

Territory Resources Ltd

(TTY \$0.16) Hold, Downgrade from Buy

Comments

Price Target: \$0.20/sh

Territory has continued to sell product throughout the financial crisis which is a credit to its marketing efforts through Noble. It maintains that it is fully sold with 3 cargoes booked in January '09. This is in contrast to other small iron ore producers which are known to have struggled to sell ore during the Dec Q.

Territory is targeting iron ore production and sales of ~2.0mt in FY'09, of which the Dec H'08 should comprise roughly 0.85mt. A 2nd crushing plant, wet screening unit and upgraded port stockpiling area were commissioned in Dec'08. Accordingly the bulk of the FY'09 capex program has been spent.

Territory currently sells ore through the spot market and has been doing so since start-up. It is now contemplating switching its sales arrangements into the long term contract market where its pricing will be referenced to benchmark. It believes it has qualified for this through various trial cargoes and a good record of delivery on-specification. Further developments on this will occur during the March Q. While the benchmark related contracts will provide certainty, we do wonder whether TTY shareholders may be disadvantaged by the lag effect in benchmark prices should a market upswing occur. This is significant given TTY's short mine life of 2-3yrs based on known ore reserves at present.

We note the recent lift in spot iron ore price to China by ~US\$10/t to ~\$US80/t cif. This should translate into roughly A\$80/t to TTY fob avg for lump and fines using spot exchange rates for Frances Ck ore.

Unfortunately TTY has been caught by out of the money FX hedging. For the 8 mths to Feb'09 TTY had commitments of US\$94m at roughly A\$1=US\$0.88. The hedging value has breached its credit limit and TTY has been issued with a standstill notice. It is unknown how much of the hedging remains unsettled at end Dec'08. TTY is attempting to renegotiate the term of the hedges. We estimate the hedging will have cost shareholders ~\$22m or \$0.08/sh.

Exploration expenditure has been curtailed since the fall in ore prices and the onset of the wet season. Restarting exploration asap is vital for TTY given its short mine life.

TTY's balance sheet at June '09 showed total borrowings of \$34.7m of which \$26.9m is an unsecured short term loan from Noble. TTY had been negotiating to replace this with a larger conventional secured debt facility prior to the financial crisis. This is now unlikely and we would not be surprised to see the Noble debt restructured in some way.

Investment Case

Territory is operating well despite sustaining several blows over the last year, such as loans to and investments in non-core companies by previous management, a poorly executed commissioning, financial crisis causing sharply lower iron ore price and out of the money hedging.

Unfortunately these issues have all left the balance sheet in a stretched shape. We acknowledge that Noble has and is continuing to support Territory very well to the benefit of all shareholders, however the risk is that if the terms change it may not be as advantageous as is currently. We would much prefer to see Territory with a balance sheet that allowed it more control of its destiny.

The lower iron ore price has diminished value significantly, with our valuation now at \$0.26/sh. In view of the balance sheet risk we believe that a discount is justified. We have downgraded our recommendation to Hold.

The real driver of value will be through exploration success however TTY is not currently investing in this area.

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Top 20 Shareholders as at 24 September 2008

Shareholders	Shares (m)	(%)
1 Crawley Resources Limited	69.99	26.45
2 OM Holdings Limited	29.16	11.02
3 DCM Decometal GMBH	28.18	10.65
4 Zero Nominees Pty Ltd	6.94	2.62
5 Sun Hung Kai Investment Services Ltd	5.00	1.89
6 ANZ Nominees Limited	3.62	1.37
7 OCJ Investment (Australia) + Pty Ltd	3.51	1.33
8 HSBC Custody Nominees (Australia) Ltd	2.85	1.08
9 National Nominees Limited	2.34	0.89
10 UOB Kay Hian Private Limited	1.51	0.57
11 Mr Chunlin Ouyang	1.33	0.50
12 DBS Vickers Securities (Singapore) Pte Ltd	1.25	0.47
13 Tinkler Investments Pty Ltd	1.22	0.46
14 Pegmont Mines Limited	1.00	0.38
15 Mr K Bartley + Mr R Bartley + Mr A Bartley	0.88	0.33
16 Citicorp Nominees Pty Limited	0.86	0.33
17 Mr Phillip Clive Hardcastle	0.85	0.32
18 Mr Keith William Sheppard	0.80	0.30
19 Palazzo Nominees Pty Ltd	0.75	0.28
20 Gibbins Investments Pty Ltd	0.72	0.27
TOTAL	162.77	61.51

