12 May 2011

Iron Road Ltd (IRD)

Initiation: On the road to magnetite production

Analyst
Fleur Grose 613 9235 1678
Authorisation
Johan Hedstrom 612 8224 2859

Recommendationi

Spec Buy

Price

$1.07

Target (12 months)

$1.60

IRD is in the final stages of a pre-feasibility study on the Central Eyre Iron Ore Project (CEIP) in South Australia. We believe that the magnetite project has the potential to be large and long life, and it is robust on our assumptions. The next stage is to progress to a feasibility study which should be completed by end 2012. We initiate coverage with a Spec Buy rating and a target of $1.60.

Expected Return

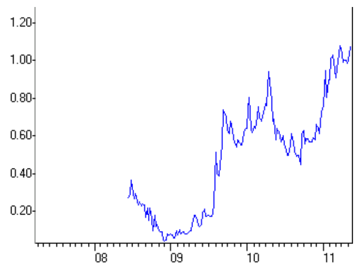
Capital growth	**50%**
Dividend yield	**0%**
Total expected return	**50%**

Company Data & Ratios

Enterprise value	**$117m**
Market cap	**$123m**
Issued capital	**114.7m**
Free float	**70%**
12 month price range	**$0.44-1.30**
GICS sector	**Materials**

Southern Cross Equities raised $8.1m at $0.55 in November 2010 and received a fee.

Absolute Price



SOURCE: IRESS

Large magnetite deposit which can be easily upgraded

The current resource of 1.2Bt @ 16.8%, is the largest iron ore resource in South Australia, and results from current extension drilling could increase this by 0.9Bt. An independent consultant has developed a conceptual target of 2.9-5.8Bt, suggesting much greater upside. The deposit is lower grade than comparable projects in WA, but the large resource is suitable for open cut mining with a low strip ratio. The coarse grained and consistent nature of the material results in low crushing and grinding costs. Rather than focusing on the low grade, we focus on our overall cost estimate of $60/t FOB pre-royalties, which compares to c.$50/t for GBG, <$60/t for GRR and $62/t for JMS. This shows that low grade can be a misleading indicator of the value of a project, physical characteristics and low strip ratio are key.

The preferred infrastructure options are to access power from Port Augusta, and to transfer product via slurry pipeline or rail to the coast to a greenfield port site at Sheep Hill, north of Tumby Bay.

Our analysis suggests a robust project

Our analysis suggests that a 10Mpta project, with capex of $2.4bn and operating costs of $60/t is worth $690m. We expect that when the final results are announced at the end of May, that the project will progress to the feasibility stage. We have developed a conceptual model and funding scenario which involves IRD selling half the project in return for 100% offtake to an Asian partner. If the project can be funded 70% debt and 30% equity, the contribution from the sale should cover IRD's equity contribution. We also assume that IRD raises $40m to fund the feasibility study in two tranches over the next 12 months, and $200m at FID to cover working capital and contingencies. Hence, although our valuation for the project 100% is $690m, or $6.00 per current share on issue, our price target of $1.60 assumes this scenario adjusted for dilution and less a discount to account for execution and funding risk. IRD's major shareholder is The Sentient Group which recently increased its holding to 29%, a private equity group which has supported all equity issues.

On the road to magnetite production

Central Eyre Iron Ore Project

The Central Eyre Iron Ore Project is located in the centre of the Eyre Peninsula, in a grain growing area 175km north of Port Lincoln, and 185km to the west of OneSteel's iron ore and steel-making operations at Whyalla. The SA government first tested magnetic anomalies in the area in the 1960's but this was prior to the boom in the iron ore market. Drilling and subsequent testing in 2000 showed that a saleable product could be produced, and Iron Road acquired the lease in 2008 to progress the project.

