob

If additional export tonnes are approved earlier than our modelling then WPG is well leveraged to benefit from the forecast short term strength in iron ore prices.

A positive decision on a deep water port. This is a bit of a pipe dream at the moment but if there is an affirmative move made by the South Australian Government or an infrastructure consortium to build a deep water multi user port in South Australia it will be not only beneficial for WPG but for the fledgling SA junior iron ore sector.

Within WPG's control

We have only ascribed a nominal value to the upside in resources for both the Hawks Nest hematite and magnetite deposits. Also we view the coal and pig iron projects as early stage projects also with significant upside potential.

3rd Party Access

The handling facility at Port Pirie is being designed to accommodate 7Mtpa of through put, with WPG forecast to use initially 3.3Mtpa there is the possibility of other iron ore companies utilising this facility and pay a tolling fee to WPG, subject to necessary approvals.

Risks

Commodity and currency changes.

The barging operation to be used by WPG is a proven and reliable but high cost operation that is profitable at current prices. In our modelling the margin at our assumed long term commodity and currency rates is reduced. Long term prices are predicted to come off from the current highs as extra global mine capacity comes online from 2015.

Capital and operational overruns

Across the Australian resources sector there is a large number of projects in construction that has put upward pressure on pricing of materials and labour. Additionally the rising Australian dollar is also putting pressure on materials.

Delays in Approvals and Construction

Additional delays in permitting appear to be low but are still a possibility. Also with the previously mentioned pressure on materials and labour supply there is a risk that construction times could be longer than forecast. Since initiating on WPG we have maintained more conservative timelines that the company and to date our conservatism has been proven correct.

COMPANY SUMMARY

WPG Res Ltd

WPG.AX

Price Information

Price (\$/share)	0.81
Mkt Cap (\$m)	201
Enterprise Value (\$m)	139

Share Price & Volume Chart



Commodity / FX forecasts

	FY11F	FY12F	LT
Iron Ore Lump Price (FOB Ham. 62%)	169.86	164.96	89
Iron Ore Fines Price (FOB Ham. 62%)	153.50	147.50	70.00
Exchange Rate A\$:US\$	1.00	0.99	0.85

Production / Costs

	FY11F	FY12F	FY13F
Hematite (Lump) mtpa	0.0	0.0	0.0
Hematite (Fines) mtpa	0.0	0.3	3.1

Business Summary

WPG is a junior iron ore developer with their projects located in South Australia. Production from their flagship project at Peculiar Knob is scheduled to commence in 2QCY12, with a 64% Fe DSO product to be exported through Port Pirie at a rate of 3.3Mtpa.

In addition to the Peculiar Knob Deposit WPG is also advancing their other DSO project at the nearby Hawks Nest Deposit and also the associated magnetite deposit.

NAV by parts

Asset	Unrisked (\$m)	Risk %	Risked (\$m)
Peculiar Knob NPV	234	5%	222
Hawks Nest (Hem) NPV	140	70%	42
Hawks Nest (Mag) NPV	40	0%	40
Coal Assets	216	95%	11
Exploration	25	0%	25
Cash (post construction)	20	0%	20
	-8	0%	-8
NAV Total (A\$m)	667.42		352.16
NAV/Share	2.71		1.43

FINANCIAL SUMMARY

Year End - Jun FY10A FY11F FY12F FY13F FY14F

KEY METRICS

EPS Growth (%)	-11	46	-365	880	14
PER (x)	-42.1	-78.2	-16.8	2.2	1.9
Dividend Yield (%)	0.0	0.0	0.0	11.6	13.2
EV/EBITDA (x)	na	na	na	0.7	0.2
EV (\$m)	185.6	138.6	235.8	122.3	49.4
ROE (%)	-8.6	-3.3	-8.2	43.4	33.8
ROA (%)	-12.0	-5.9	-8.7	46.7	51.9
ROIC (%)	-11.0	-4.2	-3.2	52.7	50.4

PROFIT & LOSS (AUD \$m)

Revenue	0	0	20	382	462
EBITDA	-2	-3	-4	166	230
Depreciation & Amortisation	0	0	3	26	29
EBIT	-2	-3	-7	140	201
Net Interest Expense	0	0	-5	-6	-4
Income Tax Expense	0	0	0	-42	-92
NPAT Reported	-2	-3	-12	92	105
NPAT Adjusted	-2	-3	-12	92	105

PER SHARE DATA (cps)

Shares on Issue (m)	122	246	246	246	246
EPS Reported	-2	-1	-5	38	43
EPS Adjusted	-2	-1	-5	38	43
DPS	0	0	0	9	11

BALANCE SHEET (AUD \$m)

Cash	15	62	43	136	186
Debtors & Inventory	1	1	9	9	9
PP&E	2	39	174	154	184
Intangibles	0	0	0	0	0
Total Assets	37	126	251	323	404
Borrowings	0	0	79	57	35
Creditors	1	3	5	5	5
Total Liabilities	3	5	85	64	41
Net Assets	35	122	166	259	363

BALANCE SHEETS RATIOS

Gearing - Debt/Equity (%)	-43.5	-51.0	21.1	-30.2	-41.7
Interest Cover (x)	na	na	na	24.7	51.3
NTA per Share (cps)	28.5	49.5	67.6	105.4	147.4

CASH FLOW (AUD \$m)

EBITDA	0	0	-2	169	230
Interest & Tax	0	0	-5	-48	-96
Working Capital Change					
Operating Cash Flow	0	0	-7	121	134
Maintenance Capex	-1	-15	-16	-4	-37
Free Cash Flow	-1	-15	-23	117	97
Expansion Capex	0	-20	-120	0	-20
Equity Issues / (Buy Backs)	13	85	0	0	0
Proceeds from Borrowings	0	0	5	-21	-23
Other	-1	-2	-75	-2	-2
Net Cash Flow	12	48	-213	94	52

Resource Statement

Peculiar Knob (Hem)	Tonnes (Mt)	Fe (%)	P (%)	SiO2 (%)	Al2O3 (%)
Resource (M,I,I)	19.2	64.0	0.0	7.2	0.3
Hawks Nest (Hem)					
Resource (M,I,I)	18.4	61.6	0.1	8.9	1.4
Hawks Nest (Mag)					
Resource (M,I,I)	569.0	36.0	-	-	-

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Recommendation Criteria**Investment View**

Austock Securities Investment View is based on an absolute 1-year total return equal to capital appreciation plus yield.

Buy	Hold	Sell
>20%	20% – 5%	<5%

A Speculative recommendation is when a company has limited experience from which to derive a fundamental investment view.

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