

Iron Ore Holdings Ltd

'Win win' deal with Fortescue expected to lead to the rapid development of the Iron Valley project

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News

Iron Ore Holdings ('IOH' or the 'Company') has received a non-refundable A\$25m cash payment and signed a binding Memorandum of Understanding ('MoU') which, subject to completion of legal documentation, will provide Fortescue Metals Group ('FMG') with an exclusive 13 month option to obtain a licence to mine IOH's 100% owned Iron Valley tenements. Under the proposed terms of the agreement IOH will receive a further \$20m cash payment and 2-5% royalty based on FOB revenue realised by FMG should they exercise the option, with IOH retaining ownership of the tenements. FMG will pay all costs associated with developing and operating Iron Valley. The deal provides IOH a small component of cash upfront (increasing its cash reserves to A\$130m² or A\$0.79/sh) and provides exposure to potentially +A\$50m pa in free cash flow from a royalty annuity (A\$675m life of mine) without any further capital outlays for the Iron Valley project.

Iron Valley is favourably located in the Central Pilbara only 25km and 20km from the existing railway lines of BHPB and RIO respectively, with the Iron Valley orebody continuing into FMG's neighbouring tenement and forming the extension of its Nyidinghu deposit. Iron Valley outcrops on IOH's land (before dipping into the FMG tenement), has a mining lease, land access and land heritage agreements already in place, with a PFS confirming the attractive economics of an operation of up to 15Mtpa at a grade of 58.6% Fe for a 12 year period. Environmental approval is expected by late 2012, which supports Iron Valley being production ready in 2013 (subject to infrastructure access).

The greater Iron Valley/Nyidinghu orebody resource is now 2.27Bt and according to Andrew Forrest is the largest discovery in the Pilbara. FMG is looking to develop its Nyidinghu project as soon as possible with feasibility studies commenced. Indeed, in FMG's Dec'11 Production Report (announced January 17th) it stated "a study team for Nyidinghu has been assembled and work is being conducted across a range of subjects including the review of mining and material handling logistics. Given a mining licence has already been granted over part of the Nyidinghu deposit, there is work progressing on an early ore project based on trucking up to 5Mtpa of direct ship Nyidinghu material to utilise available port capacity". Nyidinghu lies just ~35km south of FMG's Cloudbreak mine and its proximity to its existing mining operations and infrastructure "boosts their collective value significantly".

Ocean Comment

While the agreement with FMG is still at an MoU stage with a 13 month exclusivity period we expect that the option will be exercised given: FMG's commitment to make the upfront A\$25m non-refundable payment; the continuous nature of the Iron Valley and Nyidinghu deposits (they are the same orebody); the significant synergies that developing Iron Valley first offers FMG for the development of Nyidinghu; FMG's track record of large scale developments; and, FMG's publically stated aggressive plans for Nyidinghu which have always been to "developing this deposit as rapidly as possible". The 13 month exclusivity period to obtain a licence to mine the Iron Valley and the adjacent Welli Wollie tenements coincides with when we expect the project to be potentially production ready with all statutory approvals in place and feasibility studies completed.

In our view Iron Valley provides FMG a potentially attractive near term, low cost trucking operation exploiting outcropping high grade mineralisation which is expected to provide excellent blending material with existing operations at Cloudbreak and Christmas Creek. We believe the commercial logic for FMG developing Iron Valley before Nyidinghu relates to: permitting; reducing the lead time to, and improving the ability to ramp up, initial production; and, reducing upfront capex with initial mining at Iron Valley effectively being the pre-strip for Nyidinghu (which lies ~40m undercover at the tenement border) and being above the water table. We would expect that the agreement between IOH and FMG in effect reflects a 'take-or-pay' structure, with minimum production levels and a fixed starting date, which safeguards IOH shareholders to ensure that the deposit is not 'warehoused'. However, given FMG's publically stated plans to integrate Nyidinghu with the Chichester Hub and potentially support a 40Mtpa operation we expect the Central and Northern zones of Iron Valley to be relatively quickly, and fully, depleted.

While there are limited financial implications of the deal included in either IOH or FMG's press release we believe the structure is an excellent outcome for IOH shareholders by providing additional near term cash (increasing cash reserves to A\$130m² or A\$0.79/sh)

Our discussion continues on the next 2 pages . . .