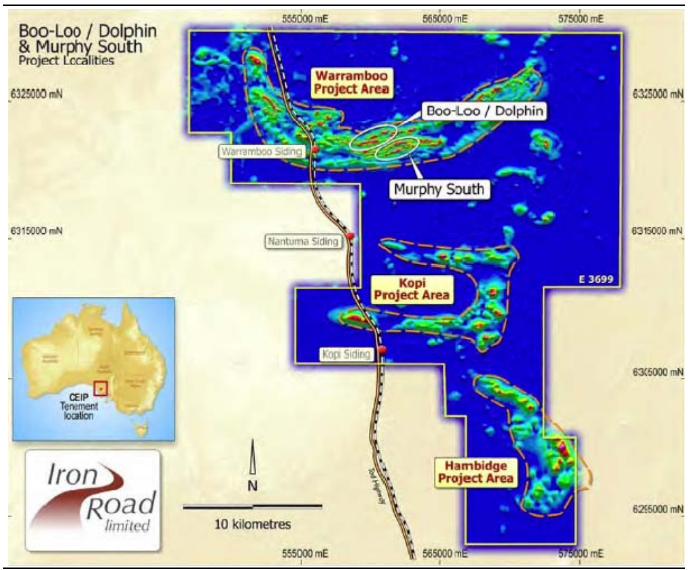
Large resource with exploration target of 2.9-5.8Bt

The project area covers extensive Archaean iron formations that occur as coarse-grained magnetite-bearing gneiss. The cumulative strike length, estimated from aeromagnetic data, is at least 95 kilometres. An independent evaluation by Coffey mining suggested an exploration target of 2.9-5.8Bt which is more than sufficient to underpin a 10Mtpa concentrate project. 1Bt was deemed sufficient for a prefeasibility study, and the latest resource of 1.2Bt @ 16.8%Fe is being used as the basis for the study. 907Mt is at Murphy South, with the balance at Boo-Loo/Dolphin. Stage V completed extension drilling at Murphy South could add 80-120Mt, and current Stage VI drilling could add a further 500-800Mt. The geometry of the deposit is suitable for a large opencut mine with a low strip ratio.

Figure 1 – Location of CEIP

SOURCE: COMPANY DATA

Figure 2 – Warramboo project area



SOURCE: COMPANY DATA

Figure 3 – CEIP Global Mineral Resource estimate

Resource Classification	Oxidation	Tonnes (Mt)	Fe (%)	SiO_2 (%)	Al_2O_3 (%)	P (%)	LOI (%)
	Fresh	572	17.1	52.7	12.0	0.09	0.4
Inferred	Transitional	40	16.5	51.2	13.2	0.07	7.3
	Oxide	81	16.8	51.1	12.9	0.08	8.2
Total Inferred		693	17.0	52.4	12.1	0.09	1.7
Indicated	Fresh	541	16.6	52.9	12.6	0.08	0.3
Total		1,234	16.8	52.6	12.3	0.09	1.1

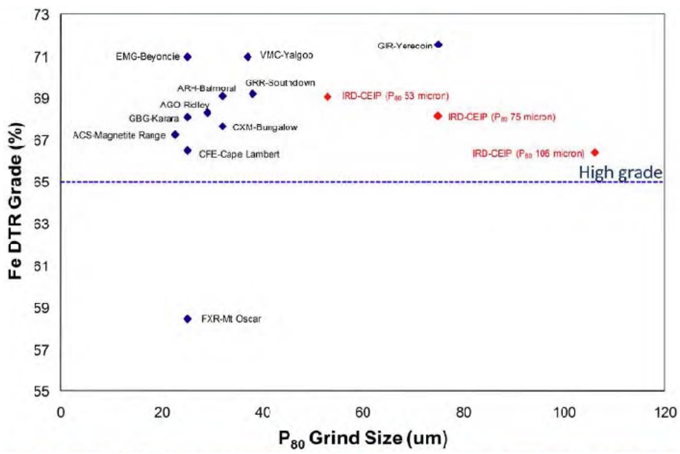
SOURCE: COMPANY DATA

Mineralogy conducive to cost competitive processing

The magnetite is coarse grained (average size 1.5mm) and the boundaries between the magnetite and enclosing host-rock minerals are sharp and clean. These physical characteristics enhance the ease of liberation of the mineralisation and are likely to reduce beneficiation costs. Figure 4 shows that a suitable concentrate grade for a sinter feed product can be produced by grinding to only 106 micron, coarser than other magnetite deposits, which will reduce power consumption. Further test work recently completed shows that saleable product with grade >67% can also be produced at a grind of only 125 micron.

