

Blackthorn Resources

Base Metals – Speculative Risk

Recommendation	Buy (initiation)
Last Price	A\$0.61
Target Price	A\$1.20
Forecast Total Return	97%

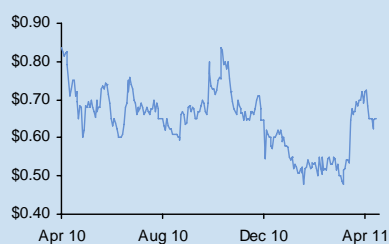
Company profile

Blackthorn Resources (ASX: BTR) is a Sydney-based, diversified mining company with a focus on African projects. BTR has a 39.9% interest with Glencore international (50.1%) in the 90ktpa Perkoa zinc project, under construction, with first production in 2012.

The JV is currently investigating potential to add a lead/silver circuit to Perkoa and increase throughput to 1mtpa. With ore grading over 1oz/t Ag, this could provide significant valuation upside.

The company is in a joint venture with BHP-Billiton on the Mumbwa Copper project, Zambia (BTR, 60%) and has a gold project in Burkina Faso, with a maiden JORC resource of 139koz announced in late 2010.

Share price performance



	1m	3m	12m
Price	(9%)	17.7%	(28%)

Source: Iress

Other Information

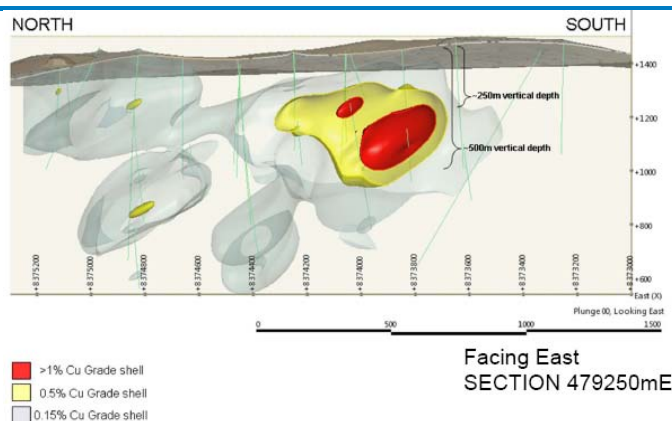
Iress / Bloomberg	BTR / BTR AU
Market cap (diluted)	A\$64.13m
Enterprise value (estimate)	A\$62.59m
Average daily volume (m)	0.12
Free float	68.7%
Number of shares on issue (m)	106.9
Reporting currency	AUD
Quote currency	AUD
Website	blackthornresources.com.au
Analyst(s)	Geoff Muers +612 923 2142 geoff.muers@investec.com.au
	Source: Iress, Capital IQ

BHP JV appears a win-win

BHP Billiton is shortly due to decide whether to continue earning back into BTR's Mumbwa copper project in Zambia, where the target is Olympic Dam-style IOCG mineralisation. Whilst a sizeable resource of over 1.6mt Cu has been established to date, the real prize of a large, high grade orebody remains elusive. In addition, BTR is moving closer towards production in 2012 from the Perkoa Zinc Project in Burkina Faso. This stock is rated speculative risk, thus suitable only for investors with significant risk tolerance.

- Recent newsflow:** BHP recently declared that it will not conduct any more drilling at Mumbwa, ahead of a decision by June 30 on whether the company will continue to earn into the project. In other news, BTR recently announced a planned equity raising with partner Glencore (A\$10m @ 0.625/share) who is considering building a circuit at Perkoa to capture lead and silver.
- Key issues:** The BHP decision is important with regards to short term sentiment. However, the structure of the deal is such that we see either outcome as positive. Should BHP stay in the deal, they can move from 40% to 60% of Mumbwa by paying BTR 150% for past expenditure (A\$13m) and moving onto the next feasibility phase. Should BHP withdraw, BTR is free to self-fund exploration or bring in a partner depending on timing of any further exploration success. Aside from the copper exposure, the group is highly leveraged to zinc prices, with production in from mid-2012E. The company should have around A\$15m in cash post the Glencore raising.
- Value:** Valuation of the early-stage copper project is difficult; however we value BTR's current 60% stake at US\$65m (details follow). We value BTR's 40% of Perkoa at US\$57m, and allow a nominal A\$5m for exploration value across the group, mainly the gold tenement in Burkina Faso (139koz @ 1.06g/t Au). We then adjust by US\$(10)m for anticipated ongoing corporate costs and other factors, giving us a total base case value of US\$1.04ps. Our current upside valuation on BTR, allowing for Perkoa expansion to 1mtpa (inc. lead/silver capture) and 100% of Mumbwa is US\$1.80/share. Our target price of A\$1.20 per share includes 30% of this upside potential on a risk-weighted basis.
- Catalysts:** The main short term catalyst is BHP's decision on Mumbwa. BTR is well funded currently should BHP withdraw. Should BHP stay in, we see this as positive as it will put BTR in a cashed up position to look at other assets, and also benefit from further work conducted on Mumbwa at BHP's expense. Despite BTR's clear copper exposure, the stock has significantly underperformed its peer group recently.

