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Melbourne	Sydney	London	Internet
Tel: 61 3) 9226 0000	Tel: 61 2) 9226 0000	Tel: 44 0) 207 201 2183	http://www.bby.com.au/
Fax: 61 3) 9226 0244	Fax: 61 2) 9226 0066	Fax: 44 0) 207 201 2181	

Arafura Resources Limited

100% upside in worst case, with potential to reduce RSPT impact

ARU A$0.44

SPECULATIVE BUY

2 June 2010

Andrew Sullivan
+61 2 9226 0100
ajs@bby.com.au

BBY has evaluated the impact of the RSPT as initially proposed and prior to the conclusion of the ongoing industry consultation process. The effect of the RSPT decreases BBY's base case NPV by 23% from AUD345M to AUD266M. Despite the potential RSPT the NPV remains 107% above Arafura Resources Limited's (ARU) current market cap. The mechanics of an RSPT for ARU may change significantly given the difference between rare earths and other commodities. The value of a 6% rare earth concentrate would be minimal without the unique chemical processing facility the company intends to build. We maintain our SPECULATIVE BUY recommendation and 12 month price target of A$1.11/sh.

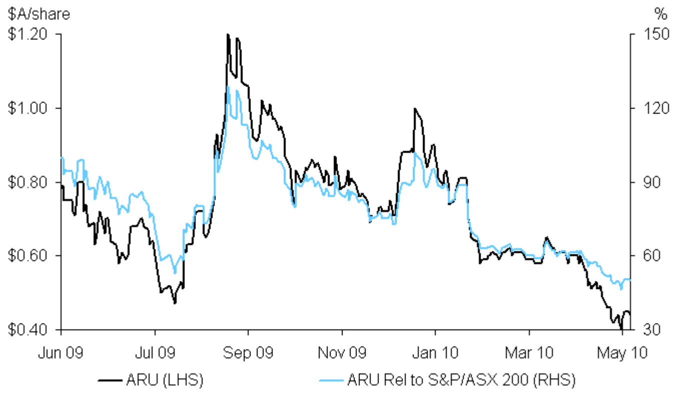
- **RSPT Impact** – As proposed (40% tax on profits with a hurdle rate set at long term bond rate) BBY's NPV for ARU's Nolans Project decreases by 23% to AUD266M. BBY's analysis shows the RSPT calculation is sensitive to these assumptions. For example, if the hurdle rate is lifted to 11.3% the effect of the new tax is negated as the RSPT allowance increases and the assessable income decreases to the point that the new tax would equal the state royalty rebate.
- **RSPT Application** – The application of the RSPT to ARU's Nolans Project is not clear. The government has stated that low value minerals may be exempted. The question is whether this will extend to the 6% rare earth concentrate ARU will be produce at Nolans. The impact of the RSPT on this mineral concentrate would be much less than that of the product from the chemical separation plant. The value uplift from ore to end product is achieved primarily through chemical separation, however this does not diminish the importance of the ore. The majority of capital and operating costs, not to mention risk, associated with the project will be sunk in the chemical separation facility.
- **Project Update** – ARU recently completed a A$19.5M capital raising which included a placement to institutional and sophisticated investors to raise A$17.5M. The proceeds are being used to progress the company's Nolans project, including the Bankable Feasibility Study (BFS) and additional resource drilling. The BFS is scheduled to be released by the end of December 2010.

Company Data	
Number of shares	290.6M
Market capitalisation	$128M
Free Float	74.0%
12 month high/low	$1.29/$0.38
Average monthly turnover	$128M
All Ordinaries Index	4437
% All Ordinaries	0.01
GICS Industry Group	Materials

Earnings summary (AUD)

Year end June	2009A	2010F	2011F	2012F
Net Attributable Profit ($M)	(13.7)	(12.8)	(12.7)	(13.8)
Reported Profit ($M)	(13.7)	(12.8)	(12.7)	(13.8)
EPS (¢)	(6.8)	(4.7)	(4.2)	(4.5)
P/E (x)	(10.2)	(9.4)	(10.6)	(9.8)
CFPS (c)	(4.8)	(5.3)	(4.1)	(4.5)
P/CF (¢)	(14.4)	(8.3)	(10.6)	(9.8)
DPS (c)	0.0	0.0	0.0	0.0
EV/EBITDA (x)	(11.1)	(7.1)	(8.2)	(9.3)
Franking (%)	100.0	100.0	100.0	100.0