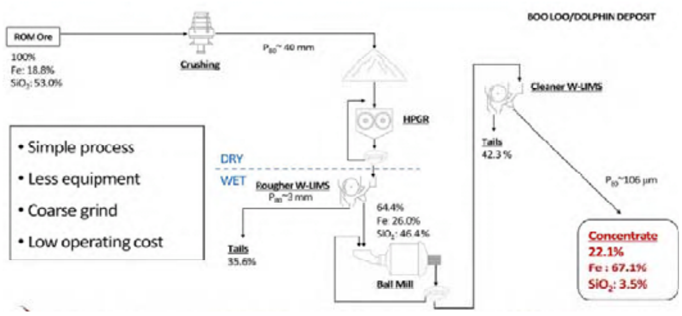
Metallurgical modelling has confirmed that process options are available using simple off the shelf processing technology, and the low grade ore is easily upgradeable. Early magnetic separation prior to the energy intensive fine grinding circuit yields very good results and is key to reducing power consumption and operating costs. Figure 5 shows that the use of HPGR (High Pressure Grinding Rolls) and W-LIMS (wet magnetic separators) removes 35.6% of waste prior to milling. A final magnetic separation process yields a concentrate with 22.1% mass recovery and grade of 67.1%, with a silica content below the upper limit of 5%.

Figure 4 – CEIP large grind size reduces power consumption



SOURCE: COMPANY DATA; P80 125 MICRON ALSO HAS GRADE >67%

Figure 5 – Suggested flow sheet



SOURCE: COMPANY DATA

Proximity to the coast provides infrastructure options

The project will need power, water, a transport method to the port and port access. The preferred transport method for a 106 micron product is a slurry pipeline to the coast, which would largely follow existing infrastructure corridors, but a rail option is also being considered for a coarser 125 micron product. The preferred port option is Sheep Hill to the north of Tumby Bay, a project being proposed by Centrex Resources. A new power transmission line is a possibility from Port Augusta to the NE, as the existing 132kV line is not suitable. A desalination plant could be built at the port to provide water needs, or at Elliston on the west side of the peninsula.

Community support

The project area is on a wheat belt. Mining would drought proof the local economy, and local farmers are supportive of the current drilling program.

Figure 6 – Concentrate pipeline route

SOURCE: COMPANY DATA

Figure 7 – 106 micron concentrate product

SOURCE: COMPANY DATA

CEIP prefeasibility study close to completion

We have modelled this project, and we expect that the pre-feasibility study results will be favourable. The next step will be to undertake extensive drilling to upgrade the existing resources plus the extension drilling to measured and indicated status, further investigate infrastructure options, begin discussions with potential financing partners, complete a full feasibility study, and commence permitting. This should be completed by end 2012, and cost c.$40m.

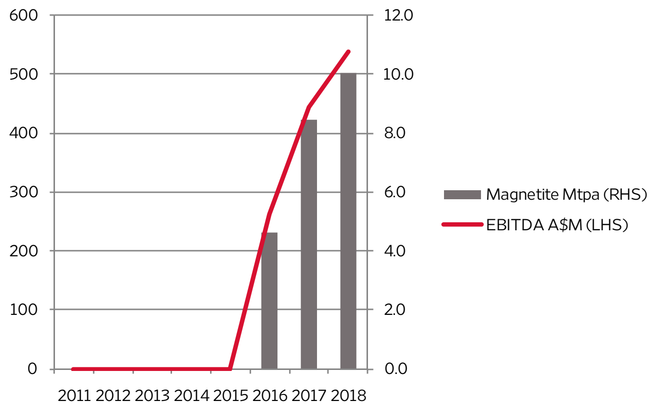
The key capex and opex assumptions that we have used for the project are given in Figure 8 and we estimate that the project is worth c. $690m on a 100% basis.

