

Terramin Australia Ltd. (TZN.ASX)

Initiation of coverage – a rare pure zinc play

Thursday 10 April 2008

Introduction. TZN is a rare pure zinc play on the verge of production. TZN's 100% owned Angas mine remains on time and budget for first concentrate production in August this year. However, it is TZN's 65% share in the 55Mt, 5% zinc and 1.2% lead Tala Hamza deposit in Algeria that will ensure its success well into the future.

Investment view. TZN is in the enviable position of having a modest sized zinc mine in South Australia to take advantage of current high metal prices and generate cash to advance the promising Tala Hamza deposit in Algeria through to production by 2012. TZN's success at Angas will be crucial in demonstrating to the market that it can deliver projects on time and budget and therefore go some way to unlocking value in the larger Tala Hamza deposit. Algeria is relatively stable, actively seeks foreign investment and has been instrumental in boosting the resources sector by conducting and financing regional exploration programs.

Consolidation opportunities. We believe that the quality smaller resources stocks will continue to consolidate over the coming years across all commodity sectors. This is based on fundamental reasons such as achieving economies of scale, reducing overheads and more efficient allocation of capital. TZN's positive cashflow from Angas in the short term and significant potential at its Tala Hamza project makes it attractive to the larger mining companies.

Favourable outlook. TZN will most likely generate more than 75% of its revenue from zinc concentrate sales. While the zinc market remains strong, the zinc price has not enjoyed the rises its other base metal cousins, such as copper and nickel have. We do believe that the supply demand balance will remain tight and it will only take a modest slip in supply to place significant upward pressure on the zinc price.

Valuation: Our current valuation for TZN based on a DCF methodology is \$4.10/share and our year-forward valuation is \$4.82/share.

Recommendation. We initiate coverage on TZN with a **BUY** recommendation. We have set our price target at \$4.50/share, largely reflecting our one year-forward valuation, but discounted for timing and sovereign risk. There is currently 50% upside to our price target. In its first full year of production at Tala Hamza, TZN is trading on a FY13 PER of just 2x. **We are attracted to the company's imminent cashflow, impressive project pipeline and exposure to the zinc price.**

Resources

Rating: **BUY**
(previous): n/a

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Share price: **\$3.00**

Price target: \$4.50
(Previous) na
NPV per share: \$4.10
Risk: Medium

Shares on issue (m): 99.7
Shares on issue (diluted) (m): 111.5
Free float: 100%
Average daily volume: 262,464

Market cap (\$m): 296.2
FY08e Enterprise value (\$m): 358.0
FY08e Net debt (\$m): 61.8
FY08e Gearing (ND/ND+E): 60%
FY08e S'holders equity (\$m): 41.9
FY08e NTA per share (\$): 0.42

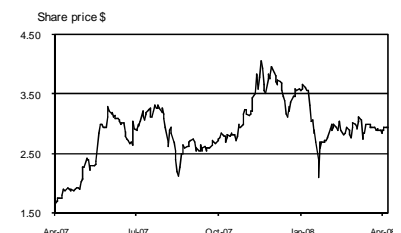
Forecast: 2008

Free cash flow (\$m): -46.9
Return on average equity: nm
Net interest cover: nm

Forecast: 2009

Free cash flow (\$m): 2.6
Return on average equity: 39%
Net interest cover: 5.0

Share price (\$):



Year to December (\$m)	2007a	2008e	2009e	2010e	2011e
Revenue	1.5	21.1	90.7	72.6	78.2
% change	74%	1267%	331%	-20%	8%
EBITDA	-4.6	-3.0	48.9	31.2	37.5
EBITDA margin	nm	nm	54%	43%	48%
NPAT rep	-3.6	-11.4	20.4	9.8	17.1
NPAT adj	-3.6	-11.4	20.4	9.8	17.1
EPS adj (c)	-3.2	-10.3	18.3	8.8	15.4
% change	nm	nm	nm	-52%	75%
Dividend (c)	0.0	0.0	0.0	0.0	0.0
PER (x)	nm	nm	14.5	30.3	17.3
EV/EBITDA (x)	nm	nm	7.5	15.0	15.1
Yield (%)	0.0%	0.0%	0.0%	0.0%	0.0%

Figures adjusted for NRIs and amortisation of intangibles

Source: Company, Foster Stockbroking

www.fostock.com.au

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BACKGROUND AND INTRODUCTION

Terramin was incorporated in December 1993 under the name of Playford Resources NL, with the objective of exploring for and developing Australian mineral resources. In 1997 Terramin acquired the Fleurieu project situated in Australia's first mining belt east of Adelaide. The tenements included the Angas Pb-Zn-Ag resource. Terramin has quadrupled the resource and identified a substantial high grade core. In late 2003 Terramin (TZN) listed on the ASX in a fully underwritten IPO and has since proved up the Angas zinc mine to a viable project while pursuing other opportunities such as the promising Tala Hamza deposit in Algeria.

First production for the company at the Angas mine is expected in August this year. At the date of this report, the Angas mine remains on track and budget with ore already mined and the processing plant more than 85% complete.

TZN has moved quickly to get the Angas Zinc mine up and running on time and budget. While initial feasibility studies envisaged mining to commence in 2007, there were early delays to that timetable due to an extended community consultation program resulting in amended designs to the Tailings Treatment Facility. This facility is arguably one of the safest tailings facilities in the world.

TZN purchased 65% of the Algerian Tala Hamza project in February 2006 and has since reviewed all previous exploration work and conducted its own drilling enabling it to define a 55Mt JORC resource @ 5% zinc and 1.2% lead. The deposit has been known since the 70's and significant work was done in the 80's by the National Government's Geological and Exploration arm – ORGM. Algeria found it hard to attract foreign investment until the Mining Act was rewritten in 2001. The deposit looks like it could be much larger and initial scoping studies using current resources indicate a project processing 2Mt per annum for 20 years plus.

We are attracted to the management's focus on zinc, its manageable growth profile, immediate cashflow prospects and a zinc project that has the ability to re-rate the company and attract the attention of larger mining companies.

