Territory Resources

Massive iron ore exploration boost

Hold TTY

Fat Mining 119, 09 Apr, 2008
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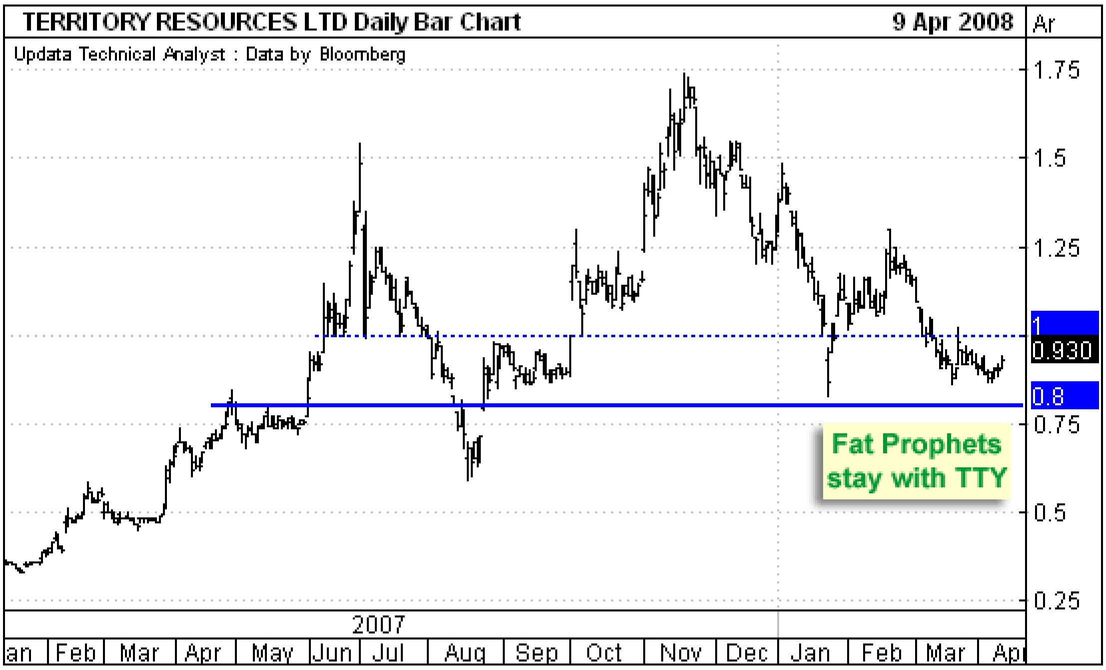
As per usual, Territory Resources has been a hive of activity over the past couple of weeks. The company has announced a maiden profit and confirmed that it is on track to achieve its production target of 500,000 tonnes shipped during April. It has also announced a massive $25 million exploration programme aimed at delivering the additional tonnage required to facilitate expansion plans, whilst it has also announced a takeover offer for emerging mineral sands player, Olympia Resources.

"We continue to support the strategy of Territory Resources, which is aimed at diversifying its earnings base away from a reliance solely on iron ore."