Figure 8 – CEIP Operating Parameters

Central Eyre Iron Ore Project	
Life (years)	35
Throughput Mtpa	10
Concentrate Grade %	67
Premium to benchmark fines %	10
Capex A$m	2400
Cost pre-royalties A$/t	60

SOURCE: SCE ESTIMATES & COMPANY DATA

Figure 9 – Conceptual production profile



SOURCE: SCE ESTIMATES

Valuation and investment view

We have taken our valuation for 100% of the CEIP and made several assumptions about how it may eventually be financed. We have assumed that IRD sells half the project to an Asian partner in exchange for 100% off-take, for $350m. If the project is then financed 70% debt and 30% equity, IRD's share of capex is covered by the sell-down. We have assumed that IRD raises $40m to cover the costs of the feasibility study in two tranches of $20m each over the next 12 months, and then at the time of FID, raises $200m to cover working capital and contingencies.

All these assumptions are wrapped up into the valuation table in Figure 10. The valuation falls in 2 years time as a result of the dilution to $2.71. As several hurdles still need to be met to reach production, we assign a 60% weighting to derive our price target of $1.60. We believe this is fair as the companies with similar magnetite projects are still trading at a similar discount.

Figure 10 – Central Eyre Iron Ore Project

	$M	$/sh	+1yr	+2yr	+3yr	+4yr
CEIP	690	3.85	4.35	1.27	1.62	2.48
Corporate	-55	-0.31	-0.31	-0.17	-0.17	-0.17
Options	7	0.04	0.04	0.02	0.01	0.01
Net Cash/Debt	46	0.25	0.02	1.59	1.39	0.51
Total	687	3.83	4.09	2.71	2.86	2.82

SOURCE: COMPANY DATA

Initiate with a Spec Buy rating

The CEIP has the potential to be a large long life project, where resources already stand at 1.2Bt. Our modelling suggests robust economics, and we expect that the project will move to a feasibility study. Our valuation suggests significant upside even accounting for dilution to fund the project.

Milestones include

- Pre-feasibility study results announced end May 2011
- Raise funds c.$20m to fund further drilling
- Resource increase to incorporate recent extension drilling mid 2011
- Further progress on infrastructure solutions end 2011
- Potential offtake and funding partner announcement 2011/2012
- Raise funds c.$20m to fund feasibility study
- Feasibility study completed end 2012

Iron Road Ltd

Iron Road's principal project is the 100% owned Central Eyre Iron Ore Project in South Australia. The project is a collection of three iron ore occurrences (Warramboo, Kopi and Hambridge) with an exploration potential of 2.9-5.8Bt of magnetic gneiss.

IRD listed in June 2008 during the GFC at 20¢, but re-rated to >60¢ after the release of the initial Warramboo resource.

Investment Strategy

We rate IRD a Spec Buy. The CEIP has the potential to be a large long life project, producing 10Mpta of magnetite. We believe there is minimal resource risk, and current management can overcome financing and execution risk. Centrex Resources has a nearby port proposal, but Centrex's project is not as well advanced which remains the key risk in our view.

Valuation

Our valuation for 100% of the project is $690m. However, accounting for a conceptual funding plan, and giving a 40% discount to account for the early stage nature of the project we arrive at a price target of $1.60. We are using long term assumptions of US$80/t FOB 2011 real for fines, and an 85¢ currency.

Shareholders

The Sentient Group (29.2%), a private equity firm specializing in resource projects, recently increased from 27.9%; Management (10.6%); Columbia University (5.4%).

Risks

Commodity price and exchange rate fluctuations. Similar to other commodity producers, IRD will be subject to fluctuations in prices.

Execution risk. Like any development project the CEIP could be subject to potential timing delays, and cost escalations.

