

## Iron Ore Holdings Ltd (IOH.ASX)

### MOU with FMG delivers a path to early cash flow

#### Event:

- Binding MOU with Fortescue Metals Group (FMG.ASX) for an exclusive 13 month option on Iron Valley tenements.

#### Details:

- FMG have paid a non-refundable \$25m cash payment to obtain a 13 month exclusive option on IOH's Iron Valley tenements.
- If exercised, FMG will provide further cash consideration of \$20m together with a 2%-5% royalty based on FOB revenue realised by Fortescue, and pay all costs associated with developing and operating a mine.
- FMG also have the right to farm-in to a 50% or greater interest on commercial terms of the Maitland River Project should IOH elect to commercialise the magnetite deposit.

#### Analysis:

- Value creating deal for shareholders.** An option deal with cash up front plus a royalty stream enables IOH to commercialise a large scale project that would otherwise remain infrastructure constrained in the near term. With \$45m in total cash from the option and exposure to upside from production and a strong Fe price outlook without the capex funding obligations, this looks a good deal for shareholders with our unrisksed valuation of \$194m.
- Low risk of FMG not exercising given \$25m non-refundable deposit.** We have long viewed FMG as the natural developer of Iron Valley and given the \$25m non-refundable deposit paid, contiguous deposit with FMG's Nyidingu and a mine plan capable of delivering ore from 2013 we believe FMG could exercise the option inside 13 months given final environmental approvals are expected late 2012.
- Royalty stream creating a junior Hancock Prospecting.** We view IOH as the potential to become a smaller version of Hancock Prospecting given the potential for long term annuity payments of \$30-50m per year can be used to develop assets in the portfolio, fund acquisitions or be used as major dividends to shareholders.
- Strong cash position to deliver growth in the West Pilbara.** With the cash balance growing to \$130m this quarter, the focus returns to resource drilling, mine studies and commercialisation initiatives across the West Pilbara and Coastal Hubs with Bungaroo South (242Mt) the only remaining independent DSO asset of any scale available for an offshore group or existing producer to grow their Pilbara portfolio.

#### Recommendation:

- We reiterate our BUY recommendation and revise our price target to \$3.00/sh.
- IOH has now demonstrated the commercialisation strategy can realise fair market value on satellite deposits as well as value upside deals on large deposits across the portfolio.

#### Metals & Mining

Rating	BUY
Previous	Buy

Share Price (\$)	1.72
52 week low - high (\$)	0.85 - 2.00
Price Target (\$)	3.00
Previous (\$)	3.30
Valuation (\$/share)	3.03
Methodology	DCF/In situ
Risk	High

#### Capital Structure

Shares on Issue (m)	166
Market Cap (\$m)	285
Net Debt/(Cash) (\$m)	-130
EV (\$m)	155
Options on issue (m)	11
12mth Av Daily Volume ('000)	190,150

#### Directors

Hon. Richard Court AC	Non Executive Chairman
Alwyn Vorster	Managing Director
Mal Randall	Non Executive Director
Ryan Stokes	Non Executive Director
Brian O'Donnell	Non Executive Director

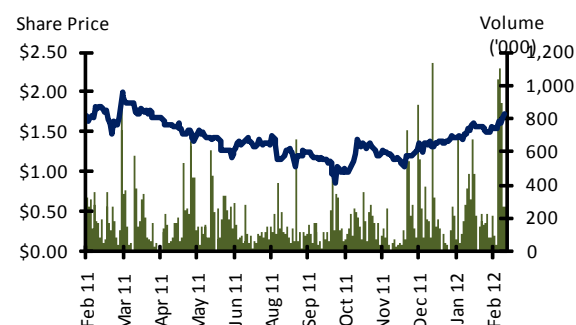
#### Major Shareholders

Wroxby Pty Ltd	51.5%
Sumisho Iron	4.0%
Directors	2.0%

#### Key Milestones

Binding Option on Iron Valley	2QCY12
Bungaroo South PFS	4QCY12
Mt Dempster Drilling Results & JORC	3QCY12

#### Share Price Graph



#### Analyst

Martin Carolan	+61 2 9993 8168
	martin.carolan@fostock.com.au

Foster Stockbroking acted as Lead Manager & Underwriter to the \$40m rights issue conducted in May 2011 by IOH and received a fee for this service.