BUSINESS STRATEGY

The key business strategy involves:

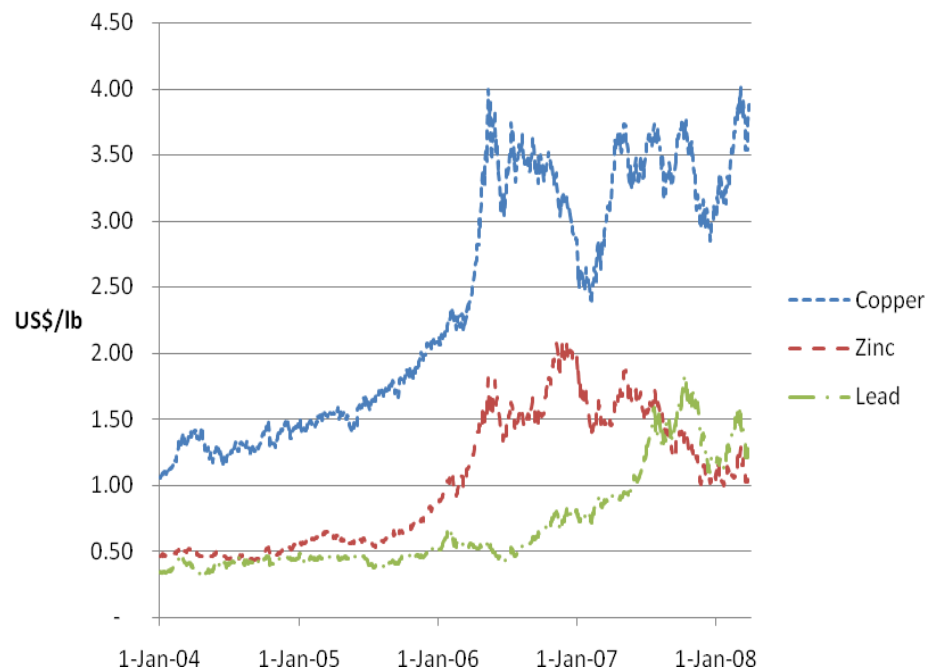
- Focusing on zinc;
- Successfully commissioning the Angas project to generate positive cashflow and underwrite company value;
- Growing the company via the long life, low cost world class Tala Hamza deposit; &
- Focus on remaining low on the zinc cost curve to ensure longevity even if zinc prices decline.

ZINC MARKETS

The World Zinc Market

The zinc price has suffered more of a decline than other base metals since late 2006, yet stocks are still only a few weeks consumption and will only increase if production at new projects reaches planned levels. ABARE estimates new projects will add 550kt of zinc to the 11.4Mt of zinc produced annually, while the International Lead and Zinc Study Group (ILZSG) are more bullish estimating an increase of 8% or 880kt of zinc mine production in 2008.

TZN – Base Metal Prices 1 January 2004 to March 31 2008



Source: IRESS

This increase in production relies on a number of proposed projects coming on line or reaching full production this year. Cerro Lindo in Peru (capacity 110kt/year) and San Cristobal in Bolivia (capacity 165kt per year) are expected to meet full capacity in 2008. Aljustrel in Portugal commenced production in late 2007 and has a full capacity of 80kt of contained zinc annually. Xstrata's Perseverance mine is expected to commence production in late 2008 and produce 228kt of zinc concentrates, but only has a mine life of four years. Closer to home, the Lennard Shelf project in Western Australia commenced production on 1 April 2007 and produced 42kt of zinc in 2007, but is not expected to reach its planned production level of around 75kt of zinc due to lower than expected grades and production levels. After making a loss for the year ending 31 December 2007 and writing down the carrying value of the asset, Teck Cominco is reviewing the options for Lennard Shelf, which may include closing earlier than planned. The operation only had a mine life of three to four years.

Risks to supply are on the downside

The cost and management pressures faced at Lennard Shelf are typical of the base metal mining industry worldwide with cost slippage, production delays and planning problems systemic in an industry competing worldwide for capital inputs, technical expertise and managerial experience. The result being, that forecast mine production is more likely to slip backwards or not reach targeted levels rather than come forward or exceed production targets.

Zinc consumption on the rise

Zinc, like its base metal cousins, is largely consumed in construction brought about by economic growth, whether it is public infrastructure construction, personal household construction or manufacturing of goods. While a slowing US economy will directly impact on the construction and manufacturing industry in the US, and therefore zinc consumption in the US, demand growth in China and India is forecast to more than compensate for any potential short term reductions in zinc consumption in parts of the US economy.

Zinc is predominantly used to produce galvanised steel and a large proportion of galvanised steel is consumed in vehicle production, with estimates that each new car consumes around 8kg of zinc. Chinese motor vehicle production increased 24% to the end of December 2007 to 8.8 million vehicles, making it the third largest automotive vehicle producer in the world behind the United States and Japan. Further, the cars produced in China are largely sating the appetite of budding local drivers with Chinese car ownership increasing 33% to 11.5 million cars by the end of 2006. China-made automobiles are mainly sold to emerging markets such as the Middle East, Latin America and Russia. This is testament to the reduced reliance base metal consumption has on the US economy.

ABARE estimate that 32% or 3.6Mt of world zinc consumption was from China in 2007 and worldwide zinc consumption is forecast to grow at around 4.6% for the 6 years ending 2013.

Will mine production be able to keep up?

ABARE forecast refined zinc production to grow at 5.1% per annum to 2013, requiring an average increase of of 651kt of zinc produced per annum. Refined zinc production increased by 694kt in 2007, however this was at a time when the zinc price was at recent peaks and the softening zinc price has already caused some mines to re-evaluate their options, such as Lennard Shelf as discussed earlier.

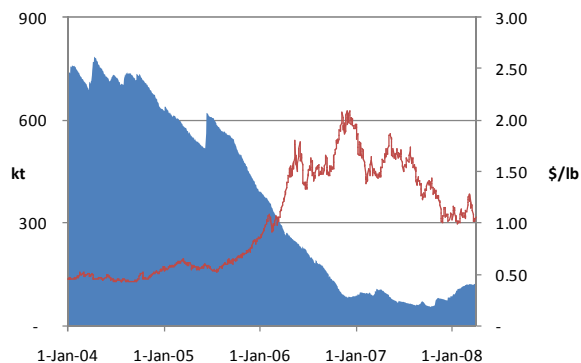
World Zinc Production and Consumption forecasts

			2006	2007	2008	2009	2010	2011	2012	2013
World zinc production	mine	Mt	10.5	11.4	11.8	12.4	12.8	12.9	13.4	13.7
	refined	Mt	10.7	11.4	11.9	12.7	13.2	13.5	14.5	15.3
- growth		%		6.5%	4.8%	6.4%	3.8%	2.8%	7.0%	5.5%
Zinc consumption		Mt	11.0	11.4	11.9	12.5	13.0	13.7	14.4	15.0
	- growth	%		3.6%	4.0%	5.1%	4.4%	5.0%	4.9%	4.2%

Source: ABARE

We are of the view that the zinc market remains tight and forecast mine growth will struggle to keep up with world demand driven largely by China. While we are in line with consensus forecasts in our valuations, we believe that pressure on the zinc price is more likely to be upwards than downwards.