Infrastructure risks. The Sheep Hill port proposal has been advanced by Centrex Resources. It has government support and has funding from WISCO, however the Centrex magnetite project is less advanced than IRD's which may create timing risk on the port.

Board and Management

Julian Gosse Chairman

Mr Gosse has extensive experience in banking and broking in Australia and overseas and has been involved in the establishment, operation and ownership of several small businesses. Mr Gosse is currently a Director of ITL Limited, Wilson Investment Fund Limited, Clime Capital Limited and Australian Leaders Fund.

Ian Hume Director

Mr Hume's career in the resources industry stretches back over thirty years, primarily in the fields of managed fund investments, capital raising and project development. Mr Ian Hume was a Founding Partner of The Sentient Group, a fund manager specialising in global investments in the natural resource industries.

Jerry Ellis Director

Mr Ellis' career includes three decades at BHP Ltd, Chairing the company from 1997 to 1999. He also served on the boards of ANZ, Newcrest Mining, Aurora Gold, the International Copper Association, the International Council on Metals and the Environment and the American Mining Congress. He is also a former Chancellor of Monash University and former President of the Minerals Council of Australia. Mr Ellis is currently Chairman of Landcare Australia and MBD Energy Limited and is on the Advisory Board of Anglo Coal Australia.

Matthew J Keegan Director

Mr Keegan is a geologist with fifteen years experience holding various mining positions with Rio Tinto, Barrick and WMC. Mr Keegan is currently an Investment Advisor at The Sentient Group. He is currently a director of Norsemont Mining and Golden Minerals Company, and formerly a director of Andean Resources.

Andrew J Stocks Managing Director

Mr Stocks is a Mining Engineer with over twenty years experience in the resources sector, primarily in mining operations and corporate roles. Mr Stocks was previously Managing Director of Siberia Mining until its merger with Monarch Gold, and Vice President, Operations of Crew Gold Corporation.

Larry J Ingle General Manager

Mr Ingle is a geologist with 22 years experience in a variety of mining operations, exploration, project development and business improvement roles in Australia and Africa.

Milo Res Geology Manager

Mr Res is a geologist, with 30 years mining industry experience in Australia and Africa. He was a key member of the Fortescue Metals Group team developing Cloudbreak and more recently actively participated in the Jack Hills magnetite/hematite mining and development project for Crosslands Resources.

Dr Fop Vanderhor Project Manager

Dr Vanderhor is a geologist with over 25 years of exploration and consulting experience, throughout Australia and overseas. Dr Vanderhor joined UMC as Exploration Manager in 2007 and led the team that discovered the Railway Iron Ore Deposit.

Graham D Anderson Company Secretary

Mr Anderson has over 20 years' commercial experience as a Chartered Accountant. He is currently Director and Company Secretary of APA Financial Services Limited, Echo Resources Limited, Pegasus Metals Limited and Dynasty Metals Australia Limited and Company Secretary of Apex Minerals NL.

Iron Road Ltd (IRD)

as at 12 May 2011

Recommendation	Spec Buy
Price	$1.07
Target (12 months)	$1.60

Table 1 - Financial summary

Iron Road (IRD)		Share price:	$	1.07
As at	12/05/2011	Market Cap:	$	122
		Recom:		Spec Buy

PROFIT AND LOSS					
Y/e June 30	2010a	2011f	2012f	2013f	2014f
Sales revenue	0	0	0	0	0
EBITDA	-11	-15	-13	-14	-6
Depreciation	0	0	0	0	0
EBIT	-11	-15	-13	-14	-6
Net Interest Expense	0	0	0	11	21
Pre-tax profit	-11	-15	-13	-3	14
Tax	0	1	0	0	-2
Net Profit	-11	-14	-13	-3	12
Adjustments	0	0	0	0	0
SCEQ adj profit	-11	-14	-13	-3	12
One-off items	0	0	0	0	0
Reported net profit	-11	-14	-13	-3	12

