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Arafura Resources Limited

Chinese Restrictions Create Market Opportunity

ARU A\$0.59

SPECULATIVE BUY

13 July 2010

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Arafura Resources Limited's (ARU) Nolans Rare Earth project is scheduled to begin production in 2013. China's continued reduction of its rare earth export quota plus the crackdown on illegal mining and export of rare earths creates an opportunity for non-Chinese supply to enter the market. We maintain our SPECULATIVE BUY recommendation and 12 month price target of AUD1.11/sh.

► **Rare earth pricing update** – Demand for rare earth material has recovered following a period of end user destocking during the Global Financial Crisis. Prices have nearly doubled since the lows of 1Q09. ARU's rare earth oxide basket price is now USD17.47/kg up from USD10.05/kg in 1Q09. BBY's long term rare earth price forecasts remain unchanged, with our long term forecast for ARU's product mix averaging USD14.20/kg.

► **Chinese Rare Earth Industry Consolidation** – The Ministry of Industry and Information Technology of China announced the first draft on Entry Criteria for the Rare Earths Industry in May 2010. Consolidation is designed to crackdown on illegal mining and exports with the aim of gaining greater control over prices in order to maximise the utilisation of the country's natural resources.

► **Chinese Rare Earth Export Quota Cut** – The Ministry of Commerce of the People's Republic of China approved the 2H10 Rare Earths export quota of just 7,976 t, a decrease of 72% pcp. The total export quota for 2010 is consequently 30,259 t, a decrease of 40% on 2009 when the quota was 50,145 t. The total export quota has fallen by more than 50% since restrictions were first introduced in 2004.

China currently supplies over 95% of global REO, a further reduction in its export quota will lead to a supply shortage for global markets.

Table 1 highlights the decline in China's Rare Earth export quota in the context of Chinese production and global demand.

Table 1	2005	2006	2007	2008	2009e	2010f
Export Quota	65,609	61,821	59,643	56,939	50,145	30,259
Production ¹	99,000	110,000	100,000	115,000	90,000	120,000
Global Demand	98,000	110,000	120,000	124,000	85,000	110,000

Source: ARU, IMOCA, LYC

e – estimate, f – forecast, 1 – Chinese production

► **ARU Not Subjected to MRRT** – The revised Mineral Resources Rent Tax will not apply to ARU.

Company Data

Number of shares	290.6M
Market capitalisation	\$164M
Free Float	74.0%
12 month high/low	\$1.29/\$0.38
Average monthly turnover	\$10M
All Ordinaries Index	4405
% 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)	(12.0)	(13.6)	(12.6)
CFPS (c)	(4.8)	(5.3)	(4.1)	(4.5)
P/CF (¢)	(14.4)	(10.6)	(13.6)	(12.6)
DPS (c)	0.0	0.0	0.0	0.0
EV/EBITDA (x)	(11.1)	(9.7)	(10.8)	(11.9)
Franking (%)	100.0	100.0	100.0	100.0

ARU versus S&P/ASX 200





Financial Summary

Arafura Resources Limited

Share Price (A\$)

\$0.59

Mkt Cap (A\$M)

164

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)	(12.0)	(13.6)	(12.6)	(8.7)	(7.2)	2.9
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)	(10.6)	(13.6)	(12.6)	(9.9)	(4.6)	3.0
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	2.9	3.8	5.6	17.2	(11.3)	3.6
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	2.9	3.8	5.6	17.2	(11.3)	3.6
EV/Sales (x)	25.3	149.6					4.4	2.0
EV/EBITDA (x)	(14.4)	(11.1)	(9.7)	(10.8)	(11.9)	(20.5)	59.4	5.3
EV/EBIT (x)	(14.1)	(10.3)	(9.7)	(10.8)	(11.9)	(17.4)	(268.8)	6.5

Source: BBY, Company Reports



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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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