

Blackthorn Resources

Base Metals – Speculative Risk

| | |
|-----------------------|---------|
| Recommendation | Buy |
| Last Price | A\$0.40 |
| Target Price | A\$1.00 |
| Forecast Total Return | 150% |

Company profile

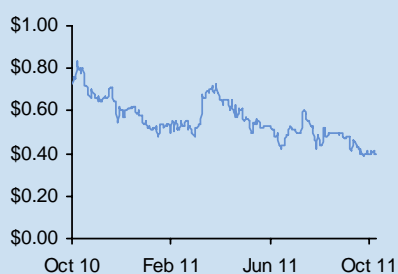
Blackthorn Resources (BTR) is a Sydney-based, diversified mining company with a focus on African projects. BTR has a 39.9% interest with Glencore international (50.1%) in the Perkoa zinc project, under construction, with first production in mid-2012E.

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 also owns 100% of the Mumbwa Copper project, Zambia with an existing resource containing 1.6mt Cu. Drilling is under way to expand the resource, to coincide with pre-feasibility studies.

Major shareholders include Glencore (13%), North Sound (8%) and JP Morgan (7%).

Share price performance



| | 1m | 3m | 12m |
|-------|-------|-------|-------|
| Price | (11%) | (20%) | (45%) |

Source: Iress

Other Information

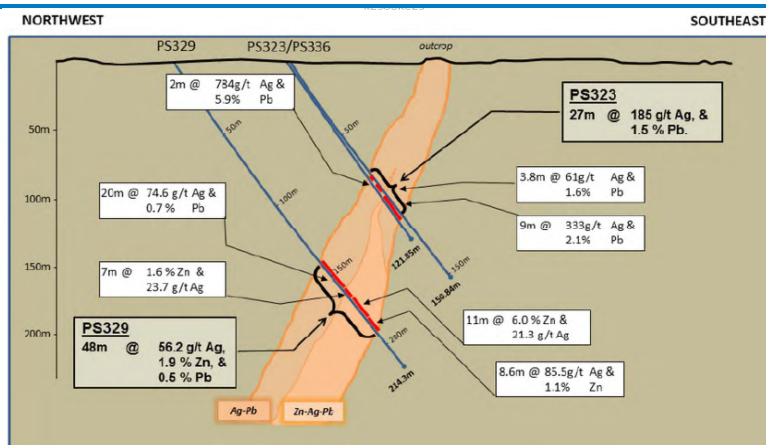
| | BTR / BTR AU |
|-------------------------------|-----------------------------|
| Iress / Bloomberg | |
| Market cap (diluted) | A\$49m |
| Enterprise value (estimate) | A\$34m |
| Average daily volume (m) | 0.1m |
| Free float | 74.02% |
| Number of shares on issue (m) | 122.9m |
| Reporting currency | AUD |
| Quote currency | AUD |
| Website | blackthornresources.com.au |
| Analyst(s) | Geoff Muers |
| | +61 2923 2142 |
| | geoff.muers@investec.com.au |
| | Source: Iress, Capital IQ |

Drilling to add value in Africa

Drilling is under way at both of BTR's projects, including Mumbwa copper in Zambia (BTR, 100%) and the Perkoa Zinc mine in Burkina Faso (BTR, 39.9%). Recent results from near-mine drilling at Perkoa have reinforced the case for a silver/lead circuit, and we expect construction to be prioritised in 2012. With first production mid'12E at Perkoa and resource upgrades likely at Mumbwa, the value case for BTR is expected to strengthen. This stock is rated speculative risk; thus it is suitable only for investors with significant risk tolerance.