LME zinc prices and LME stocks



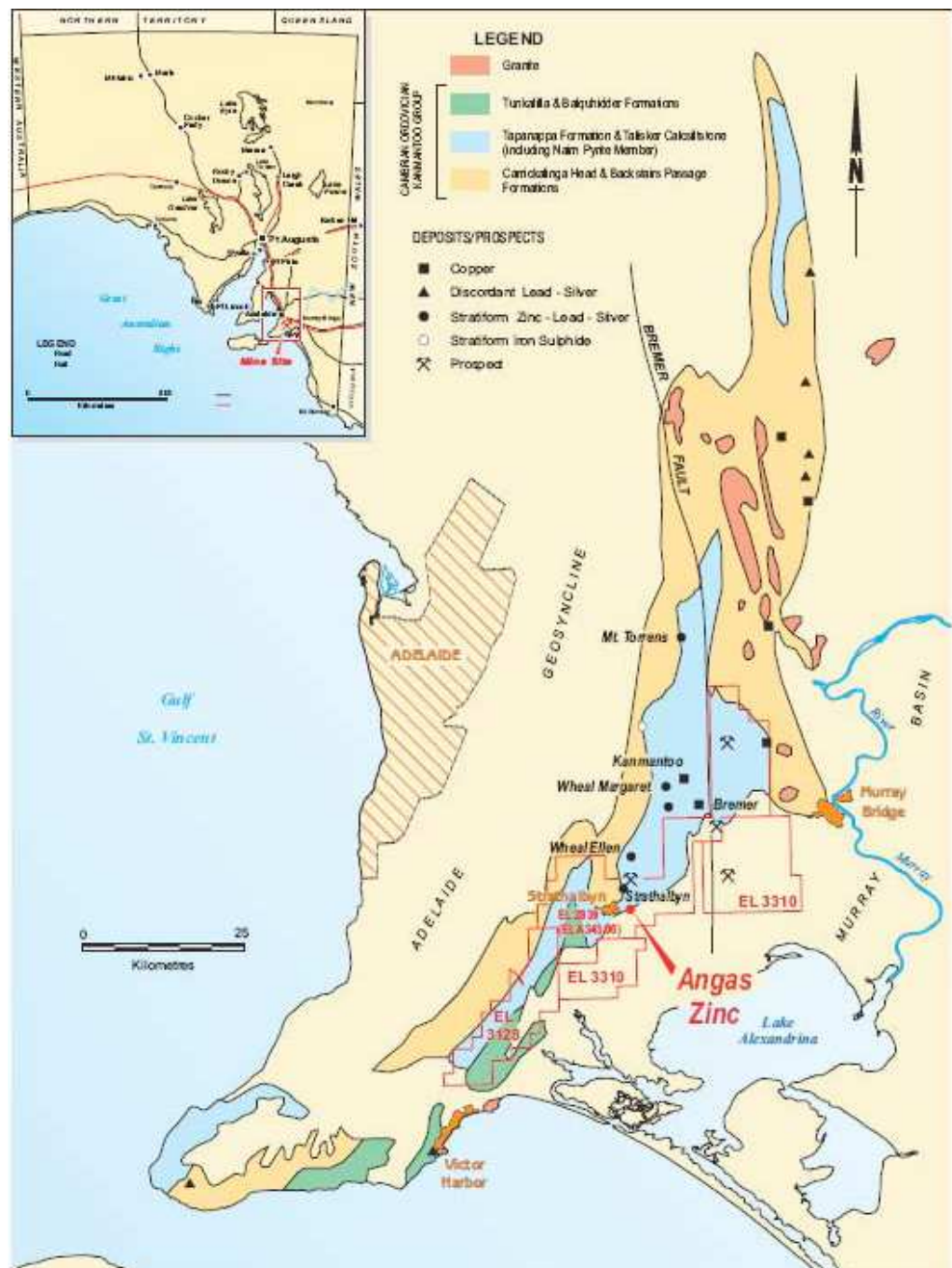
Source: Iress

THE ANGAS MINE – building the company

While we believe most of the value of TZN will be unlocked from the Tala Hamza mine over the next three years, the 100% owned Angas mine in South Australia provides a great opportunity for TZN management to sharpen their operational skills as a team and take advantage of current high metal prices.

The Angas mine is located 60km south east of Adelaide, and is forecast to **produce around 30kt of zinc in concentrate and 20kt of lead-copper concentrate per annum for at least seven years. The process plant is expected to be commissioned in July 2008** and first concentrate shipped in August 2008.

TZN – Location of TZN’s Angas mine showing significant exploration licences

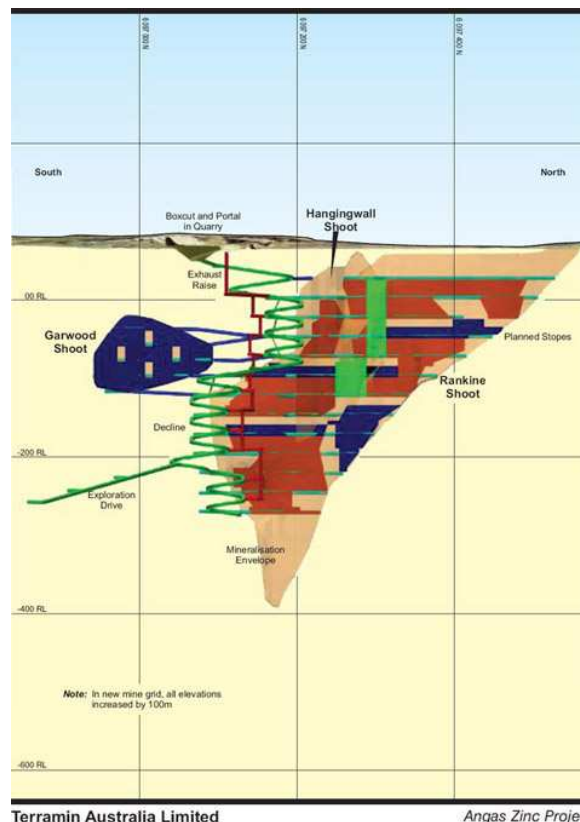


Source: TZN

Production rates are expected to be around 400kt of ore per annum. To the credit of management, despite a few delays largely outside the control of the company, the Angas operation remains largely on time and within budget in an environment where cost blow-outs and project slippages are almost becoming the norm rather than the exception. The mine lies in one of Australia's oldest mining belts and the company has focused its exploration efforts on a number of very old tenements where mining took place at shallow depths prior to modern mechanisation.