## **BINDING MOU WITH FMG FOR 13 MONTH OPTION ON IRON VALLEY DEVELOPMENT**

***Binding MOU with FMG for a 13mth option includes \$45m total cash up front plus 2-5% FOB royalty.***

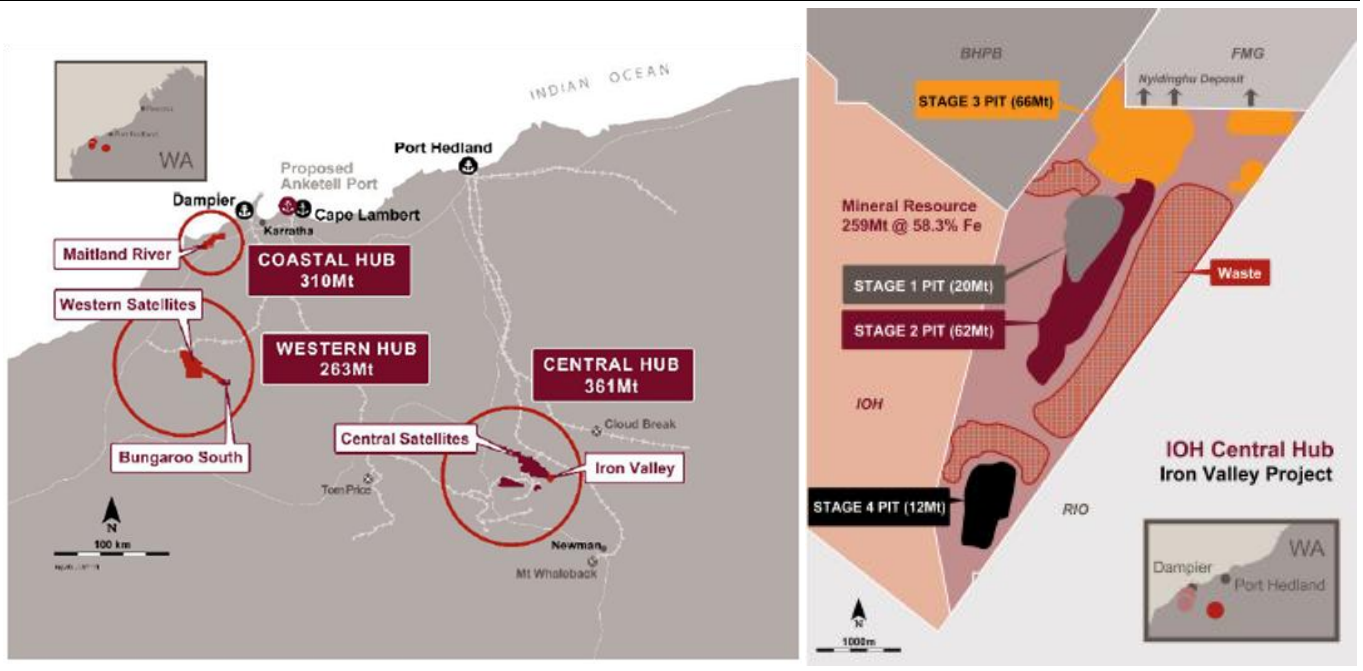
***Iron Valley deposit contains 259Mt resources at 58% Fe, with ~170Mt recoverable resource on a joint development basis with FMG.***

***Advanced stage of Iron Valley could see FMG exercise option to develop inside 13mth term with final environmental approvals expected by late 2012.***