OCEAN EQUITIES

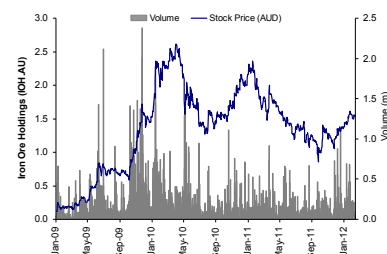
Iron Ore : AUSTRALIA

14th February 2012

Market Cap	A\$255.6m
Listing:Ticker	ASX - IOH
Share Price	A\$1.54
Shares o/s	166m ¹
52 week High/Low	A\$2.04 / 0.85
Net Cash	A\$130m ²

¹ pre share buyback, with 1.45m shares bought back to date

² expected cash balance post completion of MinRes transaction in 1Q'12 and non-refundable option payment made by Fortescue



Source: Bloomberg

Highlighted Related Research:

16th Jan'12: IOH "Satellite" project disposal's provide strong balance sheet as share buy-back & development of core assets continues"

28th Nov'11: IOH "Hidden value' illustrated in Flinders takeout with expected operational and corporate catalysts"

28th Feb'11: IOH "Nyidinghu/Iron Valley orebody a world class discovery, looking to be part developed 'as rapidly as possible'"

15th Nov'10: IOH "IOH the last independent pure iron ore developer in the Pilbara?"

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and providing exposure to medium term cash flow without significant dilution or funding risk. Based on the Aug'11 SRK PFS, and incorporating the Central and Northern zones of the Iron Valley resource, we estimate that the agreement with Fortescue, assuming a realised price of A\$100/t and 3.5% royalty, would generate total undiscounted cash flow to IOH of A\$675m or over A\$50m pa in steady state production (refer to Exhibits 1 & 5).

We estimate that the Net Present Value ('NPV') under this scenario is worth ~A\$264m (or A\$1.59/sh) assuming production commences in 2017 with a 10% discount rate and believe there is upside risk to the expected commencement date of operations (we believe FMG is currently investigating a near term 5Mtpa trucking operation) and iron ore price assumption. On a resource basis we highlight the agreement is worth A\$1.75/t_{Fe Unit}, a significant premium to the recent non-core "Satellite" disposals of A\$1.32/t_{Fe Unit} for the Koodaideri South tenements to Rio Tinto (Sep'11) and A\$1.35/t_{Fe Unit} for the Phil's Creek, Lamb Creek & Yandicoogina Creek tenements to Mineral Resources (Oct'11). We believe this premium is justified given the greater commercial appeal of the asset given Iron Valley's economies of scale, location to existing (and proposed) infrastructure, and level of feasibility studies.

Exhibit 1: Production profile based on the adjusted SRK Aug'11 PFS for Iron Valley which we estimate would generate total undiscounted cash flow to IOH of A\$675m or over A\$50m pa in steady state production

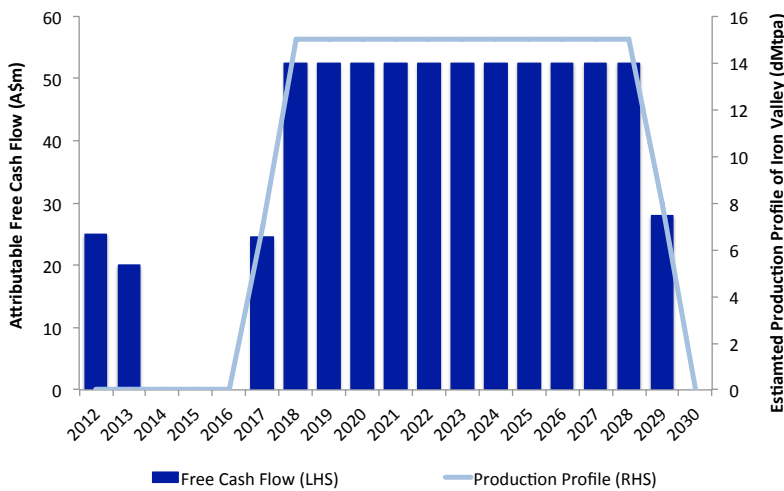


Exhibit 2: Summary of key valuation metrics which highlights IOH's current capitalisation ascribes little or no value for the announced deal with FMG

Cash NPV	A\$m	42.3
Royalty NPV	A\$m	221.7
NPV of FCF	A\$m	264.0
Implied value p share	A\$/sh	1.59