The mining method is conventional open stoping, with stopes in the Rankine shoot around 8m wide and level access built at 20m or 25m intervals. The Garwood shoot is a narrower lens and will therefore have narrower stopes. The increased unit cost of mining this shoot is more than offset by the increased grade in the Garwood shoot. At the time of visiting the mine on 25 March, decline development had advanced 293m and level development had commenced on the first two drives. Development drives are placed at vertical intervals that are considered to balance the competing requirements of reducing development metres and maintaining ore grade and geotechnical control, given the nature and shape of the orebody.

TZN – Schematic cross section of the Angas mine showing decline, development drives and stopes



Source: TZN

Processing of the ore will be conducted using conventional flotation to produce a zinc concentrate and a lead concentrate containing copper, silver and gold. Primary crushing will be done on the surface prior to grinding in a SAG mill to achieve the 106 micron particle size required for optimum flotation. Tailings from the processing plant are piped to a heavy duty plastic lined Tailings Dam where the water is treated prior to being re-used in the flotation process. It is likely the lead concentrates will be trucked to Port Pirie for smelting and the zinc concentrates will be trucked to Port Adelaide for shipping.

Capital costs for the project were estimated by the company to be A\$70m and life of mine operating costs (including mining, milling, freight to Port Pirie and admin.) were estimated to be A\$79 per tonne mined. The project is fully financed through equity, a \$10m subordinated loan with Sempra Metals, a \$10m Convertible Facility with Investec and the balance being funded by a partial drawdown of a \$45m Investec Construction Facility.

Revenues: Net revenue from concentrate sales are summarised in the graph below. Current smelting and payment terms are quite severe, resulting in miners getting paid between 65% and 70% of the value of payable metal in the concentrates. We have assumed zinc treatment charges of US\$300 per tonne of concentrate reducing to US\$150 per tonne over four years as zinc smelter capacity is increased significantly, particularly in China. We have assumed lead concentrate charges are currently US\$300 per tonne reducing to \$110 per tonne over a four year period.

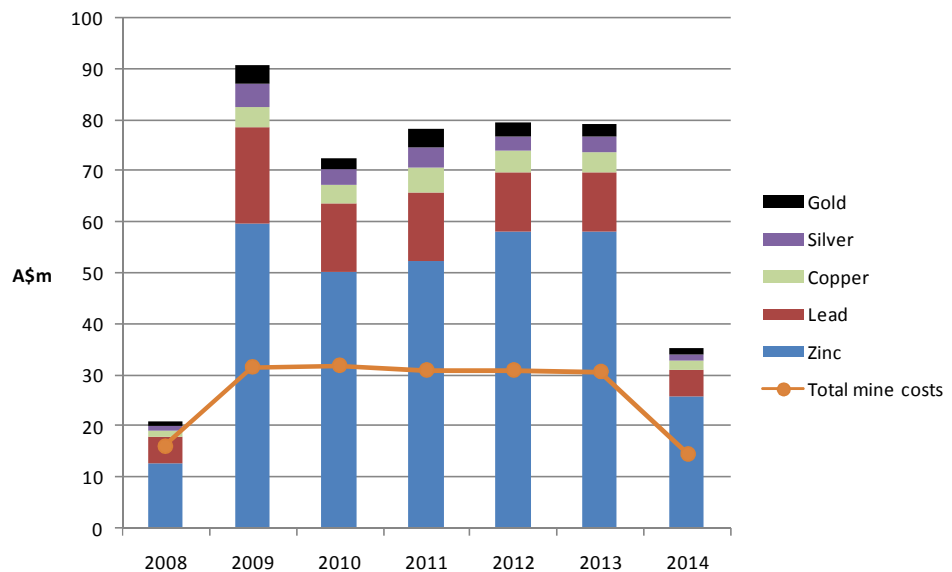
The lead concentrate, containing copper, silver and gold credits will, depending on commodity prices, account for around 25% of total revenues. Commodity price forecasts we have used are shown below.

TZN – Commodity price forecast assumptions

Year ending December		2008e	2009e	2010e	2011e	2012e
Zinc	US\$/lb	1.02	1.06	0.96	0.92	1.01
Lead	US\$/lb	1.08	0.92	0.72	0.59	0.59

Source: Bloomberg

TZN – Angas Mine net revenue and operating costs (excluding royalties)



Source: FSB estimates

Angas mine valuation

For valuation purposes we have used the company’s guidance on capital, operating costs discussed above as well as the company’s estimates for production rates for ore mined and processed. We have assumed sustaining capital to be negligible as the vast majority of the equipment is new and the cycle life for most mining machinery is at least 7 years. We have assumed that if the mine was to close after seven years, the salvage value of the equipment and assets would meet or exceed the closure costs of the mine and have therefore not modelled either.

TZN – Angas Mine – Operational modelling assumptions

Year to December		2008e	2009e	2010e	2011e	2012e
Ore mined	kt	238	462	481	396	396
Ore milled	kt	162	400	400	400	400
Site costs	A\$/t	86	76	75	78	78
Zn grade	%	6.0	9.4	7.9	7.8	8.1
Pb grade	%	2.2	3.3	3.0	3.4	3.1
Zn recovery	%	84	86	87	87	87
Pb recovery	%	80	82	83	85	84
Zn treatment charge	US\$/t	300	250	200	150	150

Source: FSB estimates, TZN

TZN – Angas Mine – forecast EBIT

Year to December	A\$m	2008e	2009e	2010e	2011e	2012e
Net revenue		21.1	90.7	72.6	78.2	79.5
Costs (inc. royalties)		17.0	34.8	34.3	33.7	33.7
EBITDA		4.0	55.9	38.2	44.5	45.8
DA		2.9	12.5	10.0	10.8	11.0
EBIT		1.1	43.4	28.2	33.7	34.8
Margin		5.3%	47.8%	38.9%	43.1%	43.8%