- Binding MOU has been signed with Fortescue Metals Group (FMG.ASX) for a 13 month exclusive option to develop the Iron Valley tenements. FMG have made a non-refundable \$25m payment, with IOH receiving a further \$20m and a 2-5% revenue royalty on future production if the option is exercised. FMG will also receive an option to farm-in to a 50% or greater interest in the Maitland River magnetite project should IOH choose to commercialise this project. We expect the MOU will convert to a binding option agreement within 4-6 weeks.
- **Value creating deal for shareholders on Iron Valley.** An option deal with cash up front plus a 2-5% royalty stream enables IOH to commercialise a large scale project that would otherwise remain infrastructure constrained in the near term. With \$45m in total cash expected from the option and exposure to upside from near term production and Fe prices without the capex funding obligations we estimate at up to \$1.1b, this looks a good deal for shareholders while the time line for IOH to secure rail and port access remains uncertain. Our unrisksed valuation of the deal is \$194m (\$1.17/sh) compared with our previous NPV for Iron Valley of \$243m.
- **Low risk of FMG not exercising given \$25m non-refundable deposit and advanced stage of project.** We have long viewed FMG as the natural developer of Iron Valley, with previous IOH research publications highlighting the technical and financial synergies of the Iron Valley and FMG's Nyidinghu project being developed as a single operation. We view the \$25m non-refundable deposit paid, Iron Valley's advanced stage of feasibility and approvals and a staged mine plan capable of delivering ore from 2013 to be sufficient incentive for FMG to exercise the option inside 13 months given final environmental approvals are expected late 2012.
- **PFS, mining lease, land access and native title agreements in place.** Given Iron Valley is at an advanced stage with a feasibility study due for completion in 2012, a mining license already granted, land access and native title agreements secured, we view the final environmental approvals as the final hurdle before mining can begin in 2013. We understand the Environment study has been lodged with the WA government and approval is expected before the end of CY12.
- **FMG's Nyidinghu project is located 35km south of the Cloudbreak operation.** With total resources of 2Bt @ 57% Fe, the Nyidinghu deposit is a key expansion project for FMG beyond its current 155Mtpa expansion plans. The deposit has been identified to be a lower cost mine than Cloudbreak and Christmas Creek with a strip ratio of <2:1 and sales exempt from the Leucadia royalty. FMG has stated its intention to fast track feasibility studies to bring Nyidinghu into production as soon as possible.
- **Potential for mining and production royalty to start in 2013.** Given the advanced status of the Iron Valley project, as outlined above, and the nature of the Nyidinghu ore body starting at surface within the Iron Valley tenements before dipping into the FMG tenement, it is likely FMG may commence mining the deposit within the Iron Valley deposit during 2013 providing IOH with royalty cash flows as early as FY13, however more likely in FY14, taking advantage of the near term higher iron ore prices and a royalty payment at the upper end of the 2-5% rate.
- **IOH likely to build in mechanisms to avoid warehousing.** We expect that as part of the legal agreements to be finalised, IOH will endeavour to ensure protection mechanisms are included to avoid FMG 'warehousing' the deposit, resulting in a delay in royalty payments during times of higher expected iron ore prices.

- **PFS mine study identified 170Mt of recoverable resource up to the FMG/IOH tenement boundary.** The Phase 1 PFS mine study released by IOH in August 2011 identified 170Mt of recoverable resources could be mined up to the IOH/FMG boundary over four stages (Figure 1). A mine development in stage 1 and 2 will be able to deliver up to 15Mtpa for a six year period recovering 82Mt resource of higher than average quality at 59-60% Fe.

**Figure 1: Iron Valley Project Location in the Central Pilbara & 4 Stage Pit Design**

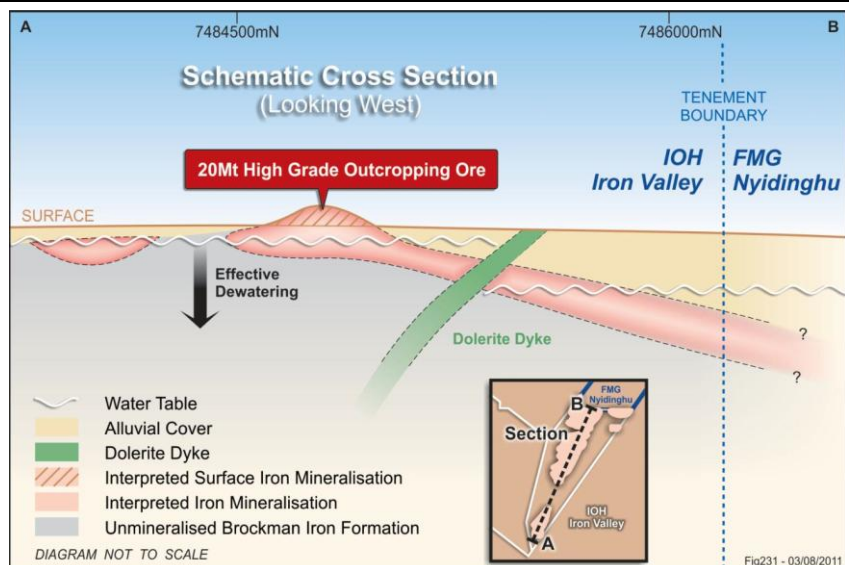


Source: Iron Ore Holdings

- **Approximately 20Mt of high grade outcropping resource in stage 1 provides FMG with an opportunity to commence mining operations from 2013 with low waste dry tonnes.** We understand hydrology engineering work is underway and soon to be finalised for stages 3 and 4 which will require manageable levels of dewatering given the water table in the proposed pit at the northern end of the tenement will have larger areas of groundwater recharge from the north and may have a greater dewatering requirement (Figure 2).