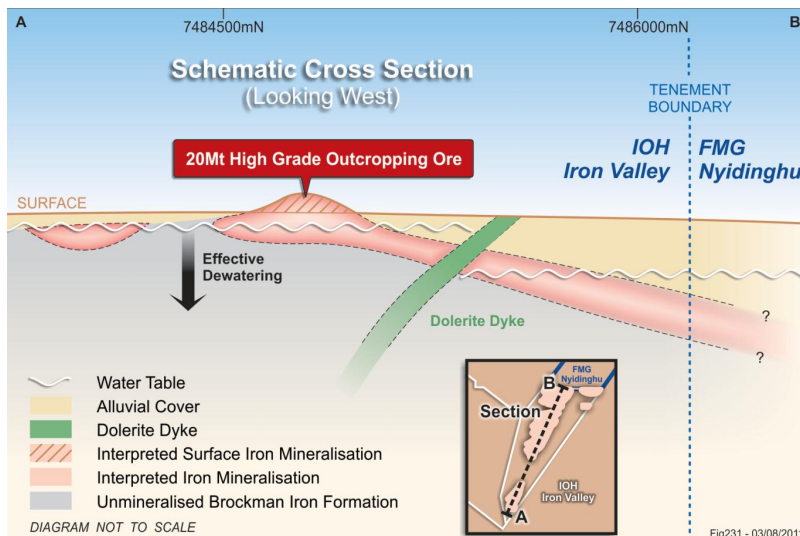
Iron Valley Transaction	\$1.75	per Fe Unit
Satellite Transactions	\$1.32-1.35	per Fe Unit

Summary Valuation of IOH	
Share Price	A\$/sh 1.54
No Shares OS (pre buy-back)	166.09
Est buy-back	1.45
Net No Shares	164.64
Market Cap	253.54
Cash Balance (post MinRes)	105
FMG deposit	25.0
Total Cash	130.0
Cash backing p share	0.79
EV	123.5
Iron Valley NPV - FMG (ex A\$25m cash paid)	239.0
Adj EV post Iron Valley-FMG deal	-115.5

Source: Ocean Equities

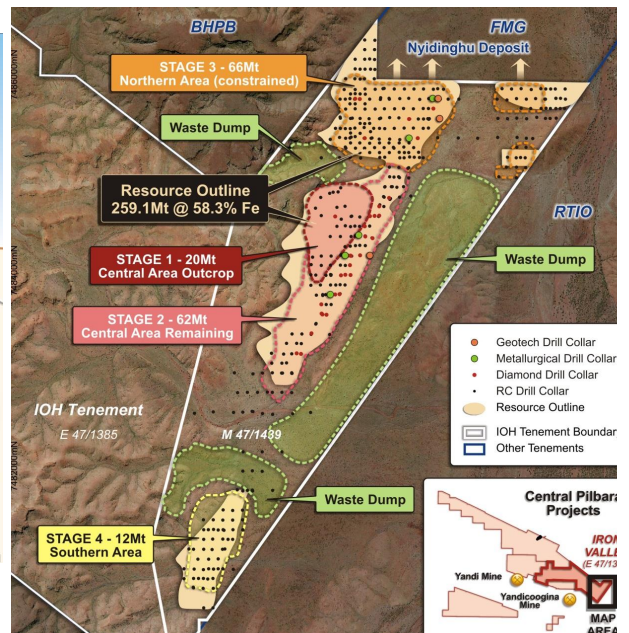
As the summary valuation table in Exhibit 2 illustrates, IOH's current capitalisation ascribes little or no value for the announced deal with FMG or its remaining assets in the Western Pilbara (total resource 573Mt), including Bungaroo South that has a 241.6Mt resource. The Company has cash reserves of A\$130m² (or A\$0.79/sh) and an implied EV of only A\$124m. We estimate the deal announced with FMG to have an NPV_{10%} of ~A\$264m (or A\$1.59/sh) with risk to the upside from our conservative assumptions.