- Recent newsflow:** Recent drill results at Perkoa including 46m @ 61.5g/t Ag, 1.8% Zn and 0.5% Pb follow up previous results such as 27m @ 185g/t Ag and 1.5% Pb and confirm the case for addition of a silver/lead circuit. We expect an investment decision by Glencore/BTR in Nov/Dec. Drilling with three rigs is under way at the Mumbwa project in Zambia, with the purpose of infill drilling and resource extension, and scout drilling of new targets. First assay results are due in early November.
- Key issues:** With production from mid-2012E, including a lead/silver circuit, the Perkoa project has potential to generate significant cashflow for BTR (>US\$20mpa). The existing resource at Mumbwa (87mt @ 0.94% Cu) could grow in size (and potentially grade) as further drilling is conducted. Whilst valuation of the copper resource is difficult due to uncertain economics, considering the inherent value in Perkoa, we feel the copper project is not factored into BTR's share price, and current drilling may help to highlight this value.
- Value:** We value BTR's 40% of Perkoa at US\$61.4m (-US\$11.6m), allowing for the expanded case (1mtpa, silver/lead circuit) including a 30% NPV risk discount. We have reduced near-term lead/zinc price expectations. Due to reduced copper equity market valuations, we have reduced our valuation multiple on the resource to US\$0.015/lb Cu equivalent (previously US\$0.02/lb) which represents 50% of peers and historical transaction multiples. In summary, our valuation declines from US\$1.14/share to US\$0.98/share (US\$0.77/share spot). Our target price of A\$1.00ps (down from A\$1.10) approximates our current valuation.
- Catalysts:** Upcoming catalysts in the short term may include drilling success at the Mumbwa copper project in Zambia. Medium term catalysts include confirmation of Perkoa on time and budget for commissioning, and a reserve for the silver deposit (below).

Perkoa near-mine exploration target (Company reports)



Source: Company reports/ Investec Bank (Australia) Ltd estimates

Blackthorn Resources

Risks to valuation, recommendation & target price

- BTR is an early-stage exploration/production company; hence, it is reliant on subjective definition resource valuation
- 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 due to pre-feasibility status

Board members

Bill Cash, Chairman

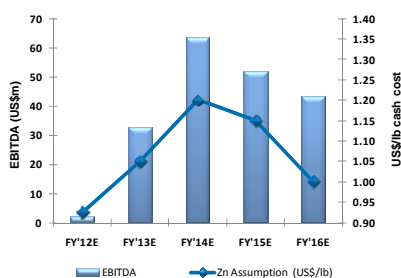
Scott Lowe, Managing Director

Nicki Bowman, Non-Executive Director

Michael Oppenheimer, Non-Executive Director

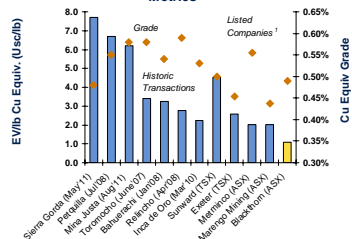
Peter Kalkandis, Non-Executive Director

Perkoa: Forecast Earnings (100%)



Source: Investec Bank (Australia) Ltd estimates

Pre-Development Copper Projects: Metrics*



* Average 3.7c/lb and 0.52% Cu Equiv. excluding BTR. Calculations exclude potential value of other assets within listed comparables, based on primary asset, hence indication only.

Source: Investec Bank (Australia) Ltd estimates

Mumbwa Project, Zambia (BTR, 100%)