ARU versus S&P/ASX 200



Financial Summary

Arafura Resources Limited

Share Price (A$) $0.44 | Mkt Cap (A$M) 128

Year ending June 30

Assumptions	2008A	2009A	2010F	2011F	2012F	2013F	2014F	2015F
Exchange Rate (A$/US$)	0.90	0.75	0.89	0.87	0.82	0.80	0.78	0.78
Rare Earth Basket Price (US$/t)	12905	10084	12426	13474	13908	14204	14204	14204
Phosphoric Acid Price (US$/t)	1119	1367	497	524	518	513	507	501
Uranium price (US$/lb)	80	51	50	53	59	57	52	49
Calcium chloride (US$/t)	100	100	100	100	100	100	100	100

Production	2008A	2009A	2010F	2011F	2012F	2013F	2014F	2015F
Rare Earths (t)	0	0	0	0	0	0	6996	14204
Phosphoric Acid (t)	0	0	0	0	0	0	55584	112853
Uranium (lb)	0	0	0	0	0	0	102267	207633
Calcium Chloride (t)	0	0	0	0	0	0	132000	268000

Profit & Loss (A$M)	2008A	2009A	2010F	2011F	2012F	2013F	2014F	2015F
Total Revenue	4.2	1.0	0.0	0.0	0.0	0.0	187.9	378.8
Growth (%)	599.3	(77.0)	(100.0)					101.6
EBITDA	(7.4)	(13.0)	(14.0)	(14.0)	(14.0)	(14.0)	13.9	145.9
Growth (%)	(36.8)	(75.9)	(7.4)	0.0	0.0	0.0	199.6	949.3
Dep'n and amort'n	(0.2)	(1.0)	0.0	0.0	0.0	(2.5)	(17.0)	(28.3)
EBIT	(7.5)	(14.0)	(14.0)	(14.0)	(14.0)	(16.4)	(3.1)	117.6
Net interest expense	0.8	0.3	1.2	1.3	0.2	(3.5)	(21.0)	(31.2)
PBT	(6.7)	(13.7)	(12.8)	(12.7)	(13.8)	(20.0)	(24.1)	86.4
Growth (%)	(33.0)	(103.0)	6.4	0.6	(8.0)	(45.2)	(20.5)	459.0
Tax	0.4	0.0	0.0	0.0	0.0	0.0	0.0	(25.9)
NPAT Underlying attrib.	**(6.4)**	**(13.7)**	**(12.8)**	**(12.7)**	**(13.8)**	**(20.0)**	**(24.1)**	**60.5**
Growth (%)	(25.6)	(114.9)	6.4	0.6	(8.0)	(45.2)	(20.5)	351.3
NPAT Reported	**(6.4)**	**(13.7)**	**(12.8)**	**(12.7)**	**(13.8)**	**(20.0)**	**(24.1)**	**60.5**
Normalised NPAT	**(6.4)**	**(13.7)**	**(12.8)**	**(12.7)**	**(13.8)**	**(20.0)**	**(24.1)**	**60.5**
Ord Shares	157.2	223.2	290.7	290.7	290.7	290.7	290.7	290.7
Options	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Fully Diluted	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
FD Wgted Av Shares	148.3	200.2	272.6	306.4	306.4	306.4	306.4	306.4

Cashflow (A$M)	2008A	2009A	2010F	2011F	2012F	2013F	2014F	2015F
Customer receipts	0.0	0.0	0.0	0.0	0.0	0.0	187.9	378.8
Supplier Payments	(9.1)	(11.0)	(14.0)	(14.0)	(14.0)	(14.0)	(174.0)	(232.9)
Net interest paid	0.8	0.3	1.2	1.3	0.2	(3.5)	(21.0)	(31.2)
Taxes Paid	0.0	0.0	0.0	0.0	0.0	0.0	0.0	(25.9)
Net operating cash flow	**(5.7)**	**(9.7)**	**(14.5)**	**(12.7)**	**(13.7)**	**(17.5)**	**(38.0)**	**57.4**
Capex	(6.4)	(11.9)	(2.1)	(2.1)	(2.1)	(102.1)	(502.1)	0.0
Net investing cash flow	**(4.3)**	**(12.8)**	**(2.1)**	**(2.1)**	**(2.1)**	**(102.1)**	**(502.1)**	**0.0**
Dividends paid	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net financing cash flow	**20.1**	**18.8**	**34.0**	**0.0**	**10.0**	**120.0**	**540.0**	**0.0**
Net Change in cash	**10.1**	**(3.7)**	**17.3**	**(14.8)**	**(5.8)**	**0.4**	**(0.1)**	**57.4**
Net cash at end of period	**14.8**	**11.1**	**28.4**	**13.6**	**7.8**	**8.2**	**8.2**	**65.6**
Free cash flow	(5.7)	(9.7)	(14.5)	(12.7)	(13.7)	(17.5)	(38.0)	57.4