CASHFLOW					
Y/e June 30	2010a	2011f	2012f	2013f	2014f
Receipts from customers	0	0	0	0	0
Payments to suppliers	-7	-16	-13	-14	-6
Net interest	0	0	0	11	21
Tax paid	0	0	0	0	-2
Other	0	0	0	0	0
Operating cashflow	-7	-16	-13	-3	12
Capex	0	-5	-10	-10	-150
Investments	0	0	0	0	0
Asset sales	0	0	0	0	0
Other	0	0	0	0	0
Investing cashflow	0	-6	-10	-10	-150
Change in borrowings	0	0	0	0	0
Equity raised	9	33	20	200	1
Dividends paid	0	0	0	0	0
Other	0	0	0	350	0
Financing cashflow	9	33	20	550	1
Net change in cash	2	11	-3	537	-137
Cash at end of period	3	14	11	548	412

BALANCE SHEET					
Y/e June 30	2010a	2011f	2012f	2013f	2014f
Cash	3	14	11	548	412
Receivables	0	1	1	1	1
Inventories	0	0	0	0	0
Investments	0	0	0	0	0
Other	0	0	0	0	0
Current assets	4	15	12	549	413
PPE	1	6	16	26	176
Investments	0	0	0	0	0
Intangibles	0	0	0	0	0
Other	0	0	0	0	0
Non-current assets	1	6	16	26	176
Total assets	4	21	29	576	589
Payables	2	1	1	1	1
Debt	0	0	0	0	0
Provisions	0	0	0	0	0
Other	0	0	0	0	0
Total liabilities	2	1	1	1	1
Shareholders' equity	2	21	28	575	589
Minorities	0	0	0	0	0
Total shareholders funds	2	21	28	575	589
Total funds employed	-1	7	17	27	177
W/A diluted shares on issue	69	124	144	329	340

VALUATION DATA					
Y/e June 30	2010a	2011f	2012f	2013f	2014f
Net profit adj ($m)	-11	-14	-13	-3	12
EPS (c)	-16	-12	-9	-1	4
EPS growth (%)	na	na	na	-89%	-464%
P/E ratio (x)	na	na	na	-107	30
CFPS (c)	na	na	na	-1	4
Price/CF (x)	na	na	na	-120	30
DPS (c)	0	0	0	0	0
Yield (%)	0	0	0	0	0
Franking (%)	0	0	0	0	0
EV/EBITDA	na	na	na	13	8
EBITDA margin (%)	na	na	na	na	na
12 month valuation per share:					4.09
A$ Target price (12 mth):					**1.60**
Total Return (including yield)					**50%**

PROFITABILITY RATIOS					
Y/e June 30	2010a	2011f	2012f	2013f	2014f
EBITDA/sales (%)	na	na	na	na	na
EBIT/sales (%)	na	na	na	na	na
Return on assets (%)	na	na	na	-1	2
Return on equity (%)	na	na	na	-1	2
Return on funds empl'd (%)	na	na	na	-11	7
Dividend cover (x)	na	na	na	0	0
Effective tax rate (%)	0	4	0	0	14

LIQUIDITY AND LEVERAGE RATIOS					
Y/e June 30	2010a	2011f	2012f	2013f	2014f
Net debt/(cash) ($m)	-3	-14	-11	-548	-412
Net debt/equity (%)	-125	-68	-41	-95	-70
Net interest cover (x)	119	91	38	1	0
Current ratio (x)	na	na	na	na	na
Inventory turnover	na	na	na	na	na
Inventory/sales	na	na	na	na	na

VALUATION					
	$M	$/sh	+1yr	+2yr	+3yr
CEIP	690	3.85	4.35	1.27	1.62
Corporate	-55	-0.31	-0.31	-0.17	-0.17
Options	7	0.04	0.04	0.02	0.01
Net Cash/Debt	46	0.25	0.02	1.59	1.39
Total	**687**	**3.83**	**4.09**	**2.71**	**2.86**