**Figure 2: Iron Valley Project Location in the Central Pilbara & 4 Stage Pit Design**

**20Mt of high grade outcropping resource in stage 1 provides FMG with an opportunity to commence mining operations from 2013 with low waste dry tonnes.**



Source: Iron Ore Holdings

## CENTRAL PILBARA PORTFOLIO SUCCESSFULLY COMMERCIALISED WITHIN 12MTHS OF STRATEGY BEING ANNOUNCED

**Successful commercialisation of the Central Hub portfolio has realised ~\$100m cash plus a potential royalty annuity stream of \$30-50m per year.**

- During 1HCY11 IOH outlined a commercialisation plan for the Central Pilbara portfolio to be commercialised by way of divestment, JV or other mechanisms to realise the value of these assets for shareholders given the market was not attributing 'fair value' given the advanced stage of feasibility and approvals of both the satellite deposits and the Iron Valley deposit.
- Inside 6 months of this announcement, IOH has successfully divested four satellite deposits in separate deals with Rio Tinto (RIO.ASX) and Mineral Resources (MIN.ASX) realising total cash consideration of \$74m plus a 2% royalty on the Koodaideri South tenement. One satellite remains to be divested. This is a positive result for shareholders given the small resource nature of these deposits and their limited infrastructure options.
- The announcement of a binding MOU with FMG for a 13mth option to develop the flagship Iron Valley deposit realises another \$45m and a valuable 2-5% royalty stream which we estimate could deliver between \$30-50m in annual royalty payments (depending on Fe price assumptions, refer to Figure 4 & 5 for our assumptions).
- In total \$99m in up front cash consideration from all three deals takes the IOH cash balance to \$130m (\$0.78/sh), plus the potential to realise >\$40m on an annual basis from royalty deals across the Central Pilbara portfolio that 12 months ago was being valued below \$0.30/ t contained Fe.

**Figure 3: Central Pilbara Commercialisation Deals**

Tenement	Acquirer	Resources	Consideration	FSB Comments/Status
Koodaideri South	Rio Tinto (RIO.ASX)	62Mt contained Fe	\$32m cash & 2% royalty	FSB valuation of cash & royalty stream \$39m, with royalty payments starting 2014 with estimated 5Mtpa production delivering ~\$6m in annual royalties from 2016.
Phil's Creek and Lamb Creek	Mineral Resources (MIN.ASX)	31.1Mt contained Fe	\$42m cash	100% cash consideration equates to \$1.35/t Fe. Final cash payment of \$37m pending Ministerial consent for the transfer of the mining tenements and approval of the Phil's Creek Mining Proposal.
Iron Valley	Fortescue Metals (FMG.ASX)	151Mt contained Fe	\$45m cash & 2-5% royalty	\$25m non-refundable deposit paid for a 13mth binding 13 option. \$20m payable when exercised.  Likely to be exercised within 13mths given final environmental approval due late 2012 will enable early start-up in 2013.

Source: FSB Research, Iron Ore Holdings

## CENTRAL PILBARA ROYALTY STREAM TO FUND GROWTH IN THE WEST PILBARA AND NEW PORTFOLIO AQUISITIONS

**Royalty deals secured across the Central Hub assets could deliver an annuity stream for shareholders between \$30-50m.**

- Figure 4 and 5 below highlights the potential value and cash flow to be generated from the royalty payments associated with the Koodaideri South tenement and the Iron Valley tenement. We have provided a base case valuation and upside case for long-term iron ore price assumptions.
- While we model the long term iron price at US\$75/t (58% Fe) for the purposes of our base case valuation of the FMG royalty at 2.5% in Figure 4, we believe there remains upside risk to stronger iron prices beyond 2016 should there be further delays in additional production capacity due to uncertainty of capex funding, higher costs or ongoing growth in steel consumption keeping bulk commodity prices higher. Our upside case is outlined in Figure 4 using a US\$100/t long term price and a 3.5% royalty provides 52% upside to our base case NPV \$194m.
- In summary, our analysis highlights that the commercial deals announced by IOH in recent months have the potential to deliver royalty payments from 2013 and an average yearly income stream between \$30-50m on combined basis through to 2024, depending on your long term view of iron ore prices.
- We view IOH has the potential to become a smaller version of Hancock Prospecting given the long term royalty payments can be used to develop assets in the portfolio, fund acquisitions or be used as major dividends to shareholders.