Source: FSB estimates

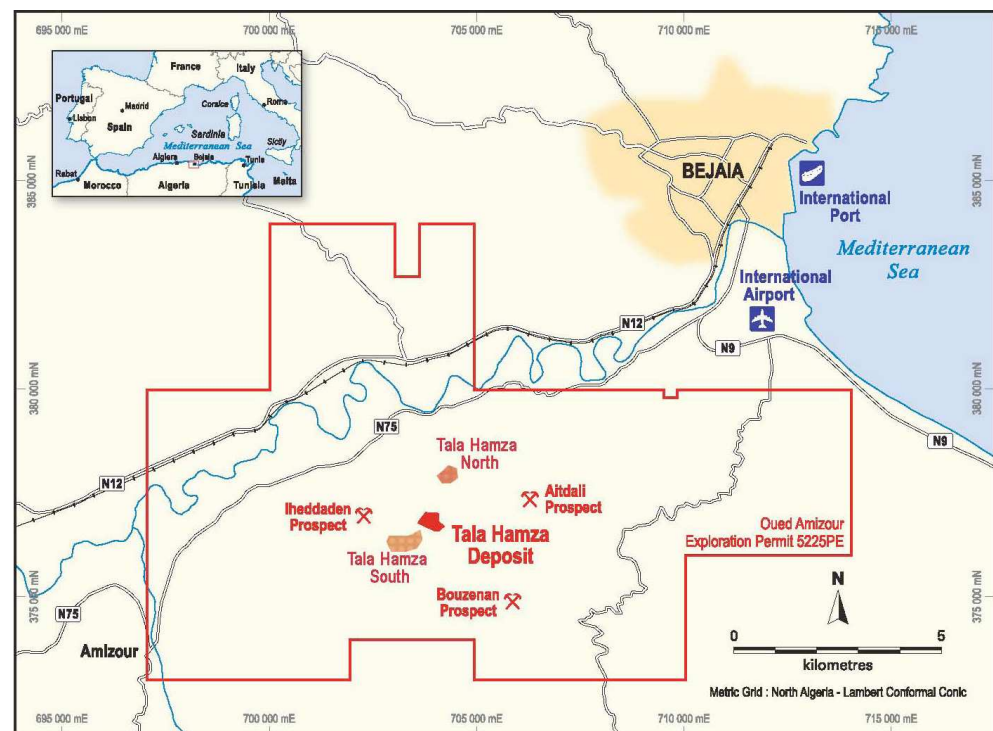
Our modelling shows that the Angas mine should generate \$250m of EBITDA and almost \$200m of cash (post tax and pre-gearing) over seven years (2008-2014e) and contributes \$1.48/share to our NPV of the company. This valuation of Angas is considered conservative as it assumes mining stops after seven years. Initial brownfield exploration in the immediate vicinity of the underground mine and exploration on its surrounding 1,160km² of tenements looks promising.

Tala Hamza – the company rain maker

The Tala Hamza zinc-lead deposit is located in Algeria and TZN has a 65% beneficial interest through a 100% owned Algerian subsidiary. The remaining 35% is held by companies that are owned by the Algerian government. TZN has a pre-emptive right to purchase the remaining 35% of shares the government holds if the government decides to sell the project. The project has a resource calculated using JORC guidelines of 55Mt at 5.0% zinc and 1.2% lead with a high grade core.

Tala Hamza is a hydrothermal sulphide deposit within a volcanic complex. The project is located in northern Algeria, 10km away from the Port city of Bejaia. Bejaia has a population of nearly 200,000 people and has significant oil and gas exports and a significant container port. It is serviced by an international airport. The deposit lies in hilly topography and is accessed via a sealed road.

TZN – Location of Tala Hamza Zinc-lead-copper-silver-gold deposit



Source: TZN

By far and away the most outstanding attribute of this project are that all signs lead to it getting bigger. Prior to obtaining a JORC resource or conducting any drilling, TZN reviewed the significant exploration work that had previously been completed by the Algerian government's mineral exploration arm – ORGM. ORGM had drilled more than 30 drill holes up to several hundred metres deep and had come up with a deposit of more than 30Mt @ 5.5% zinc and 1.4% lead. The exploration work was not considered to be within current JORC guidelines. To get the resource to within JORC guidelines, TZN planned a five hole drilling campaign, two of which were to be twinned holes to test the validity of previous drilling. They are shown on the drilling map overleaf as TH004 and TH006.

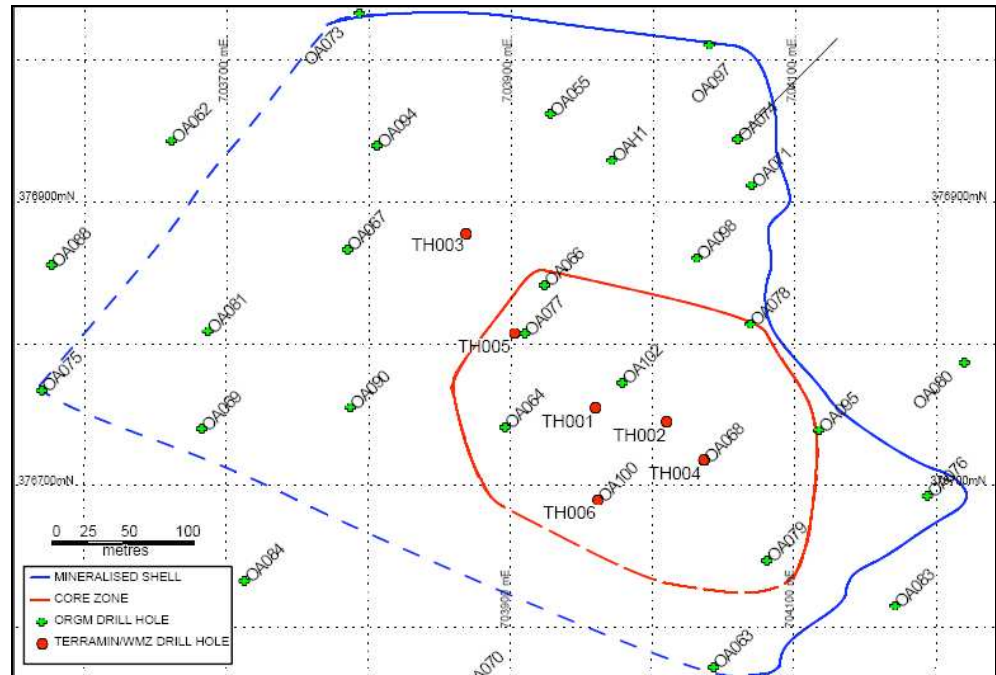
The results from all drilling thus far have been very encouraging. The two twinned holes have shown that the older ORGM holes have understated the grade and actual average grades are significantly higher in the twinned holes. TH004 showed that the zinc grade was almost twice that calculated in an older hole over an 83m interval.

TZN – Twinned holes compared to older holes

Hole number	Interval (m)	Zn %	Pb %
68 (older ORGM hole)	127	7.5	2.4
TH004	142	9.2	2.1
Higher core section			
68 (older ORGM hole)	83	6.4	2.5
TH004	83	12.6	3.1

Source: TZN

TZN – Drill holes at Tala Hamza



Source: TZN

TH006 showed even more encouraging results, showing up to a 90% increase in lead-zinc grades over the original hole largely due to improved core recoveries. Old drill holes were only getting recoveries of drill core in the 30 percent plus range, whereas the newer holes are getting recoveries greater than 97%.

