

EQUITY RESEARCH: MINING COMPANY

CASE STUDY: FINANCIAL MODELING

Iron-Ore

Objective

To forecast the financial statements and perform valuation analyses of a mining company based out of Australia.

Background and Challenges

Our client is a ASX-listed mineral exploration company focused on the development of its iron ore assets. The company has identified a significant maiden JORC compliant magnetite resource with a hematite exploration target that makes it a highly prospective iron ore development company.

Having recently strengthened the operations through strategic mergers with a peer iron ore exploration enterprise, the company is looking for Capex investment to strengthen its shipment infrastructure.

One of the major challenges in this exercise is to examine the presence of unexplored resources in the surrounding region likely to possess high economic value. We need to rely on scrutinizing various geological reports to substantiate the information provided by our esteemed client. As the iron ore prices are highly volatile, it is difficult to forecast short and long term DMTU prices of magnetite and hematite ores. And our approach is to analyze, in detail, the global market price trends for each of the ores to ensure that ample business opportunities are available for the growth of the business.

"I would like to congratulate you and your team on a fantastic effort with the 2012 forecast numbers. Market sentiments favored the analysis and the share prices jumped by 30% as soon as we released the financials.

*- Director
Investment Advisory Company*



Insights into the company's future growth is achievable by keen Observation on the Details

Insights into Equity Research

- Study the Management Reports well
- Validate Company's Strategies on Historical Data
- Look beyond Numbers to Capture the Intangible

