

Company Review

Ord Minnett Research

Friday, 21st December 2007

Territory Resources Limited

Building up production at high spot prices

We regard the way Territory Resources Limited (Territory) is taking advantage of the high spot prices for iron ore as the company ramps up its output as an astute use of current market conditions. Territory is maximising its geographic proximity to the Asian markets for its output and in doing so is benefiting in a relative sense more than any other Australian iron ore exporter. The speed and extent to which Territory can increase its resources and in turn lift its sales of iron ore to take advantage of these favourable market conditions will determine its success in the medium term. Our recommendation is based on the following:

- Increasing output at Frances Creek to maximise the company's advantage as a producer of haematite DSO that is being successfully sold in the spot market at prices well above the ruling benchmark level
- Having direct access to infrastructure that can be readily expanded
- Potential to expand iron ore production with addition of output from Mt Bunday and other areas
- Leveraging opportunities to become a more broadly based carbon steel materials supplier using its iron ore operations and strong Northern Territory tenement position as a springboard

Our base case valuation of Territory is \$1.77 per share and upside valuation is \$2.14 per share. Our 12-month price target is \$1.65.

Key Financials

Year-end June (A\$)	FY07A	FY08E	FY09E	FY10E
Total Revenue (\$M)	0.7	106.6	229.0	286.5
Op Profit before tax (\$M)	(6.9)	34.2	95.6	123.4
Reported NPAT (\$M)	(6.9)	26.0	73.0	86.4
Reported EPS (¢)	(3.0)	12.4	33.9	40.2
Fully diluted EPS (¢)	(4.7)	12.2	33.2	39.2
Reported P/E (x)	(46.8)	11.2	4.1	3.4
EV/EBITDA	(37.2)	5.8	2.3	1.7
Dividend (¢)	0.0	0.0	0.0	0.0
Net Yield (%)	0.0	0.0	0.0	0.0
Franking (%)	0%	0%	0%	0%
EPS Growth (%)	Na	na	171%	18%
Normalised P/E (x)	(27.6)	10.7	4.0	3.3
Normalised ROE (%)	-17%	30%	69%	66%

Source: Iress, Company Data, Ord Minnett Estimates.
Share price: \$ 1.31 Dec 17, 2007.

TTY A\$1.31

Recommendation
Buy

Risk Assessment
High

Materials, Metals and Mining

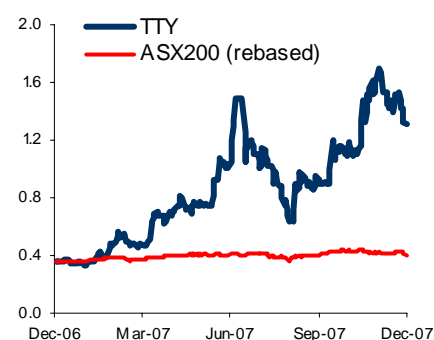
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Territory Resources

ASX Code	TTY
52 week range	A\$1.74 - A\$ 0.33
Market Cap	\$289M
Shares Outstanding	215.1M
Av Daily Turnover	\$0.9M
ASX All Ordinaries	6331.8
ASX200 Resources	6119.6
Net Cash Sep 07	\$4M

Relative price performance



Source: Iress

Background and Strategy

After having listed in March 2005 as Territory Iron with the objective of developing the Frances Creek iron ore mine in the Northern Territory, the company's strategy has been broadened recently to becoming a significant force in the carbon steel materials supply area. The change of the company's name to Territory Resources in May 2007 reflected this broader focus while indicating the company's continuing concentration on exploration and development projects in the Northern Territory.

Development of the Frances Creek mine remains the company's major focus as part of the company's long term vision is to build its iron ore output up to about 10Mtpa and also to produce significant amounts of manganese, chrome and mineral sands, particularly zircon. To this end, the company has recently taken a number of minority positions in small resource companies involved in the exploration and production of these commodities.

Iron ore was original focus

Operations

The company began producing a relatively small amount of direct shipping high grade haematite ore from the Frances Creek mine, located near Pine Creek (Figure 21), about 200 km south of Darwin in the Northern Territory in June 2007. The Frances Creek deposits, which were discovered in 1960 by two Darwin prospectors, Mr L. Harmarnis and Mr K. Waters, were first mined by an Australian company, Duval Holdings, from mid 1967 to December 1974 when the operations were closed because the Government-owned shiploader at Darwin was destroyed by Cyclone Tracy that followed a very big increase in rail freights on the aging Katherine railway line.