PRODUCTION					
	2010a	2011f	2012f	2013f	2014f
CEIP - Mt	0.0	0.0	0.0	0.0	0.0

ASSUMPTIONS					
Y/e June 30	2010a	2011f	2012f	2013f	2014f
A$	0.88	0.97	0.96	0.91	0.85
Iron Ore Lump (US¢/%Fe)	144	304	316	274	208
Iron Ore Fine (US¢/%Fe)	128	235	244	211	181

SOURCE: SOUTHERN CROSS EQUITIES ESTIMATES

Recommendation structure

Spec Buy: Expect >30% total return on a 12 month view but carries significantly higher risk than its sector

Buy: Expect >15% total return on a 12 month view

Accumulate: Expect total return between 5% and 15% on a 12 month view

Hold: Expect total return between -5% and 5% on a 12 month view

Reduce: Expect total return between -15% and -5% on a 12 month view

Sell: Expect <-15% total return on a 12 month view

Research Team

Steve Goldberg
Head of Research
T 612 8224 2809
E sgoldberg@sceq.com.au

Trent Allen
Resources Analyst
T 612 8224 2868
E tallen@sceq.com.au

Daniel Blair
Industrial Analyst - Telco/Media
T 612 8224 2886
E dblair@sceq.com.au

Peter Chapman
Resources Analyst - Gold/Uranium
T 612 8224 2847
E pchapman@sceq.com.au

David George
Resources Analyst- Diversifieds
T 613 9235 1972
E dgeorge@sceq.com.au

Fleur Grose
Resources Analyst
T 613 9235 1678
E fgrose@sceq.com.au

Johan Hedstrom
Resources Analyst - Energy
T 612 8224 2859
E jhedstrom@sceq.com.au

Justin Hilford
Industrial Analyst - Emerging Growth
T 613 9235 1966
E jhilford@sceq.com.au

Stuart Howe
Resources Analyst - Coal
T 613 9235 1782
E showe@sceq.com.au

Judith Kan
Associate Analyst - Energy
T 612 8224 2844
E jkan@sceq.com.au

TS Lim
Financials Analyst - Banks/Regionals
T 612 8224 2810
E tslim@sceq.com.au

Toby Molineaux
Associate Analyst - Industrial
T 612 8224 2813
E tmolineaux@sceq.com.au

Paresh Patel
Industrial Analyst - Retail/Beverages
T 612 8224 2894
E ppatel@sceq.com.au

Hamish Perks
Industrial Analyst – Emerging Growth
T 612 8224 2804
E hperks@sceq.com.au

Stuart Roberts
Industrial Analyst - Healthcare/Biotech
T 612 8224 2871
E sroberts@sceq.com.au

Emma Sellen
Executive Assistant
T 612 8224 2853
E esellen@sceq.com.au

Jonathan Snape
Industrial Analyst- Emerging Growth
T 613 9235 1601
E jsnape@sceq.com.au

Mathan Somasundaram
Quantitative Analyst
Head of Quant & Data Services
T 612 8224 2825
E mathan@sceq.com.au

Lafitani Sotiriou
Analyst - Financials/Industrials
T 613 9235 1668
E lsotiriou@sceq.com.au

Janice Tai
Quantitative & System Analyst
T 612 8224 2833
E jtai@sceq.com.au

Fred Truong
Associate Analyst - Resources
T 613 9235 1629
E ftruong@sceq.com.au

Joel Weiss
Associate Analyst - Industrial
T 612 8224 2895
E jweiss@sceq.com.au

Chris Whitehead
Associate Analyst - Resources
T 612 8224 2838
E cwhitehead@sceq.com.au

Southern Cross Equities Ltd and its associates hold 1,695,050shares in IRD as at the date of this report. This position is subject to change without notice..

Southern Cross Equities raised $8.1m at $0.55 in November 2010 and received a fee.

Southern Cross Equities

Limited Incorporated ACN 071 935 441
Level 32, Aurora Place
88 Phillip Street, Sydney 2000
Telephone +61 2 8224 2811
Facsimile +61 2 9231 0588
Email general@sceq.com.au
www.sceq.com.au