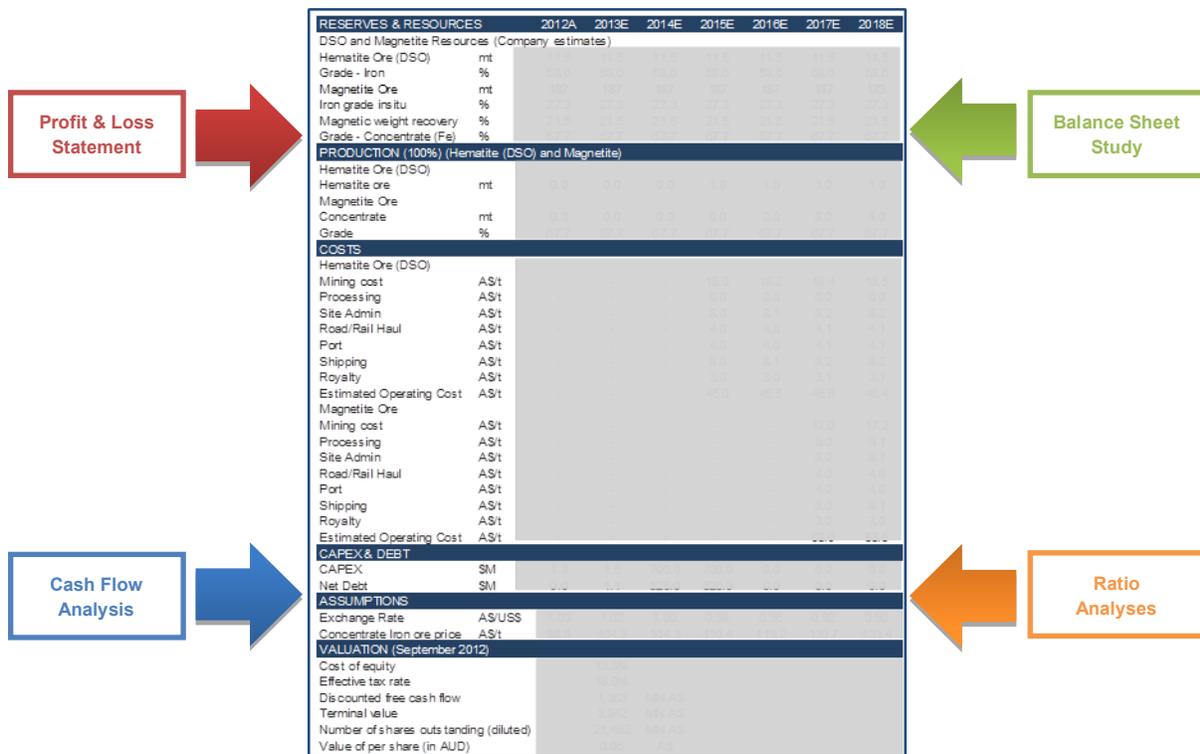
Our Approach

Method: Discounted Cash Flow using WACC

Analyses Performed: Sensitivity Analysis

Studying financial statement and annual reports: As a first step, to gain a complete understanding of their current operations, we study the financial statements and management reports of the company available for the last 5 years period. Our analysts engage with the management board of the company to understand their strategies for the coming years. We perform a feasibility study to validate how much of the proposed strategy is achievable given the realistic circumstances.

We collect financial statement data for the past 5 years and perform a comprehensive analysis of the financials using multiple tools: analyzing the revenue drivers and the net revenue pattern, year on year CAGR growth, comparative studies of margins (Gross, Operating, Pre Tax and Net Margins), cash flows from activities, ratio analysis, comparative study of quarterly results, amongst others.



Note: Values have been kept hidden due to confidentiality

Illustration 1: Valuation Model Summary

Forecasting the revenue drivers: A detailed analysis of the revenue drivers is done to study ore resources, mining capacity, mine life, mass yield, beneficiated ore, and prices. Revenue projections are made based on the historic trends of the company and common-size financial statements with projected figures being rationalized to be in sync with the management outlook. Assumptions for rationalization are placed in the report to substantiate the projections, and our team provides an opinion on the under-and-over valuation of the stocks.

Building the Financial Models and various Scenarios: The revenues are scaled back to Net Present value with the help of the discount factor and, using the capital structure study of the company, the correct WACC is calculated using the CAPM theory. Further to analysis, various scenarios are prepared - base, bear, & bull to incorporate influences to the valuation inputs triggered by internal and external variables.

Sensitivity Analysis: As the Australian dollar witnessed regular volatility, the mining costs in the region have also responded with high fluctuations. Due to the current market volatility, we incorporate wide range of assumptions within the model scenarios concerning pricing and foreign exchange. As a due diligence practice, we further perform sensitivity analysis to cope up with the changes in the two aforementioned factors.

DCF Sensitivity Analysis

Value Per Share (in AS)		Ore price Variations (with respect to US\$100/t)								
		-20%	-15%	-10%	-5%	0%	5%	10%	15%	20%
AUD: USD Exchange Rate	0.80	-0.0319	0.0022	0.0362	0.0703	0.1043	0.1384	0.1724	0.2065	0.2405
	0.85	0.0022	0.0384	0.0745	0.1107	0.1469	0.1831	0.2192	0.2554	0.2916
	0.90	0.0362	0.0745	0.1128	0.1511	0.1895	0.2278	0.2661	0.3044	0.3427
	0.95	0.0703	0.1107	0.1511	0.1916	0.2320	0.2724	0.3129	0.3533	0.3937
	1.00	0.1043	0.1469	0.1895	0.2320	0.2746	0.3171	0.3597	0.4023	0.4448
	1.05	0.1384	0.1831	0.2278	0.2724	0.3171	0.3618	0.4065	0.4512	0.4959
	1.10	0.1724	0.2192	0.2661	0.3129	0.3597	0.4065	0.4533	0.5002	0.5470

Note: Values have been masked due to confidentiality

Illustration 2: DCF Sensitivity Analysis

Results and Benefits

We ascertain the key performance indicators (KPIs) based on projections to evaluate how the company would perform considering industry average ratios as base. We determine the company's free cash flows and terminal value at the end of six & ten years of its operations and publish the intrinsic value at the end of the projected period. Our report also includes a detailed financial commentary wherein the projected financials are analyzed against the industry benchmarks.

The actuals came significantly closer to our predictions:

- The Net Profit figure comes out to be \$1.4m versus predicted at \$1.3m.
- The Revenue is slightly lower at \$27.6m vs. predicted at \$29.0m.
- EBITDA is \$5.9m vs. predicted at \$7.1m, with Basic EPS of 0.72 cents per share vs. predicted as 0.63 cents per share. EBITDA grew \$3.54m (150%) against predicted growth of 144%.

Contact Us

- Financial Modeling
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