Figure 21. Map showing location of Territory's iron ore projects



Source: Territory Resources

Frances Creek Project

The company achieved its first shipment of iron ore from Darwin in September 2007, which was sent to China following initial ore production by the company at the Frances Creek mine in June 2007. The mine is a collection of deposits, of which the main ones are Helene 6/7 and Thelma Rosemary.

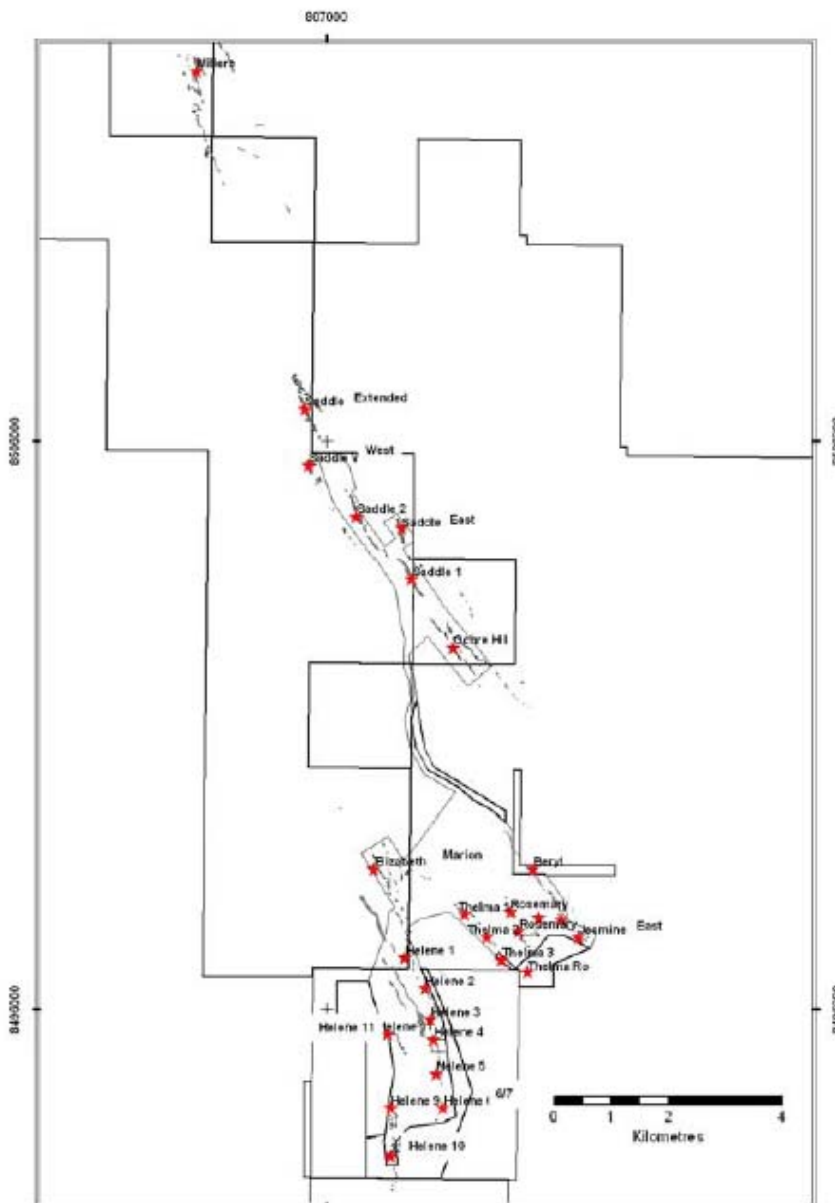
Mine production is currently building up to a rate of 1.5Mtpa, expected to be achieved in early 2008. Further expansion of output after that is currently under review, which is being done in conjunction with a major drilling program to extend the mine life and increase reserves, but it is likely that production will be raised towards about 2.5Mtpa over the course of 2008 as the company moves towards its stated desire to lift output to 3Mtpa, which is the nameplate capacity of the crushing and screening plant.

Current operations consist of mining and then crushing and screening (after the ore has dried out sufficiently) followed by transportation. The screened ore is taken 16km from the mine by road train to a new automated loadout facility at the Frances Creek siding from where it is loaded into rail cars and transported about 190km along the new Alice Springs to Darwin railway. At Darwin, the ore is unloaded at the company's new 0.25Mt stockpile area at the Port of Darwin for subsequent shiploading using the Darwin Port Corporation's new bulk loader which is capable of loading panamax-sized vessels. The ore is exported to Asia, principally China.