**Figure 4: FSBe Royalty Payment Stream on Iron Valley**

Base Case:	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	Total
<b>Production (Mtpa)</b>	<b>0</b>	<b>3</b>	<b>10</b>	<b>10</b>	<b>15</b>	<b>15</b>	<b>15</b>	<b>15</b>	<b>15</b>	<b>15</b>	<b>15</b>	<b>15</b>	<b>15</b>	<b>10</b>	168
<b>USD/t Fe Fines Price</b>	<b>164</b>	<b>140</b>	<b>145</b>	<b>145</b>	<b>99.2</b>	<b>75</b>	<b>75</b>	<b>75</b>	<b>75</b>	<b>75</b>	<b>75</b>	<b>75</b>	<b>75</b>	<b>75</b>	
FOB Revenue (US\$m)		420	1,450	1,450	1,488	1,125	1,125	1,125	1,125	1,125	1,125	1,125	1,125	750	12,688
2.5%	-	11	36	36	37	28	28	28	28	28	28	28	28	19	364
Payments (A\$m)	25	29	31	31	32	24	24	24	24	24	24	24	24	16	329
NPV (A\$)	194														
<b>Upside Case: LT US\$100/t, A\$0.85:</b>															
<b>USD/t Fe Fines Price</b>	<b>164</b>	<b>140</b>	<b>145</b>	<b>145</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>	
FOB Revenue (US\$m)	-	420	1,450	1,450	1,500	1,500	1,500	1,500	1,500	1,500	1,500	1,500	1,500	1,000	15,950
3.5%	-	15	51	51	53	53	53	53	53	53	53	53	53	35	624
Payments (A\$m)	25	32	43	43	45	45	45	45	45	45	45	45	45	30	575
NPV (A\$)	295														

Source: FSB Research

**Figure 5: FSBe Royalty Payment Summary on Koodaideri South**

	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	2026
<b>Production (Mtpa)</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>5</b>	<b>5</b>	<b>5</b>	<b>5</b>	<b>5</b>	<b>5</b>	<b>5</b>	<b>5</b>	<b>5</b>	<b>5</b>	<b>5</b>	<b>5</b>
<b>USD/t Fe Fines Price</b>	<b>164</b>	<b>140</b>	<b>145</b>	<b>145</b>	<b>99</b>	<b>75</b>	<b>75</b>	<b>75</b>	<b>75</b>	<b>75</b>	<b>75</b>	<b>75</b>	<b>75</b>	<b>75</b>	<b>75</b>	<b>75</b>	<b>75</b>
FOB Revenue (US\$m)	-	-	-	-	-	375	375	375	375	375	375	375	375	375	375	375	375
2.0%	-	-	-	-	-	8	8	8	8	8	8	8	8	8	8	8	8
Payments (A\$m)	32	-	-	-	-	6	6	6	6	6	6	6	6	6	6	6	6
NPV (A\$)		30															