- Three rigs are working in Zambia, with a total of 16 holes on average 550m deep planned. One hole was recently completed to 481m depth, with the plan to extend the existing resource of 87mt @ 0.94% Cu (including 22mt @ 1.73% Cu). With a delay of up to eight weeks from start of drilling to assays, we expect first results by late October/early November 2011, with program completion early in the new year with each rig completing ~30m/day.
- Whilst large-scale mining economics appear uncertain, the 22mt @ 1.73% Cu may present a smaller scale scenario, and the resource is open at depth and strike. The deposit is of similar grade to Discovery Metals (DML, Not Rated) Zeta underground deposit (25mt @ 1.7% Cu equivalent). The current A\$5m program involves ~8900m of drilling, with seven infill holes, seven step-out holes and two scout holes initially. The aim of the drilling is to upgrade the resource category (potential grade/size increase).
- On average, large tonnage projects grading 0.5% Cu equivalent have been changing hands for about US\$0.06/lb (EV) in recent years on our calculations. Including current listed TSX/ASX peers, the average is US\$0.037/lb (down 0.006/lb since our last review in July). The value is closer to US\$0.024/lb including only listed comparables; however, we are yet to see any evidence of reduced corporate transaction value in the copper space. Using a conservative value of US\$0.018/lb, we value 100% of the project at US\$66m. BTR is currently trading at US\$0.011/lb Cu (EV) excluding any valuation for Perkoa.

Perkoa Zinc Mine, Burkina Faso (BTR, 39.9%; Glencore, 50.1%)

- Over 400 workers are currently on-site, progressing the decline and plant construction ahead of commissioning in 2Q'12E. We anticipate open-pit mining may commence next year, and provide early feed to the plant complementing the underground reserves.
- We allow A\$30m of capital for plant expansion (additional tanks etc) and a silver circuit, assuming funding via a loan from Glencore (i.e. no BTR cash upfront). We assume silver recovery of 55%, which is low by industry standards, due to a lack of information on likely metallurgical performance at this stage. We currently value the mine at US\$154m (8% NPV) allowing for a 30% NPV discount for pre-construction/ramp-up risk, down US\$10m on our last published valuation due to our lower zinc price assumptions.
- Our valuation excludes US\$80m or so of remaining capital (US\$50m put up by Glencore to earn equity); hence, the actual value to BTR is higher than our base assessment. Applying spot prices, the value reduces to US\$125m (un-risked, capital excluded). Under a bear-case scenario, with effective flat metal prices 20% lower than spot (Zn, US\$0.69/lb) the valuation of Perkoa reduces to a nominal US\$20m (un-risked, excluding remaining capital needed) indicating project leverage to zinc. Our valuation of BTR would be A\$0.31/share, assuming a further 50% reduction in our valuation for the copper project. With global average zinc production costs around US\$0.60/lb, we don't see this negative scenario as likely.

| Strengths | Weaknesses | Opportunities | Threats |
|--|---|--|---|
| <ul style="list-style-type: none"> ▪ Production from mid-2012E could enable the company to grow via acquisition or organically ▪ Conservative and experienced management team appears focused on shareholder value without excess risk | <ul style="list-style-type: none"> ▪ Two projects in Burkina Faso, one in Zambia; hence relative political risks ▪ Commercial potential of copper project uncertain; hence, the value is subjective | <ul style="list-style-type: none"> ▪ Expansion of Perkoa to 1mtpa, and addition of a silver circuit could be a major boost to valuation ▪ Expansion of resource and potential for grade improvement at Kitumba, Mumbwa project in Zambia ▪ Completion of scoping/PFS studies to indicate mining potential and economics | <ul style="list-style-type: none"> ▪ Minority interests in projects tend to dilute investor interest ▪ African risk is a consideration ▪ Significant discount to valuation and peer group comparison means company is vulnerable to takeover |

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Definition of research ratings - Expected 12m performance

| | 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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Level 31, Chifley Tower
2 Chifley Square
Sydney NSW 2000
Tel: +61 2 9293 2000
Fax: +61 2 9293 2002

Resource Analysts

Tim Gerrard

+612 9293 2168

tim.gerrard@investec.com.au

Colin McLelland

+612 9293 2140

colin.mcllelland@investec.com.au

Geoff Muers

+612 9293 2142

geoff.muers@investec.com.au

Specialty Sales

Roderick Clarkson

+612 9293 2278

rod.clarkson@investec.com.au

Matt Martin

+612 9293 6246

matt.martin@investec.com.au

Dealing

David Gulson

+612 9293 2197

david.gulson@investec.com.au