After achieving the initial target rate of 1.5Mtpa, mine production is expected to be raised towards 3Mtpa with opportunities for that being reviewed and assessed currently. Output could be raised further if additional ore reserves can be established at Frances Creek and if other satellite orebodies are brought on stream and an additional railway siding is added along the route to Darwin.

Marketing of Frances Creek ore is done by the company's partner, the Noble Group Limited (Noble) of Hong Kong, which has a life-of-mine marketing agreement. Noble currently trades 20Mtpa of iron ore in China.

Figure 22. Iron ore prospects at Frances Creek



Source: Territory Resources

Territory has outlined resources of 10Mt averaging 60.5% Fe at Frances Creek from which current ore reserves of 5Mt averaging 61.3% Fe had been defined (Tables 14 and 15 below). The reserves established to date at Frances Creek underpin initial operations at a modest level for three to four years but with numerous deposits and prospects already identified in and around the existing Frances Creek mine and at places along the 40km of strike of the Wildman Siltstone, which is the main prospective iron ore unit, it is most likely that reserves at Frances Creek will be expanded significantly over the next few years. Territory has added to its tenement holdings in the area and has been conducting a very aggressive drilling program to identify further resources and to increase reserves.

Exploration at Frances Creek, including ongoing drilling programs, is continuing to focus on the mine area and northern tenements. Over 16,000m of RC drilling was completed in the latest quarter.

Table 14. Total indicated and inferred resources for Frances Creek at 55% Fe cut-off

Deposit	Mt	%Fe	% P
Helene 2/3	0.7	62.4	0.08
Helene 5	1.4	59.7	0.13
Helene 6/7	3.0	61.9	0.04
Thelma Rosemary	1.9	61.1	0.19
Jasmine East	0.3	59.5	0.07
Thelma 2	0.2	63.5	-
Ochre Hill	1.2	59.4	0.11
Saddle East	0.1	58.7	0.08
Millers1	1.0	58.5	0.09
Ore Fines2	0.4	53.7	0.08
TOTAL	10.1	60.5	0.10

Note: 1. Fe grade quoted is Fe + Mn grade at a 50% Fe cut-off
2. Ore fines quoted at a 50% Fe cut-off

Table 15. Frances Creek ore reserves at 55% Fe cut-off

Deposit	Mt	%Fe	% SiO ₂	% P	% Al ₂ O ₃
Helene 2/3	0.3	64.4	3.73	0.08	2.01
Helene 5	0.6	59.1	8.85	0.06	3.31
Helene 6/7	1.4	63.4	5.46	0.03	2.29
Thelma Rosemary	1.3	61.1	5.58	0.19	3.59
Jasmine East	0.2	59.3	8.01	0.06	4.12
Ochre Hill	1.0	59.5	9.29	0.09	2.81
Ore Fines1	0.2	60.0	8.00	0.08	3.40
TOTAL	5.0	61.3	6.77	0.09	2.95

Note: 1. Ore fines quoted at a 50% Fe cut-off

Mt Bunday Project

The Mt Bunday project, located about 95kms southeast of Darwin in the Northern Territory, is also the site of previous iron ore mining, with Mount Morgan Ltd having operated a small haematite mine there between 1968 and 1971 that produced less than 1Mt. The mine shut for various reasons, but particularly because of rapidly escalating freight rates on the old Katherine railway.

Exploration work at Mt Bunday over the past year has included the drilling of three of the seven high priority aeromagnetic and conducting radiometric a survey and soil geochemical sampling survey. Recent drilling of the aeromagnetic anomalies intersected strong magnetite mineralisation with visible pyrrhotite and pyrite in holes adjacent to a shallow hole drilled last year that included the intersection of 7m averaging 62.4% Fe.

The recent geochemical soil sampling survey was carried out over an area of about 1km² that straddled drill holes from last year that intersected anomalous copper-cobalt-molybdenum mineralisation. A strongly defined 200m diameter anomaly was defined by copper and molybdenum values and was planned to be drilled in the December 2007 quarter.

The company had previously identified three uranium anomalies in the Mt Goyder area that appeared to be related to palaeochannel and regolith features and so it recently conducted a radiometric survey that identified 20 anomalous features that are also expected to be followed up by further work in the December 2007 quarter.