The old resource based on the older ORGM drill holes contained a non JORC compliant high grade core of 11Mt at 10.9% zinc and 3% lead. TZN are currently in the process of establishing a high grade central zone resource around the old core that complies with JORC guidelines. Based on the dramatically improved drilling results, **we believe that the new high grade zone will be even more superior than the old resource** in probably, both grade and tonnage.

Further, there are other encouraging results at Tala Hamza North, where drilling and geophysical work has identified that **the deposit may repeat** in a similar sequence of rocks. Old drill results have also identified significant zinc mineralisation and grade just to the south of the main orebody. Both these prospects and other prospects are well within TZN's Exploration Licence boundary. Based on the Initial Inferred JORC resource, TZN completed a scoping study on Tala Hamza in March this year, the results of which were very promising.

Other factors we like about the project are its close proximity to required infrastructure – including roads, electricity supply and ports, well educated (but not necessarily well experienced), low cost workforce and low cost of electricity at US2.5c/kWh. All these factors

combined with the size of the resource give us confidence that capital and unit operating costs can be kept to a minimum.

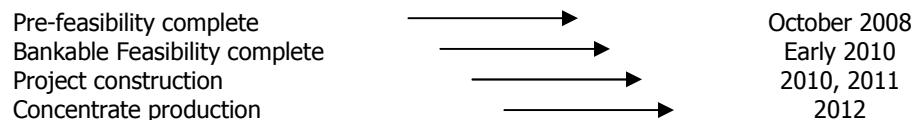
SCOPING STUDY RESULTS

The study, completed by Worley Parsons and Golder Associates, was based on processing 2.0mt of ore per annum producing 206Mlb of payable zinc metal per year at a cash cost of US43 cents per lb. This cost includes smelting charges and is after lead credits. Capital costs for the project have been estimated to be US\$356m including a US\$52m contingency. The study identified potential infrastructure savings of up to US\$70m that will be the subject of further review during the pre-feasibility study.

The mining method chosen at this stage is sub-level caving and mill grade estimate are forecast to be 6.3% zinc and 1.9% lead. The mining method chosen is suitable for large underground deposits with wide expressions and has easily crackable ore. It is low cost per tonne, with the downside being it can take significant capital prior to producing ore and there can also be a loss of geotechnical control, potentially leading to dilution of the ore.

PROJECT TIMELINE AND FUNDING

An estimate of the project timeline is shown below.



Funding for the next stage of feasibility work has already been sourced by Sempra Metals and Concentrates who have agreed to purchase 100,000 tonnes of concentrates per annum for the first five years of production from Tala Hamza, with an option to extend the purchases for another five years. Sempra has agreed to subscribe for US\$15m of five year unlisted convertible redeemable notes. The deal, announced in mid March is a strong sign of confidence and support in both the company and the project.

Funding of the project is expected to come in part from cashflows generated from the Angas mine in Australia and the balance from debt. The company has stated that at this stage it does not intend to raise equity via a share issue to fund development of Tala Hamza. As stated, we estimate the Angas project to produce post tax ungeared cash flow of almost A\$200m over seven years. Given that TZN's share of capital costs for the Tala Hamza deposit is expected to be just under A\$300m, it is possible that TZN can fund development of Tala Hamza with a combination of cash generated from Angas and debt facilities. However, gearing levels and interest cover requirements may result in the company raising some new equity prior to full development of Tala Hamza.

VALUATION

Our valuation of Tala Hamza is predominantly based on the results of the Scoping Study performed by the company. We have assumed mining and processing commences in 2H12 at a rate of 2Mt per annum. Given that there are already 55Mt of resources, even after converting to reserves, there should easily be enough ore for 20 years. Further, given the old non-JORC resource of a higher grade central zone of 11Mt @ 10.9% zinc and 3% lead, we have assumed the high grade section is mined in the first five years front loading cashflow and reducing the payback period. For modelling purposes, we have assumed that the zinc grade in the first five years is 10% and the lead grade is 2.5%.

We have taken the Scoping Study's figures on Capital Costs – US\$356m – and assumed US\$25/t for mining, milling, administration, concentrate freight, port and environmental costs for the ore mined at Tala Hamza. Recoveries in the modelling are 91% and 75% for lead and zinc respectively. We have also assumed that Payable metal equates to 73% of

metal contained in the concentrate. The mining corporate tax rate in Algeria is 33%. Royalty rates are 2% of the contained metal mined.

We believe the capital costs to be reasonable given the size and location of the project. Any increase in production should definitely lead to a reduced capital spend per unit of throughput and production as economies of scale are realised.

The NPV for TZN's 65% of the project at December 2008 is A\$462m or \$4.64 per share.

TZN – Operational assumptions for Tala Hamza

		2012e	2013e	2014e	2015e	2016e
<u>100%</u>						
Ore mined	kt	1,000	2,000	2,000	2,000	2,000
Ore milled	kt	1,000	2,000	2,000	2,000	2,000
Zn recovery	%	90	91	91	91	91
Pb recovery	%	74	75	75	75	75
Payable amounts	%	73	73	73	73	73

Source: FSB estimates

TZN – Tala Hamza – forecast EBIT, TZN share (65%)

Year to December	A\$m	2012e	2013e	2014e	2015e	2016e
Net revenue		136.6	276.2	276.2	276.2	276.2
Costs (inc. royalties)		30.1	52.0	52.0	52.0	52.0
EBITDA		106.5	224.3	224.3	224.3	224.3
DA		11.4	23.2	23.2	23.2	23.2
EBIT		95.0	201.1	201.1	201.1	201.1
Margin		69.6%	72.8%	72.8%	72.8%	72.8%

Source: FSB estimates

Menninnie Dam Exploration JV

TZN has a 24% beneficial interest in a promising zinc-lead resource located about 160km west of the Port Pyrie lead smelter in South Australia. The inaugural resource statement released was 3.8Mt with 4.0% zinc, 3.2% lead and 34g/t silver. The JV is with Zinifex Australia which has spent \$8m in exploration on the project to earn its 76% interest and Zinifex will assume control of the project in March 2008.

The resource is at an Inferred status and is 200m to 400m below the surface and requires further work to upgrade both the quality and the size of the resource. The JV intend to spend A\$10m on exploration on the tenements over the next 12 months, of which TZN will contribute its 24% share.

Menninnie Dam has long been an exciting prospect for the company and Zinifex, however, the resource will have to be significantly upgraded before a viable project is likely.