Exhibit 3: Iron Valley cross section into Nyidinghu illustrating high grade outcropping ore at Iron Valley sits above the water table before the orebody dips into FMG's tenement



Source: IOH, Ocean Equities

Exhibit 4: We expect the Central and Northern zones of Iron Valley to be relatively quickly, and fully, depleted



News Flow & Catalysts

IOH's business model is to create value through discovering, de-risking, and commercialising steel-feed commodities. To this end it is looking to monetise its existing portfolio of iron ore projects and also utilise its balance sheet via the acquisition of undervalued assets and has commenced a share buy-back. The Company in the last 6 months has very successfully executed an orderly approach to creating value for shareholders with three commercial agreements with existing iron ore producers realising value and successfully executing its commercialisation strategy.

In our view these transactions have established a precedent for the commercialisation of its remaining West Pilbara assets (total resources 573Mt). IOH's key asset in this region is its Bungaroo South (241.6Mt @ 57.2% Fe CID/Yandi ore) and is contiguous with Aquila/API's Buckland Hills project (in a similar nature to Iron Valley and Nyidinghu). Based on our estimated NPV value of IOH's deal with FMG for Iron Valley (A\$1.75/t_{Fe Unit}) the implied value of Bungaroo South is in the order of ~A\$240m. We expect the West Pilbara's infrastructure landscape to significantly change as plans for the proposed development of the new Anketell port are announced in the near term. At an operational level for Bungaroo South, PFS and port/rail/commercial structure negotiations remain ongoing. Exploration activities are planned to build resource inventory at its Maitland River magnetite project (existing 310Mt @ 34.7% Fe resource), the recent magnetite discovery at Mt Dempster, and the recently acquired Mardie project (prospective for hematite, magnetite and salt). These are all favourably located to the coast and/or existing and proposed infrastructure.

On December 14th, IOH announced an initial on-market share buy-back of up to A\$10m (up to 10% of its ordinary shares). IOH's buy-back activities commenced January 3rd and A\$2.1m of stock has been bought to date. Following the announcement of the agreement with FMG we would expect IOH to recommence its share buy-back.

Resumption of the ongoing share buy-back, completion of the MoU with FMG to a commercial agreement and increased understanding of the financial implications of the deal for Iron Valley are expected to be key near term share price catalysts.

Exhibit 5: Further details of our production profile and estimated NPV based on the adjusted SRK Aug'11 PFS for Iron Valley which we estimate would generate total undiscounted cash flow to IOH of A\$675m or over A\$50m pa in steady state production and an NPV10% of ~A\$264m

		2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030
Production Profile																				
Stage 1 & 2	dmt	0	0	0	0	0	7	15	15	15	15	15	0	0	0	0	0	0	0	0
Stage 3	dmt	0	0	0	0	0	0	0	0	0	0	0	15	15	15	15	6	0	0	0
Stage 4	dmt	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
FMG Boundary Agreement	dmt	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	9	4	0	0
Jun'11 Resource upgrade	dmt	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	11	8	0
	dmt	0	0	0	0	0	7	15	15	15	15	15	15	15	15	15	15	15	8	0
Product Price	US\$/t	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100
FX rate	USD:AUD	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Product Price	A\$/t	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100
Gross Sales Revenue	A\$m	0	0	0	0	0	700	1,500	1,500	1,500	1,500	1,500	1,500	1,500	1,500	1,500	1,500	1,500	800	0
Royalty	3.5%	3.5%	3.5%	3.5%	3.5%	3.5%	3.5%	3.5%	3.5%	3.5%	3.5%	3.5%	3.5%	3.5%	3.5%	3.5%	3.5%	3.5%	3.5%	3.5%
Net Royalty Income	A\$m	0	0	0	0	0	24.5	52.5	52.5	52.5	52.5	52.5	52.5	52.5	52.5	52.5	52.5	52.5	28	0
Cash Consideration																				
Non-refundable Option payment		25																		
Exercise of Option consideration			20																	
Free Cash Flow	A\$m	25.0	20.0	0.0	0.0	0.0	24.5	52.5	52.5	52.5	52.5	52.5	52.5	52.5	52.5	52.5	52.5	52.5	28.0	0.0
Undiscounted Cash Flow	A\$m	675.0																		
Discounted, real cash flow	A\$m	25.0	17.3	0.0	0.0	0.0	14.5	28.3	25.7	23.4	21.2	19.3	17.5	15.9	14.5	13.2	12.0	10.9	5.3	0.0
Cash NPV	A\$m	42.3																		
Royalty NPV	A\$m	221.7																		
NPV of FCF	A\$m	264.0																		
Implied value p share	A\$/sh	1.59																		

Source: IOH, Ocean Equities

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