Other Project Areas

The focus on the Frances Creek and to a lesser extent the Mt Bundey area and unavailability of drilling rigs meant that the company's other projects, being Yarram (for iron ore), Bachelor (for goethite – limonite iron ore and possibly uranium), and Warrego (where the magnetite tailings have been the subject of studies by a third party into the recovery of metals other than iron such as gold, copper, and bismuth) in the Northern Territory, and its Burkina Faso joint venture in Africa were subjected to little or no exploration work in the past year.

Mining Investments

As part of its strategy to broaden its focus to carbon steel materials, the company has recently acquired a number of holdings in listed resource companies. These include a shareholding of 8.6% in Matilda Minerals (MAL), 15.7% and 4M options in Northern Mining (NMI), and 19.7% of Olympia Resources (OLY). The current market value of these interests is just under \$7M.

Financial Position

As a result of raising \$15.8M in its recent shareholder share purchase plan, the company is estimated to be in a good financial position to expand its Frances Creek operations to the initial target rate of 1.5Mtpa and undertake the associated exploration and evaluation activities of the mine and its other project areas. The company held cash of just over \$4M at 30 September 2007 and is believed to have negligible debt so that as it builds up its iron ore sales, it should be starting to generate useful operating cash flow from them.

With capital expenditure on the Frances Creek mine over the course of FY08 expected to be relatively modest at less than \$12M (of which the majority has already been spent) and the cost of building up ore stocks in the same time estimated at about \$10M (and also largely already done), the company's major cash outflows should have stopped and the company should be strongly cash flow positive in 2H08. This should enable it to build up its net cash position towards an estimated \$49M by the end of FY08 as it assesses its expansion options.

Most capital expenditure completed so strong cash flows set to build cash reserves ahead of expansion options

Directors And Management

While Territory has assembled a board and management team with considerable and varied mining industry experience, most of the management team has relatively limited direct iron ore experience and lacks extensive contacts and long standing relationships with the steel mills and related iron ore customers. Nevertheless, the company does have an experienced partner in Noble of Hong Kong, with which it has a life-of-mine marketing agreement. Noble has considerable experience in shipping and logistics, and iron ore marketing that includes direct relationships with Chinese steel mills.

Michael Kiernan is the Executive Chairman. He has more than 30 years experience in the resources industry including transport, contracting, and mining, having held executive positions with Australia's major mining and transport contractors. He was the founding Managing Director of Consolidated Minerals. He is currently a director of Monarch Gold, Mineral Resources, India Resources, Precious Metals Australia, Matilda Minerals, and Peel Exploration. He holds a 30% shareholding in Crawley Resources, which is the major shareholder of Territory with a 27.9% holding.

Alan Quadrio is the Managing Director. He is a metallurgist with over 25 years of experience of mining operations that has included positions as resident manager at

various nickel and gold mining operations in Western Australia. He is currently a director of Monarch Gold mining Company and India Resources and was previously a director of Consolidated Minerals, Mithril Resources and Croesus Mining.

Bruce McFadzean is Director of Operations. He is a mining engineer with 30 years of experience in iron ore, diamonds, gold, nickel, and cobalt operations in Australia, Indonesia and New Zealand, which has included 15 years with BHP Iron Ore and Rio Tinto.

Andrew Simpson is Director of Marketing. He is a senior marketing executive with extensive global marketing experience in the resources sector, having held various marketing positions throughout Asia and Europe. He is a director of Vital Metals, Swick Mining Services, ABM Resources, Crawley Resources, India Resources, Precious Metals Australia and Matilda Minerals.

JulieAnne Wolseley is a non-executive director. She is a Chartered Accountant and the principal of a corporate advisory firm that is active in the resources sector. She is a director of OM Holdings and is joint company secretary of that company.

Peter Rutledge is the Company Secretary. He is a Chartered Accountant and has held the position of Company Secretary for a number of listed companies over the past 20 years.

John Murphy is the Mine Operations Manager and is a mining engineer with over 24 years of experience in Australia.

Bob Vivian is the Exploration Manager and is a geologist with over 30 years of experience throughout Australasia, Southeast Asia, Papua New Guinea and Indonesia.

Adam Roach is the Mine Superintendent and is a civil and mining engineer with over eight years experience in the mining industry.