Balance sheet (A$M)	2008A	2009A	2010F	2011F	2012F	2013F	2014F	2015F
Cash	14.8	11.1	28.4	13.6	7.8	8.2	8.2	65.6
Receivables	0.2	0.1	0.0	0.0	0.0	0.0	15.4	31.1
Inventories	0.0	0.0	0.0	0.0	0.0	0.0	30.9	62.3
Current assets	**15.0**	**11.2**	**28.4**	**13.6**	**7.8**	**8.2**	**54.5**	**159.0**
Tangible Assets	15.3	24.7	26.8	28.8	30.9	130.5	615.6	587.3
Investments	0.8	0.9	0.9	0.9	0.9	0.9	0.9	0.9
Goodwill	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total assets	**31.2**	**36.7**	**56.1**	**43.3**	**39.6**	**139.6**	**671.0**	**747.1**
Payables	4.5	1.8	0.0	0.0	0.0	0.0	15.4	31.1
Current Term debt	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Long term debt	0.0	0.0	0.0	0.0	10.0	130.0	670.0	670.0
Total liabilities	**4.6**	**1.9**	**0.1**	**0.1**	**10.1**	**130.1**	**685.5**	**701.2**
Total Shareholder Equity	**26.5**	**34.9**	**56.0**	**43.3**	**29.5**	**9.6**	**(14.5)**	**45.9**

