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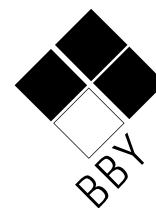
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Grange Resources Limited

GRR consolidates control of the Southdown deposit on favourable terms

GRR

**A\$2.85
BUY**

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We maintain our BUY recommendation on GRR after the company announced that it had consolidated control of the Southdown magnetite deposit after securing RIO's 6km strike of the deposit. Consideration for the transaction is A\$45.1M based on GRR share price of A\$2.80/sh and includes (i) A\$1M in cash (ii) 9M GRR shares (iii) 8.5M 1 year options at a strike price of A\$1.95/sh and (iv) 9M 3 year options at a strike price of A\$1.50/sh. RIO's fully diluted equity interest in GRR represents 19.9%. Developing the Southdown deposit into a single mining operation is an optimal development strategy for both GRR and RIO. BBY forecasts that the RIO ore body could add >300Mt to GRR's resource of 479Mt @ 37.3%Fe and extend the mine life by 12 years to 34 years. We have revised our valuation to A\$5.66/sh (previously A\$5.69/sh) post the RIO transaction. Our revised valuation will be discussed in a subsequent note.

RIO transaction highlights

- Consideration** – A\$45.1M based on Friday's closing GRR share price of A\$2.80/sh and includes A\$1M cash, 9M GRR shares and 17.5M options (8.5M 1Yr @ A\$1.95/sh & 9M 3Yr @ A\$1.50/sh). The planned issue of shares and options are subject to shareholder approval. Shares issued and 3 year options are subject to a 12 month escrow period, and 1 year options are subject to a 10 month escrow period.
- Resources** – BBY forecasts that RIO's Southdown tenements could add 300Mt to mineable resources. The ore body on RIO's tenements on average is deeper and will require significant pre-strip. Total Southdown resource of 780Mt @ 37.3%Fe, supports a mine life of 34 years at current planned concentrate production rates of 6.8Mtpa.
- Recent transactions** – CITIC Pacific of HK paid equivalent to A\$0.26/t for a 1Bt magnetite deposit in the Pilbara. MGX sold its 73% interest in Asian Iron Holdings which controls the 240Mt Extension Hill Magnetite deposit for A\$52.3M or A\$0.30/t and CFE sold 70% of its Cape Lambert magnetite project to Best Decade for A\$250M; equivalent to A\$0.31/t. We estimate GRR paid A\$0.15/t for the 300Mt RIO magnetite deposit.
- Development** – Even though we do not expect the RIO strike of the deposit to be developed in the short term it will allow GRR to factor the expanded resource base into its development plans for the project, which could include a future expansion of output.

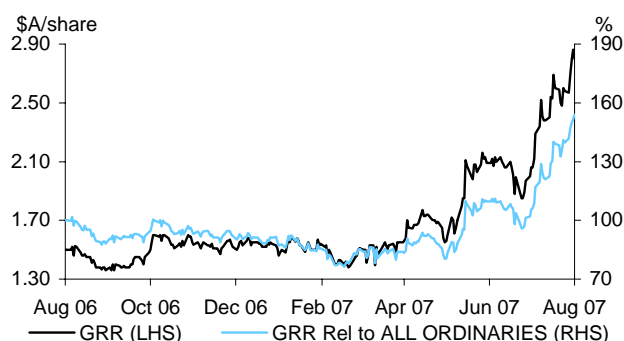
Company Data

Number of shares	106.2M
Market capitalisation	\$297.4M
12 month high/low	\$2.92 / \$1.35
Average monthly turnover	\$9.6M
All Ordinaries Index	6049

Financial Summary (GRR 70% share of the project)

Year end June	2006A	2007F	2008F	2009F	2010F	2011F
EBITDA (\$M)	1.6	(0.1)	0.3	0.7	107.5	450.8
NPAT: (\$M)	1.9	0.6	0.8	7.9	38.3	311.9
EPS (¢/sh)	1.9	0.5	0.7	3.0	14.3	122.0
PER (x)	na	na	na	94.3	20.0	2.3
EBITDA Multiple (x)	na	na	na	na	13.5	2.4
Cashflow (\$M)	4.1	1.0	12.4	14.3	112.0	369.9
CFPS (¢/sh)	4.3	0.9	4.8	5.3	41.7	137.2
P/CFPS (x)	65.7	na	59.6	53.6	6.8	2.1
Dividend (¢/sh)	0.0	0.0	0.0	0.0	0.0	0.0
Return on Assets (%)	3.2	na	0.1	0.1	5.6	22.9
Return on Equity (%)	3.7	na	0.1	0.2	18.5	52.9
Gearing ND/(ND+E) (%)	0.0	0.0	0.0	58.6	61.4	31.1
Interest Cover (x)	na	na	na	na	2.0	5.0
EBITDA margin (%)	21.3	na	na	na	64.3	62.6
EBIT margin (%)	16.7	na	na	na	47.6	54.7