Ian McCubbing is the General Manager Finance and Administration and is a Chartered Accountant with about 30 years experience in corporate advisory mergers and acquisitions and equity raisings.

Eric Palmbachs is the Chief Financial Officer and is an accountant with over 25 years of experience in the mining, brewing, timber and energy industries.

Key Investment Drivers and Risks

The **key investment drivers** for Territory are

- The ability to rapidly expand resources and reserves at the Frances Creek mine to enable the operations to be expanded to take advantage of the strong iron ore market conditions and access to infrastructure
- The ability to consistently and readily achieve a price for its iron ore that is above the benchmark contract price without having to build up large stockpiles
- To develop other iron ore deposits to give the company operational diversification and added ability to sustainably expand its output
- To generate consistently strong financial returns that enable appropriate returns to be made to the shareholders by way of dividends and other rewards

Bruce McFadzean has extensive iron ore operations experience

Expansion of output is a key driver

Building resource base is a key challenge

Key risks for the company are

- That weather or other factors affect its ability to produce, rail or ship its iron ore which results in it losing its ability to obtain sales on favourable terms
- That it is unable to define sufficient additional reserves and resources to enable its operations to expand or continue for more than a few years
- That iron ore demand deteriorates and spot prices fall below the benchmark contract price, making the company sell its iron ore on a less favourable basis

Valuation Aspects

Our valuation of the company's assets is dominated by the value of the Frances Creek DSO project, which is conditional on the ability of Territory to establish significantly larger ore reserves to support DSO operations that build up to the rate of 3Mtpa by the end of 2011 and rise to 4Mtpa in 2012 for total production of 23Mt over 8 years. Our analysis of the indicative economics of an additional haematite/magnetite project at the Mt Bundey project indicates that while it could be potentially marginal if it requires significant capital expenditure to make an appropriate magnetite product, the ability to produce even relatively small volumes of haematite could be highly attractive provided the capital cost is modest as it was at Frances Creek. We have ascribed upside value to the potential for the operations to be extended by another 4 years at the rate of 4Mtpa and for some exploration success from the company's other mineral interests.

Table 16. Summary valuation of Territory Resources

	Base Case		Upside Case	
	\$M	Value (\$) per Share ¹ (fully diluted)	\$M	Value (\$) per Share ¹ (fully diluted)
Assessed value of Frances Creek DSO projects	328	1.51	405	1.96
Assessed value of Mt Bundey and Warrego magnetite projects ²	10	0.05	10	0.05
Assessed value of other mineral assets	10	0.05	15	0.07
Market value of mining investments	7	0.04	7	0.04
Sub total of mineral assets	355	1.63	437	2.00
Add - Net financial assets	31	0.14	31	0.14
Total net value	387	1.77	468	2.14

Note: 1. Per share valuation does not add exactly as each component has been done on a fully diluted basis, making for duplication when summed

2. Based on NPV at 10% discount rate of DSO projects

Recommendation

The strong global steel demand has driven up spot prices to where they are now at a significant premium to the longer term benchmark contract price level. Territory, as the most spot market price-oriented Australian producer, stands to be a major beneficiary of this as spot prices are set to remain well above the benchmark level as the company ramps up its output. The speed and extent of the company's ability to increase its resources and reserves and in turn lift its sales of iron ore to take advantage of these favourable market conditions will determine its success in the medium term. The level of success the company can achieve from its position as an existing iron ore producer and one with important Northern Territory tenements will also ultimately have a large bearing on how quickly it can advance towards its goal of becoming a significant and diversified carbon steel material producer and generate strong returns for its shareholders in the process.

Financial Summary

Territory Resources Limited

Profit & Loss Statement (\$M)	FY07A	FY08E	FY09E	FY10E
Operating Revenue	0	106	226	283
Operating Costs	(7)	(64)	(120)	(147)
EBITDA	(7)	42	107	137
Depreciation & Amortisation	(0)	(8)	(14)	(17)
EBIT	(8)	33	93	120
Net Interest Expense	1	1	3	3
Pre-Tax Profit	(7)	34	96	123
Tax Expense / Benefits	0	(8)	(23)	(37)
Reported NPAT	(7)	26	73	86
Significant items (after-tax)	0	0	0	0
Normalised NPAT	(7)	26	73	86
EBITDA Margin (%)	na	0	0	0
Effective tax Rate (%)	0	0	0	0
EPS Reported (cps)	(3)	12	34	40
EPS Normalised (cps)	(5)	12	33	39
DPS (cps)	0	0	0	0
Payout Ratio (%)	0	0	0	0
Franking (%)	0	0	0	0