Investment summary	2008A	2009A	2010F	2011F	2012F	2013F	2014F	2015F
NPAT reported	(6.4)	(13.7)	(12.8)	(12.7)	(13.8)	(20.0)	(24.1)	60.5
NPAT Underlying	(6.4)	(13.7)	(12.8)	(12.7)	(13.8)	(20.0)	(24.1)	60.5
EPS Reported	(4.3)	(6.8)	(4.7)	(4.2)	(4.5)	(6.5)	(7.9)	19.7
EPS Underlying	(4.3)	(6.8)	(4.7)	(4.2)	(4.5)	(6.5)	(7.9)	19.7
EPS Growth (%)	(0.1)	(59.2)	31.3	11.6	(8.0)	(45.2)	(20.5)	351.3
P/E Underlying (x)	(18.4)	(10.2)	(9.4)	(10.6)	(9.8)	(6.8)	(5.6)	2.2
Dividend (¢/sh)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Payout Ratio (%)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Yield (%)								
Franking (%)	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Key Ratios	2008A	2009A	2010F	2011F	2012F	2013F	2014F	2015F
Profitability (%)								
EBITDA	(7.4)	(13.0)	(14.0)	(14.0)	(14.0)	(14.0)	13.9	145.9
EBITDA/Rev (%)	(176.0)	(1,349.6)	na	na	na	na	7.4	38.5
EBIT	(7.5)	(14.0)	(14.0)	(14.0)	(14.0)	(16.4)	(3.1)	117.6
EBIT/Rev (%)	(179.7)	(1,454.6)	na	na	na	na	(1.6)	31.0
NPAT	(6.4)	(13.7)	(12.8)	(12.7)	(13.8)	(20.0)	(24.1)	60.5
NPAT/Rev (%)	(151.8)	(1,421.5)	na	na	na	na	(12.8)	16.0
ROE (%)	(32.0)	(44.6)	(28.2)	(25.7)	(37.8)	(102.2)	(972.9)	384.4
ROA (%)	(33.4)	(41.3)	(30.2)	(28.2)	(33.7)	(18.3)	(0.8)	16.6
ROIC (%)	(73.2)	(78.6)	(54.4)	(48.8)	(45.5)	(20.1)	(0.8)	18.1
Financial Strength								
Debt to equity (%)	0.5	0.2	0.1	0.1	34.1	1,361.1	(4,620.9)	1,458.2
Net debt ($M)	(14.7)	(11.0)	(28.4)	(13.6)	2.2	121.8	661.9	604.5
Net debt to equity (%)	(55.4)	(31.7)	(50.7)	(31.4)	7.6	1,275.0	(4,564.5)	1,315.5
Net Debt to EBITDA (%)	2.0	0.8	2.0	1.0	(0.2)	(8.7)	47.6	4.1
Interest Cover EBIT (x)	(499.1)	(2,229.1)	(3,895.0)	(3,224.2)	(34.6)	(4.1)	(0.1)	3.5
Current Ratio (x)	3.3	6.0	1,422.4	682.3	391.3	411.5	3.5	5.1
Quick Ratio (x)	3.3	6.0	1,422.4	682.3	391.3	411.5	1.5	3.1
Valuation								
Operating cash flow	(5.7)	(9.7)	(14.5)	(12.7)	(13.7)	(17.5)	(38.0)	57.4
CFPS (¢ - FD)	(3.8)	(4.8)	(5.3)	(4.1)	(4.5)	(5.7)	(12.4)	18.7
Price/CF	(20.8)	(14.4)	(8.3)	(10.6)	(9.8)	(7.7)	(3.6)	2.3
BV per share ($)	0.2	0.2	0.2	0.1	0.1	0.0	0.0	0.2
Price/Book Value (x)	4.7	4.5	2.3	3.0	4.3	13.4	(8.8)	2.8
NTA ($)	26.5	34.9	56.0	43.3	29.5	9.6	(14.5)	45.9
NTA per share ($)	0.2	0.2	0.2	0.1	0.1	0.0	0.0	0.2
Price/NTA (x)	4.7	4.5	2.3	3.0	4.3	13.4	(8.8)	2.8
EV/Sales (x)	25.3	149.6					4.2	1.9
EV/EBITDA (x)	(14.4)	(11.1)	(7.1)	(8.2)	(9.3)	(17.9)	56.8	5.0
EV/EBIT (x)	(14.1)	(10.3)	(7.1)	(8.2)	(9.3)	(15.2)	(257.0)	6.2

Source: BBY, Company Reports

RSPT

BBY has modelled the effect of the RSPT as proposed and run a number of scenarios assuming the hurdle rate is increased. Table 1 shows the NPV of the Nolans project with the RSPT calculated at various hurdle rates. Table 1 also shows BBY's NPV for the Nolans project with no RSPT (AUD345M).

TABLE 1: RSPT SCENARIO ANALYSIS

Hurdle Rate	NPV (AUD M)	NPV/sh
No RSPT	345	1.19
6.0%	266	0.92
10.0%	317	1.09
11.3%	345	1.19

Source: BBY

RSPT and the Nolans project – Commodity or Chemical?

RSPT application unclear

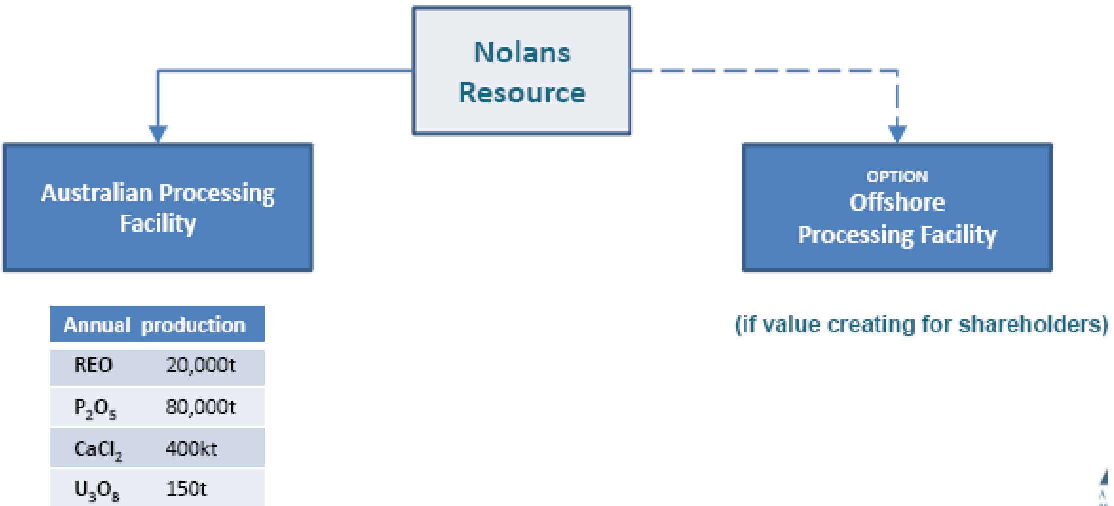
The mechanics of the application of the RSPT to the Nolans Project is unclear. The government has stated that low value minerals may be exempted. Should the Nolans project be treated as a chemical project which uses a rare earth commodity input? The impact of the RSPT on this mineral concentrate may be much less than that of the product from the chemical separation plant. The value uplift from deposit to end product is achieved primarily through the chemical separation plant. However this does not diminish the importance of the ore. The majority of capital and operating costs, not to mention risk, associated with the project will be sunk in the chemical separation facility.