PRICE FORECAST ASSUMPTIONS

TZN – Consensus commodity price forecasts

Year ending December		2008e	2009e	2010e	2011e	2012e
Zinc	US\$/lb	1.02	1.06	0.96	0.92	1.01
Lead	US\$/lb	1.08	0.92	0.72	0.59	0.59
Copper	US\$/lb	3.23	3.00	2.74	2.47	2.47
Silver	US\$/oz	15.60	15.50	14.19	12.00	12.00
Gold	US\$/oz	883	843	780	729	729
AUD/USD		0.86	0.82	0.8	0.77	0.78
Zinc	A\$/lb	1.19	1.29	1.20	1.19	1.29
Lead	A\$/lb	1.26	1.12	0.90	0.77	0.76
Copper	A\$/lb	3.76	3.66	3.42	3.21	3.17
Silver	A\$/oz	18.14	18.90	17.74	15.58	15.38
Gold	A\$/oz	1026	1028	975	946	934

Source: Bloomberg

VALUATION

Given the company is in a growth phase over the next five years, we value TZN using a DCF methodology with a risk weighting for Tala Hamza of 75%.

Key factors regarding our valuation.

- Angus has been modelled to reflect the mining of the current reserves and no extension of mine life has been modelled.
- **Tala Hamza's value is discounted to 75% of its NPV value** reflecting the inherent risks in bringing an operation from a scoping study stage through to successful commissioning.
 - While arguably the discount rate could be more given the stage of the project, **we consider the modelling to be conservative at 2mt per annum** and expect final production rates will be much greater as the resource is expected to increase significantly in size over the next two years.
- The value of Menninnie has been derived using Zinifex's buy-in price of \$8m for 76%, implying a valuation of \$10.5m for 100% of the project or \$2.5m for the 24% beneficial interest TZN retain. Again, in the current climate, we think this is conservative; implying any further success at Menninnie is pure upside for the TZN share price.
- We have assumed a nominal value for TZN's other exploration ground of \$10m; again considered very conservative given the significant ground holdings TZN holds around the Angus mine and already identified mineral targets.

TZN – DCF breakdown

	Now		One year forward	
	A\$m	\$/share	A\$m	\$/share
Angus	147.7	1.48	158.4	1.59
Tala Hamza*	346.8	3.48	395.8	3.97
Sub-total	494.5	4.96	554.3	5.56
Menninnie	2.5	0.03	2.5	0.03
Other Exploration	10.0	0.10	20.0	0.20
Corporate	(36.8)	(0.37)	(36.8)	(0.37)
Net debt	(61.8)	(0.62)	(59.2)	(0.59)
NPV Total	408.3	4.10	480.7	4.82

Source: FSB estimates. *Tala Hamza NPV is discounted to 75% of Actual NPV

We have calculated a current NPV of \$4.10/share and a one year out DCF of \$4.82/share. This is based on a WACC of 10%. Our 12 month target of \$4.50 per share reflects a slight discount to our 12 month valuation as we do not believe the market will attribute appropriate value to a project that is some years off production and on the African continent.

RECOMMENDATION AND CONCLUSION

We initiate coverage on TZN with a **BUY** recommendation. We have set our price target at \$4.50/share. There is currently 50% upside between the current share price and our price target. **In its first full year of production at Tala Hamza, TZN is trading on a FY13 PER of just 2x.**

We believe our modelling on Tala Hamza deposit to be conservative. **The NPV of the project provides underlying base line support.** The real value of the company will be unlocked over the next two years as feasibility studies progress and the likely size of the deposit increases significantly and production rates increase accordingly.

Key catalysts for the stock include the zinc price, ensuring smooth operations at the Angas mine and de-risking the Tala Hamza Deposit.

KEY RISKS

- **Zinc price downturn:** A potential cyclical downturn in zinc prices could lead to a decline in the value of TZN. To mitigate this risk, TZN has adopted a strategy of pursuing assets that are at the lower end of the zinc cost curve. Given the continued tightness in the zinc market, we are of the view that upward pressure on zinc prices will prevail and actual mine production growth will not reach that forecast. **We view this risk as medium.**
- **Commissioning Risk:** A proportion of technical risks are eliminated or come to the surface at commissioning. TZN is in an important phase of its life as it commissions the mill at the Angas mine. Any delays in production or underperformance, while damaging cashflows in the short term, will have a far greater effect on the share price by reducing the markets faith in the ability of TZN management to bring the Tala Hamza deposit through to production on time and budget. **We view these risks as medium and manageable.**
- **Technical Risks:** Other typical technical risks inherent in mining are lower than planned mining grades (often due to excessive dilution from low grade rock or inadequately modelled ore bodies and zones) and geotechnical problems. Careful mine planning at Angas should minimise the risk of such events. Risks in processing include lower than planned recoveries in the mill due to a number of reasons. Such factors can impact severely on project economics. **We view these risks as medium and manageable.**
- **Algerian country risk:** While there are always inherent risks in operating overseas, we rate Algeria as one of the more stable, investment friendly countries in Africa. Algeria is the main supplier of natural gas to Europe and has a free trade agreement with the European Union. Foreign investment is encouraged as the government has stated a public mandate to reduce the unemployment rate which stands at 30%. Despite this, the country is well endowed with natural gas, oil and minerals. Algeria ranks 7th in the world with regard to proven natural gas resources and 14th in the world with regard to oil reserves. The country wants to reduce its reliance on hydrocarbons as downward moves in oil prices have had severe impacts on the economy in the past and the government want to lift employment and GDP per capita by growing other industries – mining being one of them. The population of Algeria is just over 30 million, the predominant religion is Sunni Muslim, yet Algeria is considered to have true freedom of religious belief. **We consider the sovereign risk of operating in Algeria as low.**

BOARD AND MANAGEMENT

Executive Chairman, CEO – Dr Kevin C Moriarty

DR Moriarty is a professional geologist and company director whose career has included involvement in geophysical and geological projects in both the petroleum and mineral sectors. Both his early and later career has focused on base and precious metal exploration and industrial mineral projects in many countries.

Non-executive Director – Mr David Paterson

Mr Paterson is a geologist and company director, having worked during his early career with Zinc Corporation, Minerals, Mining and Metallurgy, New Guinea Goldfields Ltd and BHP Exploration. He was a member of the Australian Stock Exchange Ltd and brings experience derived from a 20-plus year career in stockbroking and capital markets to the company.

Non-executive Director – Mr Steve Bonnett

Mr Bonnett is a former partner of Finalyson's Lawyers and holds degrees in Commerce and Law(Hons). He is recognised as an expert in the field of corporate and commercial law and corporate governance.