GRR versus ALL ORDINARIES Index



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Analysis – GRR (70% project equity)

Year End 30 June																	
PROFIT & LOSS								RESERVES & RESOURCES									
	2006A	2007F	2008F	2009F	2010F	2011F	2012F	2006A	2007F	2008F	2009F	2010F	2011F	2012F			
Sales Revenue	\$M	7.4	0.0	0.0	0.0	167.2	720.2	681.5	Resources - Freshwater & Redhill (Royalty interest only)								
Other Income	\$M	2.8	4.0	22.2	4.0	6.5	10.8	10.2	Tonnes	mt	7.8	6.5	5.2	3.9	2.6	1.3	0.0
Operating Costs	\$M	(4.3)	0.0	0.0	0.0	(58.2)	(256.1)	(261.1)	Grade - gold	g/t	3.1	3.1	3.1	3.1	3.1	3.1	3.1
State Royalties	\$M	0.0	0.0	0.0	0.0	(5.0)	(21.2)	(19.1)	Contained gold	Koz	766	638	510	383	255	127	0
Corporate Costs	\$M	(4.1)	(3.7)	(3.7)	(3.3)	(3.0)	(3.0)	(3.0)	Resources & Reserves - Southdown (GRR & BBY estimates)								
Other	\$M	(0.3)	(0.4)	(18.2)	0.0	0.0	0.0	0.0	Resources	mt	479	479	479	779	775	757	740
EBITDA	\$M	1.6	(0.1)	0.3	0.7	107.5	450.8	408.6	Reserves ¹	mt		383	383	623	619	602	584
Depreciation & Am.	\$M	(0.3)	(0.0)	0.0	0.0	(28.0)	(56.8)	(57.9)	Magnetite grade	%		37.3	37.3	37.3	37.3	37.3	37.3
EBIT	\$M	1.2	(0.1)	0.3	0.7	79.5	394.0	350.7	Weight recovery (DTC) ²	%		37.6	37.6	37.6	37.6	37.6	37.6
Net Interest	\$M	0.6	0.7	0.5	7.2	(39.8)	(78.9)	(60.0)	Concentrate (Fe)	%		69.0	69.0	69.0	69.0	69.0	69.0
Pre-Tax Profit	\$M	1.9	0.6	0.8	7.9	39.7	315.1	290.7	Silica (SiO ₂)	%		1.9	1.9	1.9	1.9	1.9	1.9
Tax	\$M	0.0	0.0	0.0	0.0	(1.4)	(3.2)	(3.1)	Alumina (Al ₂ O ₃)	%		1.4	1.4	1.4	1.4	1.4	1.4
Other	\$M	0.1	0.0	0.0	0.0	0.0	0.0	0.0	¹ Assumes an 80% conversion to reserves. ² Davis Tube Concentrate (DTC)								
NPAT	\$M	1.9	0.6	0.8	7.9	38.3	311.9	287.6	PRODUCTION (100%) - Magnetite & Iron Pellets								
Reported Profit	\$M	1.9	0.6	0.8	7.9	38.3	311.9	287.6	Tonnes mined	mt	0.0	0.0	0.0	0.0	12.0	62.0	62.0
Dividends Paid	\$M	0.0	0.0	0.0	0.0	0.0	0.0	(47.9)	Strip ratio	mt	0.0	0.0	0.0	0.0	1.0	2.5	2.5
Retained Earnings	\$M	(21.1)	(20.5)	(19.7)	(11.8)	26.5	338.4	578.1	Mill throughput	mt	0.0	0.0	0.0	0.0	4.0	17.7	17.7
CASH FLOW								COSTS									
Revenue	\$M	8.2	3.9	15.6	10.6	139.8	694.4	695.5	Mining costs	US\$/t	0.0	0.0	0.0	0.0	13.5	13.6	13.8
Costs	\$M	(4.8)	0.0	0.0	0.0	(29.1)	(220.8)	(259.9)	Concentrate costs	US\$/t	0.0	0.0	0.0	0.0	10.0	10.2	10.4
Royalties	\$M	0.0	0.0	0.0	0.0	(2.5)	(18.7)	(19.6)	Transport	US\$/t	0.0	0.0	0.0	0.0	1.3	1.3	1.4
Net Interest	\$M	0.6	0.7	0.5	7.2	6.8	(78.9)	(65.4)	Royalties	US\$/t	0.0	0.0	0.0	0.0	3.4	3.3	2.9
Tax Paid	\$M	0.0	0.0	0.0	0.0	0.0	(3.0)	(3.1)	Pelletisation costs	US\$/t	0.0	0.0	0.0	0.0	5.5	5.6	5.7
Corporate / Other	\$M	0.0	(3.5)	(3.7)	(3.5)	(3.0)	(3.0)	(3.0)	Depreciation	US\$/t	0.0	0.0	0.0	0.0	19.2	8.8	8.9
Gross Cash Flow	\$M	4.1	1.0	12.4	14.3	112.0	369.9	344.5	Total Cost	US\$/t	0.0	0.0	0.0	0.0	61.6	51.6	52.3
Net Capex	\$M	(0.3)	(7.9)	(161.2)	(722.6)	(199.5)	(20.5)	(21.0)	CAPEX & DEBT								