No market for 6% rare earth concentrate

There is currently no market for the ore as it is to be mined at Nolans. Even if ARU was to simply mine and beneficiate the ore to a 6% rare earth concentrate it is unlikely there would be a market for the product. The reason for this is that each rare earth ore body is relatively unique. The key to commercial success is determining an economic route to unlock the mineralogy using chemical treatment. ARU has been working on the chemical separation of Nolans ore since 2001, it is clearly a complicated process and is difficult to compare with other commodities such as iron ore, coal or even gold.

Figure 1 shows a slide from recent ARU presentations. The company has reiterated a number of times that it intends to beneficiate ore onsite at Nolans before chemical separation at a purpose built facility in Australia. If the RSPT does prove detrimental to shareholder value it will be interesting to see if management will opt for an alternate strategy of processing concentrate at an offshore facility as Lynas Corporation Limited (LYC) intends to do.

FIGURE 1: PROJECT OPTIONS



Source: ARU

Project Update

REE mineralisation was first detected at Nolans in 1995 and reconfirmed by further exploration activity in 1999. In 2001 ARU engaged the Australian Nuclear Science and Technology Organisation – Minerals Division (ANSTO) to conduct a preliminary desktop study on the Nolans deposit mineralogy. In March 2009 the pilot plant at ANSTO produced its first Rare Earth Carbonate (REC) using a patented hydrometallurgical process.

Pilot Plant Demonstration Activities

Clearly it is a long road from exploration success to unlocking the mineralogy into a saleable product, the Nolans project is now 15 years into this process and the BFS is now finalising the chemical processing evaluation to produce separated Rare Earth Oxides (REO).

The final pilot, demonstration and optimisation studies of the BFS will focus on REO separation and the optimisation of the acid bake stage. A 3,000t sample will be used to demonstrate the acid bake flowsheet.