Market Statistics

Share Price	\$0.16 A\$/sh	Directors	
Issued Capital		A Simpson	Chair
FP Ord	264.6 m	A Quadrio	Mg Dir
Opt (@\$0.20/sh)	0.3 m	I McCubbing	NE Dir
Opt (@\$0.25/sh)	0.5 m	J Ariti	NE Dir
Opt (@\$0.40/sh)	7.0 m	M Donaldson	NE Dir
Opt (@\$0.50/sh)	2.5 m	F Harris	NE Dir
Opt (@\$0.60/sh)	1.3 m		
Total Dil. FPOrd	264.6 m	Shareholders	
Market Capitalisation	\$42 m	OM Holdings	11.0%
Enterprise Value	\$80 m	Noble	26.5%
Debt	\$40 m	DECOmetal	10.7%
Cash	\$2 m	CCJ Inv	5.0%

Share Price Performance



Territory Resources Ltd

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EUROZ

SECURITIES LIMITED

AUSTRALIAN RESEARCH

TERRITORY RESOURCES LTD (TTY)		YEAR END 30 JUNE				
		A\$M	A\$/sh			
ASSET VALUATION						
Frances Creek		74	0.28			
Hedging		0	0.00			
Corporate		-7	-0.03			
Residual Value		10	0.04			
Frances Ck Expl'n		15	0.06			
Other FeO Projects		5	0.02			
Investments (excl MON)		2	0.01			
Investments (MON)		0	0.00			
Loan to MON		0	0.00			
Working Capital		6	0.02			
Unpaid Capital		0	0.00			
Debt		-40	-0.15			
Cash		2	0.01			
Total @ 10% nom		68	0.26			
Total @ 0% nom		88	0.33			
Total @ 5% nom		77	0.29			
Total @ 15% nom		60	0.23			
FORECAST PRODUCTION		2008a	Jun H'09f	2009f	2010f	2011f
Frances Creek (100%)						
Lump Sales	kt	365	550	975	1,125	1,000
Fines Sales	kt	275	550	975	1,125	1,000
Total Fe Ore Sales	kt	640	1,100	1,950	2,250	2,000
Total Cash Costs	A\$/t	67	54	57	56	54
Net Lump Rec'd	US\$/t	88	62	72	71	-
Net Fines Rec'd	US\$/t	67	47	54	49	-
B'mark Lump JFY fob	US\$/dmtu	172.4	171.5	102.7	201.8	141.2
Foreign Exchange						
Avg Rate Ach'd	US\$:A\$	0.90	0.86	0.85	0.75	0.80
Ass'd Spot Rate	US\$:A\$	0.90	0.70	0.74	0.75	0.80
RATIO ANALYSIS		2008a	Jun H'09f	2009f	2010f	2011f
CF (A\$m)		(49.1)	4.1	4.1	39.4	30.9
CF / Sh (Ac/sh)		(18.5)	1.5	1.6	14.9	11.7
CF Ratio (x)		(4.6)	-	10.3	1.1	1.4
Earnings (A\$m)		(3.1)	(7.0)	(7.7)	18.3	12.5
EPS (Ac/sh)		(1.2)	(2.6)	(2.9)	6.9	4.7
EPS Growth (%)		-116%	-264%	-291%	692%	472%
Earnings Ratio (x)		-	-	-	2.3	3.4
E'prise Val. (A\$m)		259	75	75	44	13
EV : EBITDA (x)		332.9	4.1	2.9	0.8	0.3
EV : EBIT (x)		(27.0)	(7.4)	(18.4)	1.5	0.7
Net Debt / ND+Eq (%)		32%	35%	35%	4%	-43%
Interest Cover (x)		-	-	6	21	(42)
EBIT Margin (%)		-15%	0%	-3%	15%	12%
ROE (%)		-4%	-11%	-12%	24%	14%
ROA (%)		-7%	-4%	-3%	23%	14%
Div. (Ac/sh)		-	-	-	-	-
Div. payout ratio		0%	0%	0%	0%	0%
Div. Yield		0.0%	0.0%	0.0%	0.0%	0.0%
Div. Franking		0%	0%	0%	0%	0%