Exploration / Mine	\$M	(16.8)	(11.9)	(1.0)	(21.0)	(7.4)	(0.8)	(0.8)	CAPEX	\$M	17.1	19.8	162.2	743.6	206.9	21.3	21.8
Dividends	\$M	0.0	0.0	0.0	0.0	0.0	0.0	0.0	Net Debt	\$M	(8.3)	(4.2)	(172.6)	(143.9)	455.4	389.4	101.7
Other	\$M	0.3	0.1	0.0	0.0	0.0	0.0	0.0	ASSUMPTIONS								
Free Cashflow	\$M	(12.7)	(18.6)	(149.8)	(729.3)	(94.9)	348.7	322.7	Exchange Rate	A\$/US\$	0.75	0.78	0.78	0.73	0.72	0.72	0.72
Equity Issues	\$M	12.9	15.0	318.2	16.6	0.0	2.5	13.5	Inflation (CPI Index)	%	2.5	2.5	2.5	2.5	2.5	2.5	2.5
Net Borrowings	\$M	0.0	0.0	0.0	684.0	196.4	(53.7)	(102.1)	Australian tax rate	%	30.0	30.0	30.0	30.0	30.0	30.0	30.0
Other	\$M	(0.7)	(0.4)	0.0	0.0	0.0	0.0	0.0	Malaysian tax rate	%	28.0	28.0	28.0	28.0	28.0	28.0	28.0
Surplus Cash Flow	\$M	(0.4)	(4.1)	168.4	(28.7)	101.5	297.4	234.0	Iron Fines Price	US\$/dmu	67.6	76.9	88.5	96.5	91.7	82.5	74.3
BALANCE SHEET								Mine NPV & NAV (Net Appraised Value = NPV less net debt) \$/share									
Cash	\$M	8.3	4.2	172.6	143.9	245.4	542.9	776.9	NAV includes cash build-up								
Other Current	\$M	3.6	3.5	4.8	3.5	42.9	88.8	84.1	2008F								
Total Current	\$M	11.9	7.7	177.4	147.4	288.4	631.7	861.1	2009F								
Mine Development	\$M	23.4	27.3	28.3	49.3	55.4	53.4	51.4	2010F								
Plant & Equip	\$M	0.7	11.2	172.4	895.0	1,067.8	1,034.3	1,000.2	2011F								
Other	\$M	2.7	2.7	2.7	2.7	2.7	2.7	2.7	2012F								
Total NC Assets	\$M	26.8	41.2	203.5	947.0	1,125.9	1,090.4	1,054.3	2013F								
TOTAL ASSETS	\$M	38.7	48.9	380.9	1,094.4	1,414.2	1,722.1	1,915.4	2014F								
Total Debt	\$M	0.0	0.0	0.0	700.8	932.3	878.6	776.4									
Current Liab	\$M	3.9	0.4	2.7	0.4	30.9	62.3	59.0									
Non Current Liab	\$M	1.0	(0.7)	9.9	0.5	20.0	35.8	81.3									
TOTAL LIAB	\$M	4.8	(0.3)	12.6	701.7	983.2	976.6	916.8									
NET ASSETS	\$M	33.9	49.2	368.2	392.7	431.0	745.4	998.6									
SH/HLDRS FUNDS	\$M	33.9	49.2	368.2	392.7	431.0	745.4	998.6									
RATIO ANALYSIS								VALUATION (December 2007)									
EPS	¢	2.0	0.5	0.3	2.9	14.3	115.7	103.2	Southdown / Kemaman (70%) @ 10.0% DCR						A\$m	A\$ps	
PER	x	na	na	na	97.3	20.0	2.5	2.8	Exploration						20.0	\$0.07	
CFPS	¢	4.3	0.9	4.8	5.3	41.7	137.2	123.6	Notional Option value						34.8	\$0.12	
PCFR	x	65.7	na	59.6	53.6	6.8	2.1	2.3	Net Debt						16.3	\$0.06	
DPS	¢	0.0	0.0	0.0	0.0	0.0	0.0	17.2	Total						1,577.2	\$5.66	
EPS growth	%	na	na	na	na	na	na	na									
Interest Cover	x	na	0.2	na	na	2.0	5.0	5.8									
Gearing: ND/(ND+E)	%	0.0	0.0	0.0	58.6	61.4	31.1	0.0									
EBITDA Margin	%	21.3	na	na	na	64.3	62.6	59.9									
EBIT Margin	%	16.7	na	na	na	47.6	54.7	51.5									
Return On Assets	%	3.2	na	0.1	0.1	5.6	22.9	18.3									
Return On Equity	%	3.7	na	0.1	0.2	18.5	52.9	38.6									

Source: BBY, GRR



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Contact with GRR has been made during the preparation of this report for assistance with verification of facts.

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