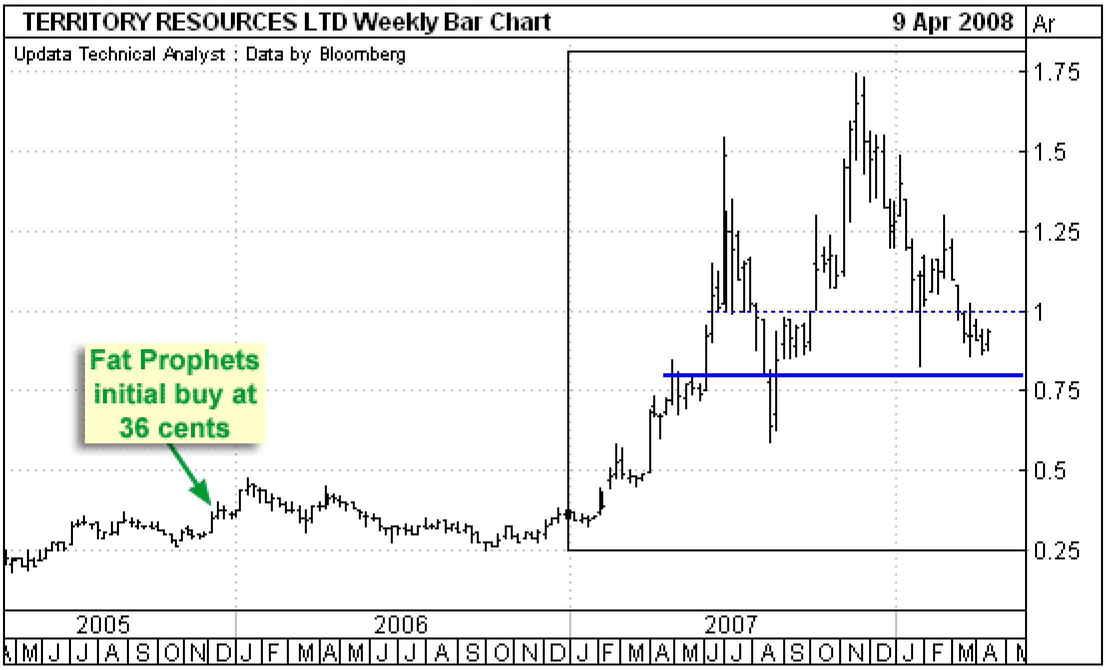
Fat Prophets initially recommended buying Territory Resources at 36 cents in December 2005 (Fat Mining 6). Our last review of the stock was during February in Fat Mining 113.



Despite a disappointing softening of prices since our last review in February, downward momentum in Territory Resources has recently slowed. As evident on the daily chart, the stock is now showing signs of establishing a base above support in the 86 cents to 83 cents region.

In the weeks ahead, we anticipate further consolidation above 80 cents. This will result in the formation of a base pattern that we believe will have the potential to support a future move to the upside.

In our opinion, a sustained break above the $1.05 region will signal the early stages of a revival longer-term upward momentum. Such a move would initially target $1.30 with further gains achievable in time.



Our most recent coverage of Territory Resources followed a meeting in Sydney with Territory Resources' Chairman, Michael Kiernan and CEO Allan Quadrio. We took comfort from their vision of building upon and expanding the company's existing Frances Creek iron ore business.

The news since that meeting has been positive, although it has not been reflected in the Territory share price. Let us start with profitability and production.

Territory announced a maiden after-tax profit of $2.037 million for the six months ended 31 December 2007. The profit result comprises an operating loss of $2.86 million for the period and an income tax credit of $4.9 million arising from the take up of a deferred tax asset.

The important number was revenue, which at $28.8 million was strong and was generated from the shipment of 340,000 tonnes of high-grade iron ore to Chinese customers during the period. This of course was the first period of steady state iron ore production from Frances Creek.

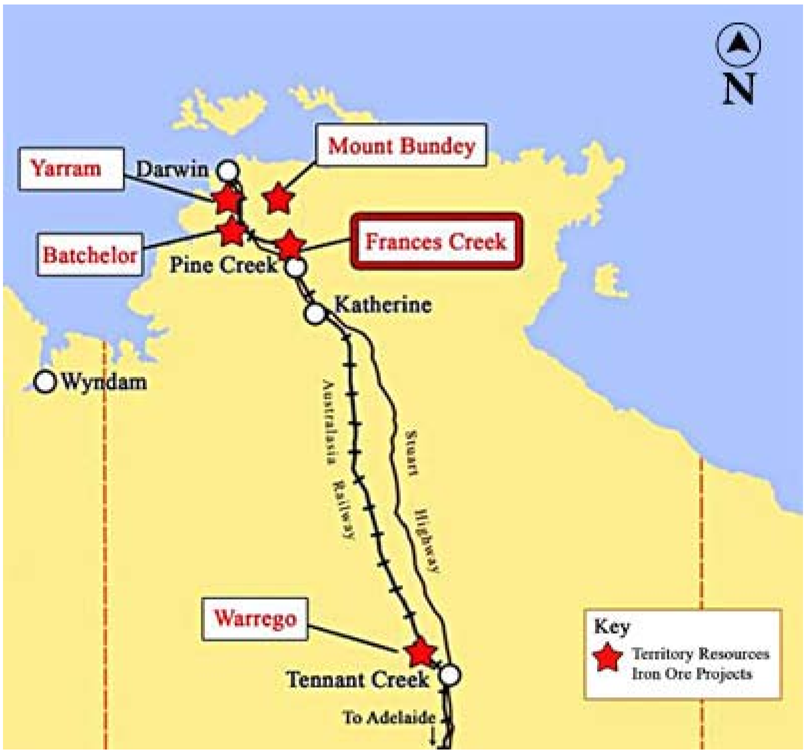
Importantly, the company maintains its strong balance sheet position, with no external bank borrowings other than equipment financing facilities.