Cross-section of Kitumba Resource (BTR, 60%)



Source: Company reports

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Risks to valuation, recommendation & target price

- BTR is an early-stage exploration/production company, hence is reliant on definition of potentially economic resources to add value
- BTR is exposed to political risks in African countries Zambia and Burkina Faso
- BTR is exposed to construction risk at Perkoa, and commodity price (namely zinc) risk
- Our valuation of the copper asset is high risk, and relatively subjective, hence may be downgraded

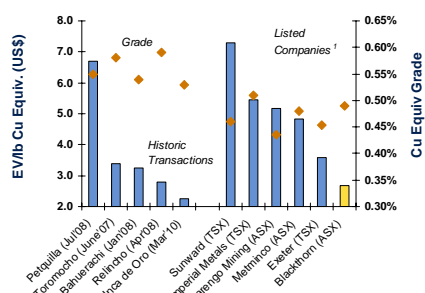
Board members

Bill Cash, Chairman
 Scott Lowe, Managing Director
 Nicki Bowman, Non-Executive Director
 Michael Oppenheimer, Non-Executive Director

Major Shareholders (est)

Glencore International (post-issue)	13.0%
North Sound	8.9%
F Brewer	7.0%
JP Morgan	6.2%

Comparable Copper Projects: Metrics*



* Average 5.3c/lb and 0.47% Cu Equiv, excluding BTR. BTR assumes 100% of Mumbwa.

Source: Investec Bank (Australia) Ltd estimates

Mumbwa Project, Zambia (BTR, 60%)

BHP is shortly to make a decision on whether to continue to claw-back interest in the Mumbwa project in Zambia, or withdraw. Should BHP elect to withdraw, BTR reverts to 100% ownership and can then drill itself or seek an alternative partner (no shortage of likely candidates in our view). BTR sees plenty of scope in untested geophysical targets and potential expansion on the existing resource of 347mt @ 0.47% Cu at Kitumba (including 87mt @ 0.94% Cu and 22mt @ 1.73%).

Valuation of the copper resource is subjective, and potential economics of an open cut mine are uncertain at present due to the large amount of cover (over 150m in some places) and depth to the top of the higher grade parts of ore. The project is on a hill, hence this may be advantageous. Potential mining methods and concepts may include underground caving. In our view, based on the grade and likely capital cost, the project may require a copper price >US\$3.00/lb long term to justify a large-scale development, which would normally be considered marginal. The 22mt @ 1.73% may present a smaller scale mining scenario, for which we have not yet investigated the conceptual economics. On average, such 'marginal' large tonnage projects with grade around 0.5% Cu have been changing hands for about US\$0.06/lb in recent years on our calculations. Using a conservative value of 50% of this amount, it is possible to value 100% of the project at US\$107m. This number is used in our initial upside valuation of BTR. Using another valuation method, assuming BHP has spent US\$10m on the last phase of work, and elects to pay A\$13m to BTR, 20% of the project can be valued at US\$22m effectively.

Perkoa Zinc Mine, Zambia (BTR, 39.9%)

BTR is in JV with Glencore (50.1%) on the Perkoa Zinc project in Burkina Faso. Glencore is funding the remaining A\$80m (BTR spend A\$90m previously) with production scheduled from mid-2012 at a rate of about 90kt zinc metal (720kt @ 13.9% Zn). Cash costs are forecast at around US\$1500/t payable, however the JV expects this could be reduced (we are using US\$1400/t long term).

We value the mine at US\$142m (8% NPV) including a 14% construction risk discount. Applying spot prices, this value reduces to US\$92m, however rises to US\$277m on the upside scenario allowing for silver/lead recovery. The JV is now drilling for silver, to potentially expand the existing 7.6moz resource within the ore zone. Throughput expansion to 1mtpa is also being considered, with potential for installation of a lead/silver circuit. On our conceptual numbers, applying silver recovery of 55% (>1.5mozpa) and 8ktpa of lead could double the NPV. Increasing our LT zinc price to US\$1.20/lb increases our base valuation by 60%, indicating strong leverage.

BTR have over 1100km² of tenements in Burkina Faso, including Perkoa and tenements with gold exploration potential. A maiden JORC resource of 139koz @ 1.1g/t was announced at the Guido prospect late in 2010. Little work has been done recently.

Summary: Whilst companies with minority stakes in projects will typically trade at a reasonable discount to valuation, we see the current discount in BTR as excessive, and a reflection of both past project history, and the ownership structures. As both projects progress over the next 1-2 years, and BTR starts receiving cash flow, we believe investor understanding of the inherent value should grow, along with the share price.

Strengths	Weaknesses	Opportunities	Threats
<ul style="list-style-type: none"> ▪ JV with BHP Billiton provides exploration expertise and upside ▪ Production from mid-2012E could enable the company to grow via acquisition or organically ▪ Conservative management team appears focused on shareholder value without excess risk 	<ul style="list-style-type: none"> ▪ Reliance on JV partners to manage project, hence limited control over direction ▪ Two projects in Burkina Faso, one in Zambia hence high political risks ▪ Commercial potential of copper project uncertain, hence value subjective 	<ul style="list-style-type: none"> ▪ BHP may elect to earn 60% of Mumbwa, thus providing further funding for work and a cash payment to BTR (A\$13m) ▪ BHP may withdraw, hence BTR fully exposed to exploration upside ▪ Expansion of Perkoa to 1mtpa, and addition of a silver circuit could be a major boost to valuation 	<ul style="list-style-type: none"> ▪ Minority interests in projects tend to dilute investor interest ▪ African risk is a consideration ▪ Presence of JV partner on register could make BTR vulnerable to takeover

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	All countries excl South Africa	South Africa
	Expected total return	
Buy	> 10%	> 20%
Hold	-10% to 10%	10% to 20%
Sell	< -10%	< 10%

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