Chemical Separation Plant Location

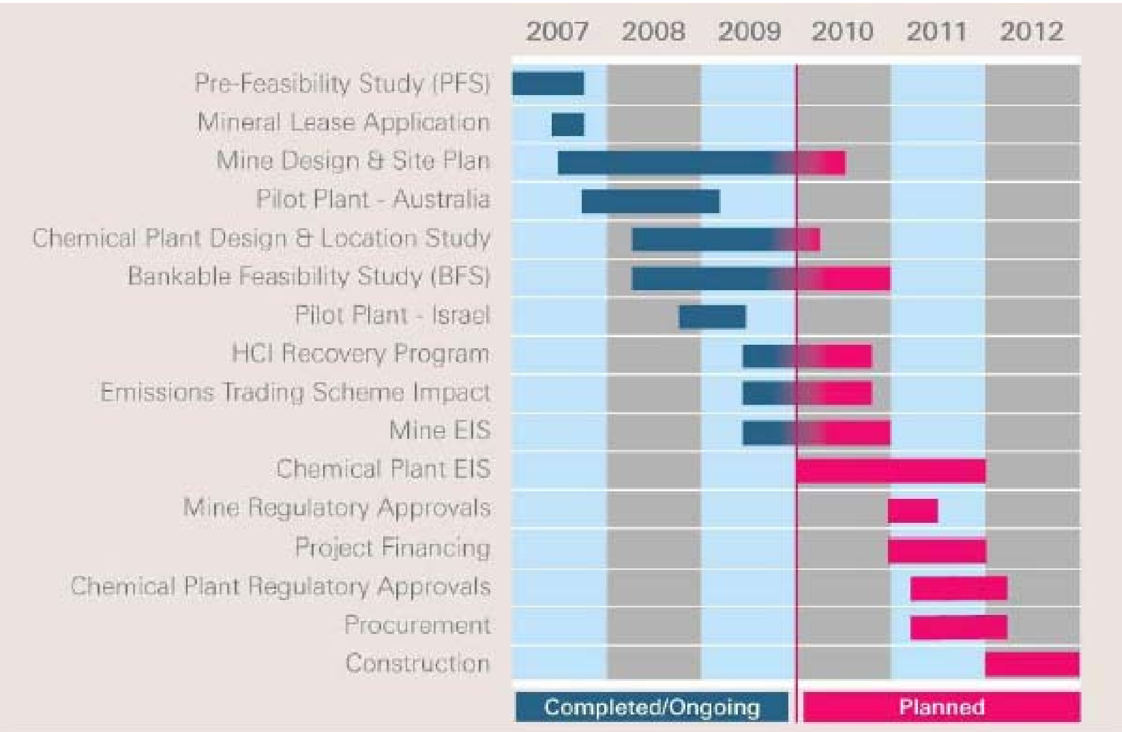
ARU expect to be in a position to announce the location of the chemical separation plant soon. BBY see this decision as critical to the company's ability to meet the target of first production in 2013 because permitting for the final location may take up to two years before construction can begin.

Key Milestones

We would expect ARU's value to increase as milestones are achieved and the project risk is decreased. We see the following milestones as being significant in the development of the project to achieve product by the end of 2013.

- Pilot plant confirmation of process flowsheet to produce REO;
- Chemical site selection and initiation of approvals process;
- Offtake agreements; and
- Project financing.

FIGURE 2: PROJECT TIMELINE



Source: ARU

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Contact with ARU has been made during the preparation of this report for assistance with verification of facts.

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Meanings of BBY Limited Ratings
Buy – Describes stocks that we expect to provide a total return (price appreciation plus yield) of 15% or more within a 12-month period.

Hold – Describes stocks that we expect to provide a total return (price appreciation plus yield) of plus or minus 15% within a 12-month period.

Underperform – Describes stocks that we expect to provide a total negative return (price appreciation plus yield) of 15% or more within a 12-month period.

NR – The investment rating and price target have been temporarily suspended. Such suspensions are in compliance with applicable regulations and/or BBY Limited policies.

CS – Coverage Suspended. BBY Limited has suspended coverage of this company.

Speculative Buy – Describes stocks we research with a positive bias, whose company fundamentals and financials are being covered, but for which there is insufficient information for BBY Limited to assign a Buy, Hold or Underperform rating.

Speculative Underperform – Describes stocks we research with a negative bias, whose company fundamentals and financials are being covered, but for which there is insufficient information for BBY Limited to assign a Buy, Hold or Underperform rating.

Monitor – Describes stocks whose company fundamentals and financials are being monitored, or for which no financial projections or opinions on the investment merits of the company are provided.

It is permitted for the total expected returns to be temporarily outside the prescribed ranges due to extreme market volatility or other justifiable company or industry-specific reasons.

Free Float (float / current shares outstanding) *100 – This float figure is the number of shares that are available to the public and is calculated by subtracting the shares held by insiders and those deemed to be stagnant shareholders. Stagnant holders include ESOP's, ESOT's, QUEST's, employee benefit trusts, founding shareholder equity stake plus senior management equity stake, corporations not actively managing money, venture capital companies and shares held by Governments.

Valuation Methodology
BBY's methodology for assigning ratings may include the following: market capitalisation, maturity, growth/value, volatility and expected total return over the next 12 months. The price targets are based on several methodologies, which may include, but are not restricted to, analyses of market risk, growth rate, revenue stream, discounted cash flow (DCF), EBITDA, EPS, cash flow (CF), free cash flow (FCF), EV/EBITDA, P/E, PE/growth, P/CF, P/FCF, premium (discount)/average group EV/EBITDA, premium (discount)/average group P/E, sum of parts, net asset value, dividend returns, and return on equity (ROE) over the next 12 months.

Approved for release by BBY Limited