On the production front, Territory has advised that production at Frances Creek remains on schedule, with the company making ongoing site improvements to increase efficiency during the wet season.

Territory has now shipped 350,000 tonnes of high grade lump and fines and is on track to achieve the milestone of 500,000 tonnes shipped during April.

Despite some delays due to wet weather, the company is generally pleased with the performance at Frances Creek during the operation's first wet season. The company is however taking steps to implement improvements, such as the introduction of a wet processing plant and paving of the 15km haul road to the rail siding.

The current mine plan is scheduled to produce at an annualized mining rate of 2 million tones per annum by June 2008, which is expected to increase to 2.5 million tones per annum by December 2008. The increased production will be complemented by enhancements to port and rail capacity.



Territory's growth plans are supported by a commitment to spend a total of $25 million over the next two years, with the aim of substantially expanding its high-grade resource base and extending mine life at Frances Creek.

A budget of $12 million including more than 100,000 metres of RC drilling, has been approved for the 2008 calendar year, with three drilling rigs engaged to undertake the works.

The immediate focus of the exploration programme will be the expansion of near-mine reserves and resources, including the areas adjacent to the known deposits.

Frances Creek currently has around 5 million of reserves @ 61.3% Fe, with indicated and inferred resources of just over 10 million tones @ 60.47% Fe.

As we have previously highlighted, Frances Creek hosts significant areas that have been largely untouched by modern exploration techniques, including 12-14 km of strike that will be targeted in the current program.

In particular, the northern tenements contain significant potential for additional discoveries. The tenements lie on the northern extension of the Frances Creek structure and sporadic outcrops exist along the structure with minimal work has been completed on the tenements to date.

Territory has also enhanced its exploration skill base with the recent appointment of Ian Hassall as Exploration Manager. We understand that he has considerable iron ore experience in the Pilbara, both as a mine geologist and in exploration.

Territory has also undertaken a complete review of the available geological information from current and historical records for Frances Creek, including collation of all geophysical, mine geology and drilling information. A helicopter-borne, electromagnetic survey and a multi-spectral survey were conducted late in 2007, and results from these are being incorporated in the proposed exploration programme.

With respect to other growth opportunities and commodity diversification, Territory has made strategic investments in minerals sands producers, acquiring a 13.7% stake in Matilda Minerals (ASX: MAL) and an initial 19.7% stake in Olympia Resources Limited (ASX: OLY). Territory has since launched an unconditional 10 cent-a-share cash takeover offer for Olympia and has taken its equity stake to 42.75%.

The rationale for these investments is that Territory is very bullish on the prospects for zircon, a commodity that should see enhanced Chinese demand as a result of greater use in the ceramics industry.

As we have previously stated, despite initial concerns that the company was taking on more than it could chew, we support Territory's diversification strategy. This is despite the company's big head-start on its iron ore peers, most of which are still years and hundreds of millions of dollars in financing away from production.

We continue to believe that earnings diversification away from a sole reliance on iron ore will be crucial, given the plethora of pure iron ore players set to hit the market over the next five years. Most of these new players will have heavy debt burdens and their operations will be very sensitive to fluctuations in iron ore prices.

Whilst iron ore prices have been rising strongly for six years now, margins historically have never been this high. As we have previously highlighted, iron ore is historically a relatively low margin business.

The major producers that currently supply 80% of the world's iron ore trade, comprising CVRD, Rio Tinto and BHP Billiton, will remain in a position of strength in our view. The key to profitability and longer-term survival in the industry therefore is the ability to minimise costs and remain dynamic. This is the big advantage that Territory Resources has over all of its smaller iron ore peers.

Territory Resources will remain firmly held within the Fat Prophets Mining & Resources portfolio.

Disclosure: Interests associated with Fat Prophets declare a holding in Territory Resources.

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