Non-executive Director – Mr Michael Kennedy

Mr Kennedy has a degree in Commerce (Economics). He began his career in 1971 with the Department of Industry & Trade, providing advice and assistance to small/medium companies seeking export market exposure, and subsequently with Humes Limited in the export marketing of concrete pipes and products, and particularly the export of technology, industrial know-how and the development of off-shore investment opportunities.

He was resident Director of the Korea Zinc group of companies in Australia from 1991 until early 2005. During that period, he was directly involved in all aspects of the group's establishment and subsequent growth into a major corporate presence in the Australian zinc industry.

Non-executive Director – Mr James T Hazel

Mr Hazel is an experienced company director, having undertaken a variety of appointments in listed companies in recent years. His executive background includes periods as managing director and as a senior executive in a number of listed companies, notably as chief general manager of Adelaide Bank. Mr Hazel's experience includes the management of turnaround situations and company expansion by organic growth and through growth by acquisition

GM Operations – Andrew Roberts

Mr Robertson is a mining engineer with over 20 years experience in the base metals and gold mining industries. Following 12 years operational experience in copper and gold projects in WA, NT and New Zealand with North Limited and Normandy Mining Limited, he moved to corporate roles providing technical support to operations and corporate activities such as M&A activity, JV management and business planning.

Chief Geologist – Bob Singer

Mr Singer manages Terramin's resource development and exploration teams. He is a geologist with more than 27 years experience in operating mines and exploration in diverse terrains. He joined Terramin from a position as Chief Geologist for the Newmont-Barrick ("Super Pit") operations at Kalgoorlie, mining 13 million tpa of gold ore. Prior to that he led the team responsible for a major expansion of zinc resources at the 1.2Mtpa Golden Grove mine. He is a competent person for the JORC Code estimation of base and precious metal resources.

General Manager, Angas Mine – John Burgess.

Mr Burgess is a process and environmental engineer with 35 years experience in zinc plants mostly at Broken Hill. He has consulted to Zinifex's Century Mine and on nickel and gold operations. His roles include manager of Metallurgy and Environment at Broken Hill and General Manager of the Renison Tin Mine. He has extensive experience in commissioning of nickel, copper and gold plants.

SUBSTANTIAL SHAREHOLDERS

Substantial Shareholders		
Investor	Holding	%
DA Paterson	9,164,302	9.19
KC Moriarty	9,024,843	9.05
JP Morgan Chase and Co	7,898,630	7.93
Geologic Resource Funds	6,508,679	6.54
Commonwealth Bank of Australia	5,562,433	5.59
Total	38,158,887	38.30

Source: TZN Annual Report (as at 28 February 2008)

FINANCIAL FORECASTS

Profit and Loss (\$m)

Year to December	2007a	2008e	2009e	2010e	1H08e	2H08e
Sales revenue	1.5	21.1	90.7	72.6	0.0	21.1
EBITDA	-4.6	-3.0	48.9	31.2	0.0	-3.0
EBITDA margin	nm	20%	64%	55%	0.0%	nm
D & A tang	0.2	2.9	12.5	10.0	0.0	2.9
Amortisation	0.0	0.0	0.0	0.0	0.0	0.0
EBIT	-4.8	-5.9	36.4	21.2	0.0	-5.9
EBIT margin	nm	nm	40%	29%	0.0%	nm
Net Interest Exp	0.5	5.6	7.2	7.2	0.0	5.6
PBT	-5.3	-11.4	29.2	14.0	0.0	-11.4
Tax	0.0	0.0	8.7	4.2	0.0	0.0
NPAT rep	-5.3	-11.4	20.4	9.8	0.0	-11.4
NPAT adj	-3.6	-11.4	20.4	9.8	0.0	-11.4
EPS adj	-3.7	-11.5	20.5	9.8	0.0	-11.5

Source: Company; FSB estimates

Financial Ratios

Year to December	2007a	2008e	2009e	2010e
Average RoE	nm	nm	39.2%	14.6%
Average RoA	nm	nm	26.7%	10.2%
Net interest cover x	10.5	nm	5.0	2.9
EV/EBITDA	nm	nm	7.5	15.0
EPS rep c	-3.7	-11.5	20.5	9.8
EPS adj c	-3.7	-11.5	20.5	9.8
EPS adj growth	-15.3%	-206.1%	nm	-52.1%
PER x	nm	nm	14.5	30.3
DPS Total	0.0	0.0	0.0	0.0
Yield	0.0%	0.0%	0.0%	0.0%

Source: Company; FSB estimates

Cashflow (\$m)

Year to December	2007a	2008e	2009e	2010e
EBITDA	-4.6	-3.0	48.9	31.2
Net Interest Expense	0.1	-5.6	-7.2	-7.2
Tax Paid	0.0	0.0	0.0	-8.7
Change in Working Capital	-0.3	-7.9	-7.3	-6.3
Other	0.0	0.0	0.0	0.0
Operating Cashflow	-4.8	-16.4	34.3	8.9
Capex	-49.9	-30.4	-31.7	-73.1
Net Acquisitions	0.0	0.0	0.0	0.0
Asset sales	0.0	0.0	0.0	0.0
Other	0.0	0.0	0.0	0.0
Investing Cashflow	-49.9	-30.4	-31.7	-73.1
Proceeds from equity	35.2	0.0	0.0	0.0
Proceeds from borrowings	53.4	16.3	0.0	100.0
Repayment of borrowings	-0.2	0.0	0.0	0.0
Dividends paid	0.0	0.0	0.0	0.0
Other	-3.8	0.0	0.0	0.0
Financing Cashflow	84.5	16.3	0.0	100.0
Net Cashflows	29.8	-30.5	2.6	35.8

Source: Company; FSB estimates

Balance Sheet (\$m)

Year to December	2007a	2008e	2009e	2010e
Cash	39.4	8.8	11.4	47.2
Receivables	1.5	1.1	5.6	8.2
Inventories	0.0	4.1	11.8	17.9
PPE	61.4	88.9	108.1	171.2
Intangibles	0.0	0.0	0.0	0.0
Investments	0.0	0.0	0.0	0.0
Other	16.3	16.3	16.3	16.3
Total Assets	118.6	119.2	153.3	260.8
Accounts payable	8.7	4.4	9.3	11.6
Provisions	1.1	1.1	9.9	5.3
Tax liabilities	0.0	0.0	0.0	0.0
Debt	54.3	70.6	70.6	170.6
Other	1.2	1.2	1.2	1.2
Total Liabilities	65.3	77.4	91.0	188.8
Reserves and capital	61.3	61.3	61.3	61.3
Retained earnings	-12.2	-23.7	-3.2	6.5
Minorities	4.2	4.2	4.2	4.2
Total Equity	53.3	41.9	62.3	72.0

Source: Company; FSB estimates

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