Source: FSB Research

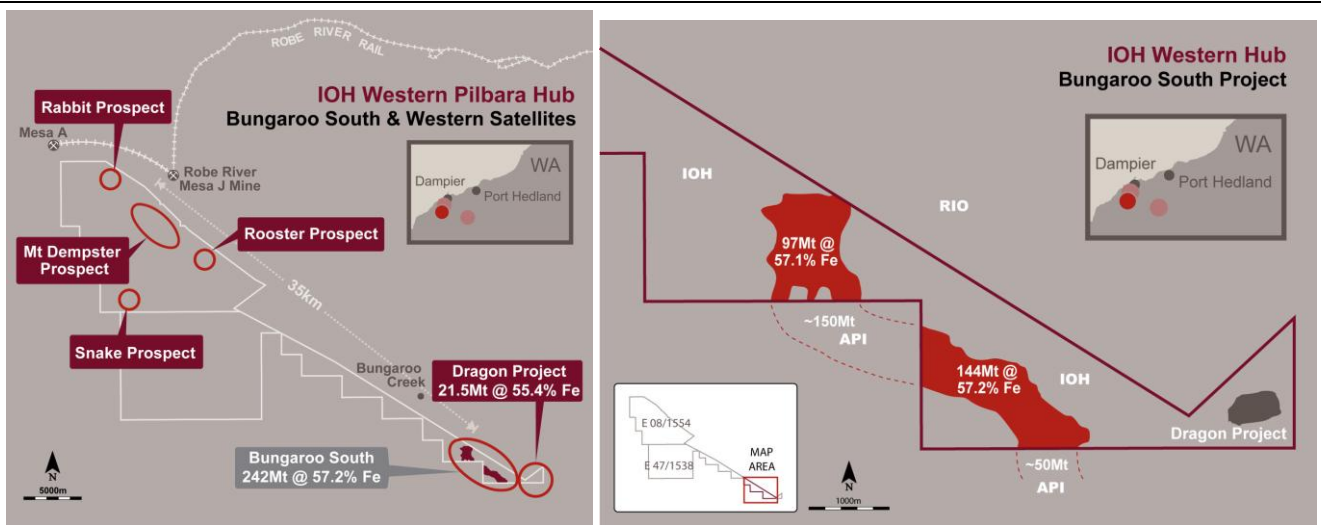
**WEST PILBARA PORTFOLIO TO DELIVER THE NEXT PHASE OF GROWTH**

*Commercial options are being reviewed with potential cornerstone and/or off-take partners to assist with the completion of a full feasibility study and development funding of Bungaroo South.*

*Pre-feasibility study commencing 1HCY12 will define a detailed mine plan, groundwater geotechnical parameters and confirm infrastructure pathway solutions for both port and rail.*

- The West Pilbara portfolio contains total JORC Mineral Resource of 263Mt, comprising the core deposit, Bungaroo South (242Mt Hematite), the Dragon satellite deposit (22Mt Hematite) and the newly discovered large-scale magnetite target Mt Dempster (multi-billion tonne potential).
- A completed Concept Study for Bungaroo South indicated a mine life of 15yrs with production between 12-15Mtpa and first production target in 2015. A PFS study is currently being scoped and due to for completion 4Q 2012.
- The Bungaroo South deposit holds strategic value, as it is adjacent to the API JV's Buckland Hills deposit and a contiguous ore body across the adjoining tenements, similar to that of Iron Valley with FMG.
- Given the integrated nature of the deposit it is considered that a co-development opportunity with API is the logical path to production with the location of the deposit 50 km from the proposed API JV's planned rail infrastructure to Anketell port. However, IOH have indicated that other commercial options are being reviewed with potential cornerstone and/or off-take partners to assist with the completion of a full feasibility study and development funding.
- We view Bungaroo South as having a greater likelihood of independent development given the API rail and Anketell port development can provide a path to market given the open access framework, unlike the rail and port options in the Central Pilbara.
- We view the Bungaroo South deposit as the last remaining independent hematite deposit in the Pilbara with a resource capable of delivering a 12-15Mtpa operation. Given the deposit is located within 50km of a rail/port infrastructure solution we believe it provides a logical addition to the API portfolio or an attractive entry point into the Pilbara for an offshore group.
- Our valuation for Bungaroo South is \$388m, which we risk by 40% to account for further feasibility studies, financing, development and timing. We expect a pre-feasibility study to commence 1HCY12 to define a detailed mine plan, groundwater geotechnical parameters and confirm infrastructure pathway solutions for both port and rail.

**Figure 6: West Pilbara Hub & Bungaroo South Deposit**



Source: Iron Ore Holdings

## VALUATION & PRICE TARGET

### Risked Discounted Cash Flow (DCF) and Sum of Parts - \$536m, \$3.03/share

#### Price Target - \$3.00/share

***Our revised risked valuation has increased to \$536m or \$3.03/sh.***

- Our updated price target of \$3.00/share is in line with our consolidated DCF/Sum of parts valuation of \$536m, equivalent to \$3.03/share as outlined in Figure 7 below. Our previous price target for IOH was \$3.15/share.
- Our valuation for Iron Valley has been revised to account for the FMG option deal using the total of \$45m in cash payments and a 2-5% royalty on price dependent scale, on 15Mtpa production for 12yrs. We derive an un-risked value of \$194, which is below our previous valuation of \$243m.
- We have adjusted our Bungaroo South valuation on the basis of a change to our long-term iron price assumptions and maintain a 60% risk weighting given the less advanced stage of feasibility studies and progress made on commercial discussions for potential JV partners.
- Our net cash balance of \$130m includes the final cash consideration from the MIN transaction given a very low risk of non-completion; however we exclude the final \$20m cash payment from the FMG option. Healthy cash balance ensures IOH is well funded for the continuation of exploration of the newly discovered Mt Dempster target and Maitland River deposit, PFS study at Bungaroo South and capacity to review new acquisition opportunities.