PROFIT AND LOSS	2008a	Jun H'09f	2009f	2010f	2011f		
Iron Ore Sales Revenue	58.0	86.1	163.0	183.0	147.5		
Forex Hedging Revenue	-	(13.9)	(19.0)	(0.0)	0.0		
Interest Revenue	1.5	0.0	0.1	0.5	0.8		
Other Revenue	4.2	-	-	-	-		
TOTAL REVENUE	63.8	72.3	144.1	183.6	148.3		
Operating Costs	46.2	59.2	110.2	125.3	108.7		
Dep/Amort	8.5	12.6	24.8	21.9	19.2		
Corp O/H	15.3	4.0	8.0	6.0	2.0		
Prov/w'off (expl'n)	0.2	0.5	5.0	1.5	0.5		
EBITDA	0.8	9.0	25.8	51.7	36.8		
EBIT	(9.6)	(5.1)	(4.0)	28.2	17.1		
Interest Expense	0.7	2.0	3.7	2.6	-		
NPBT	(8.8)	(7.0)	(7.7)	26.2	17.8		
Tax	(5.7)	-	-	7.9	5.4		
Minority Interest	-	-	-	-	-		
NET PROFIT	(3.1)	(7.0)	(7.7)	18.3	12.5		
Net Abnormal Gain/(Loss)	(44.6)	-	-	-	-		
NET PROFIT After Abn'l	(47.7)	(7.0)	(7.7)	18.3	12.5		
CASH FLOW		2008a	Jun H'09f	2009f	2010f	2011f	
Net Profit	-3.1	-7.0	-7.7	18.3	12.5		
+ Working Capital Adjustment	-11.8	0.0	0.0	0.0	0.0		
+ Dep/Amort	8.5	12.6	24.8	21.9	19.2		
+ Provisions / writeoffs (explor)	1.9	1.5	5.0	1.5	0.5		
+ Tax Expense	-5.7	0.0	0.0	7.9	5.4		
- Tax Paid	0.0	0.0	0.0	6.2	4.7		
Operating Cashflow	-10.1	7.1	22.1	43.4	32.9		
-Capex + Development	39.0	3.0	18.0	4.0	2.0		
-Exploration	2.1	1.0	5.0	8.5	0.0		
-Assets Purchased	76.4	0.0	0.0	0.0	0.0		
+Asset Sales	11.4	0.0	0.0	0.0	0.0		
Investing Cashflow	-106.0	-4.0	-23.0	-12.5	-2.0		
+ Equity Issues	66.5	0.0	0.0	0.0	0.0		
+Loan Drawdown/Receivable	0.0	0.0	5.0	0.0	0.0		
+Loans repaid from/(to) other entities	47.5	0.0	0.0	0.0	0.0		
-Loan Repayment	16.0	2.0	2.0	20.0	17.0		
-Dividends	0.0	0.0	0.0	0.0	0.0		
Financing Cashflow	98.0	-2.0	3.0	-20.0	-17.0		
Period Sur (Def)	-18.2	1.1	2.1	10.9	13.9		
Cash Balance	1.1	3.2	3.2	14.2	28.1		
BALANCE SHEET		2008a	Jun H'09f	2009f	2010f	2011f	
Assets							
Cash		1.1	3.2	3.2	14.2	28.1	
Current Receivables		12.2	12.2	12.2	12.2	12.2	
Other Current Assets		20.9	20.9	20.9	20.9	20.9	
Non-Current Assets		102.0	95.2	95.2	77.2	60.0	
Total Assets		136.2	131.5	131.5	124.5	121.2	
Liabilities							
Borrowings		34.7	37.7	37.7	17.7	0.7	
Current Accounts Payable		15.6	15.6	15.6	15.6	15.6	
Other Liabilities		14.4	14.4	14.4	14.4	14.4	
Total Liabilities		64.7	67.7	67.7	47.7	30.7	
Net Assets		71.5	63.8	63.8	76.8	90.5	
RESOURCES AND RESERVES							
		Reserves			Resources		
		mt	Fe	P	mt	Fe	P
Helene 6/7		1.83	61.2%	0.03%	2.45	61.6%	0.04%
Helene 5		1.13	59.0%	0.10%	1.38	59.7%	0.13%
Helene 2/3		0.10	65.2%	0.05%	0.68	62.3%	0.08%
Helene 9		0.15	59.8%	0.13%	0.19	59.6%	0.13%
Helene 11		0.14	60.2%	0.12%	0.18	60.0%	0.14%
Thelma/Rosemary		1.08	61.3%	0.20%	1.34	61.1%	0.21%
Jasmine East		0.71	61.8%	0.07%	1.28	61.0%	0.09%
Ochre Hill		0.47	59.8%	0.11%	1.21	59.8%	0.12%
Millers					1.28	53.2%	0.11%
Surface Fines					0.29	53.6%	0.08%
Others					0.44	58.7%	0.12%
Total		5.6	60.8%	0.10%	10.7	59.6%	0.11%

Resources Quarterly ▶ January 2009

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