Cash Flow Statement (\$M)	FY07A	FY08E	FY09E	FY10E
Pre-Tax Operating Cash Flow	(5)	29	111	142
Tax Paid	0	0	(21)	(33)
Operating Cash Flow	(5)	29	90	109
Explorations / Net Acquisitions	(5)	(9)	(8)	(5)
Capex	(14)	(12)	(10)	(7)
Other Investing Items	(1)	0	(3)	(6)
Investing Cash Flow	(20)	(21)	(21)	(18)
Inc/(Dec) in Equity	29	19	0	0
Inc/(Dec) in Borrowings	0	0	0	0
Dividends Paid	0	0	0	0
Financing Cash Flow	29	19	0	0
Net Inc/(Dec) in Cash	4	27	69	91

Balance Sheet (\$M)	FY07A	FY08E	FY09E	FY10E
Cash	19	46	46	60
Other Current Assets	3	3	3	3
Total Current Assets	22	49	49	63
Fixed Assets	10	22	32	39
Explorations & Developments	18	23	31	36
Other Non Current Assets	0	4	4	4
Total Assets	50	98	116	142
Current liabilities	8	8	8	8
Long term Debt	0	0	0	0
Other Non Current Liabilities	1	1	1	1
Total Liabilities	10	10	10	10
Total Equity	40	88	106	132
Net Debt	(19)	(46)	(46)	(60)

Source: Ord Minnett estimates, Company data.

Assumptions	FY07A	FY08E	FY09E	FY10E
Iron Ore Lump (¢US/dmtu)	96	110	138	152
Iron Ore Fines (¢US/dmtu)	75	86	108	119
\$US/\$A	0.88	0.90	0.90	0.90

Production	FY07A	FY08E	FY09E	FY10E
DSO - Frances Creek	0.0 Mt	1.3 Mt	2.0 Mt	2.3 Mt

JORC Resource Estimates	Owned	Size	%Fe
Frances Creek	100%	10.1 Mt	60.5%
Total		10.1 Mt	60.5%

Major Shareholders	Million	(%)	Date
Crawley Resources	60.0	27.9	23/11/07
OM Holdings	25.0	11.6	23/11/07

Valuation Ratios (x)	FY07A	FY08E	FY09E	FY10E
Reported P/E	-44.4	10.6	3.9	3.3
Normalised P/E	-27.6	10.7	4.0	3.3
Price To Cash Flow	-54.8	10.0	3.2	2.7
EV/EBITDA	-37.2	5.8	2.3	1.7
EV/EBIT	-35.4	7.3	2.6	1.9

Leverage	FY07A	FY08E	FY09E	FY10E
Net Debt/Equity	Net Cash	Net Cash	Net Cash	Net Cash
Net Debt/Total Assets	Net Cash	Net Cash	Net Cash	Net Cash
Interest Cover (x)	846.6	na	na	na

Valuation	Base		Upside	
	\$M	¢ per share	\$M	¢ per share
NPV @ 10% of DSO operations	328	151	405	185
Mt BundeWarrego Magnetite	10	5	10	5
Other Mineral Assets	10	5	15	7
Mining investments	7	4	7	4
Total Mineral Assets	355	163	437	200
Less Net Financials	31	14	31	14
Total Net Assets	387	177	468	214

NPV	Base: \$1.77	Upside: \$2.14
Discount to valuation	35%	63%

Current price	\$1.31
Recommendation	Buy
Risk rating	High

Please contact your Ord Minnett Adviser for further information on our document.

Guide to Ord Minnett Recommendations

BUY	The stock's total return (nominal dividend yield plus capital appreciation) is expected to exceed 15% over 12 months.
ACCUMULATE	The stock's total return is expected to be between 5% and 15%. Investors may add to existing holdings, or initiate holdings on share price weakness.
HOLD	The stock is fairly priced, and its total return is expected to be between 0% and 5%.
LIGHTEN	The stock's total return is expected to be less than 0% and possibly down 15%. Investors should consider selling into share price strength.
SELL	The stock's total return is expected to lose 15% or more.
RISK ASSESSMENT	Classified as High, Medium or Low, denotes the relative assessment of an individual stock's risk based on an appraisal of its disclosed financial information, volatility, nature of its operations and other relevant quantitative and qualitative criteria.

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