***Strong cash balance ensures IOH is well funded for the continuation of exploration of the newly discovered Mt Dempster target and Maitland River deposit, PFS study at Bungaroo South and capacity to review new acquisition opportunities.***

**Figure 7: Valuation Summary**

Valuation Summary	(A\$m)	P/NPV (risk)	Risked (A\$m)	Risked A\$/sh
Bungaroo South	388	0.60	233	1.32
Iron Valley - Option & Royalty	194	0.70	136	0.77
Satellite projects*	18	0.70	12	0.07
Maitland River Project	32	0.25	8	0.05
Koodaideri South - Royalty	30	1.00	30	0.17
Net cash/(debt)**	130	1.00	130	0.74
Unpaid Capital	21	1.00	21	0.12
Corporate	-34	1.00	-34	-0.19
<b>TOTAL NPV</b>	<b>779</b>		<b>536</b>	<b>\$3.03</b>
<b>Price Target</b>				<b>\$3.00</b>
		<b>Current Price</b>		<b>\$1.72</b>
		<b>Upside</b>		<b>75%</b>

\* Includes both remaining Central and Western Satellites

\*\* Assumes final \$37m payment from Mineral Resources is paid this 1QCY12.

Source: FSB Research

## RECOMMENDATION

- **We reiterate our BUY recommendation with and revise our price target to \$3.00/sh.**
- IOH management have now demonstrated the IOH commercialisation strategy can realise fair market value on satellite deposits as well as value upside deals on large deposits across the portfolio. **We view IOH has the potential to become a smaller version of Hancock Prospecting given the long term royalty payments of \$30-50m per year can be used to develop assets in the portfolio, fund acquisitions or be used as major dividends to shareholders.**

**FOSTER STOCKBROKING DIRECTORY**

Name	Department	Phone	Email
Stuart Foster	Equities Dealing	+61 2 9993 8131	stuart.foster@fostock.com.au
Kevin Massey	Equities Dealing	+61 2 9993 8130	kevin.massey@fostock.com.au
Trenton Brown	Equities Dealing	+61 2 9993 8161	trenton.brown@fostock.com.au
Alex Drysdale	Equities Dealing	+61 2 9993 8167	alex.drysdale@fostock.com.au
Tolga Dokumcu	Trade Execution	+61 2 9993 8144	tolga.dokumco@fostock.com.au
George Mourtzouhos	Trade Execution	+61 2 9993 8136	george.mourtzouhos@fostock.com.au
Martin Carolan	Equity Research Sales	+61 2 9993 8168	martin.carolan@fostock.com.au
Mark Hinsley	Equity Research Sales	+61 2 9993 8166	mark.hinsley@fostock.com.au
Craig Brown	Equities Research	+61 2 9998 8163	craig.brown@fostock.com.au
Haris Khaliqi	Equities Research	+61 2 9993 8152	haris.khaliqi@fostock.com.au

**Foster Stockbroking Pty Limited**

A.B.N 15 088 747 148 FSR Licence No. 223687

Level 21, 25 Bligh Street, SYDNEY, NSW 2000 Australia

Tel: +612 9221 8711 Dealing: +612 9221 8700 Fax: +612 9221 1031

Email: [contact@fostock.com.au](mailto:contact@fostock.com.au)

PARTICIPANT OF ASX GROUP

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**Specific disclosure:** The analyst, Foster Stockbroking and/or associated parties have beneficial ownership or other interests in securities issued by IOH at the time of this report. Diligent care has been taken by the analyst to maintain an honest and fair objectivity in writing the report and making the recommendation.

**Specific disclosure:** Foster Stockbroking and/or associated parties have received fees in the past 12 months for services provided to IOH in respect of the May 2011 equity capital raising.