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Gunson Resources Ltd (GUN)

Recommendation: Speculative Buy — 9 January 2007

Coburn Project approvals expected by March. Mount Gunson drilling to start shortly.

- **All statutory and financial approvals for the Coburn Project are now expected by March 2007.**
- **Our estimated valuation range for Gunson has been reduced to 50-60 cents per share due to expected increases in capital cost estimates for the Coburn Project. A larger equity raising is likely.**
- **At the Mount Gunson Copper Project, Xstrata Copper confirmed their intention to fund a drilling program which is now planned to start early in 2007.**
- **At 29.5 cents per share, we retain a Speculative Buy recommendation. Gunson has all the usual project funding, construction, operations and marketing risks of small exploration/mining stocks.**

Share price:	$0.295
Market capitalisation ($m):	29
52 week share price range:	$0.42 - $0.24

Gunson's wholly owned Coburn Mineral Sand Project in WA is the third largest zircon development project in the world. The project is located 250km north of Geraldton and east of the Shark Bay World Heritage Area.

Update on Coburn Project

The approvals process has now delayed the project by about 12 months, due in part to the projects location abutting the World Heritage Area. Gunson reported (on 2 January 2007) that the ten environmental management plans have been reviewed by government regulators. Nine of these have been submitted to the Statement Management Section of the WA Department of Environment and Conservation (DEC) for final statutory approval.

All statutory and financial approvals are now expected by March 2007. Given the delays and the significant increases in operating and capital costs in WA, Gunson has decided not to finalise the Definitive Feasibility Study (DFS) until all the necessary Government approvals are granted.

In the meantime, work on the DFS has continued. Encouraging results have been received from metallurgical testwork by Outokumpu Technology, aimed at optimising mineral recoveries in prospective toll treatment facilities in WA and East Asia. This work has focused on removing iron oxide coatings on the heavy mineral grains with a low cost attritioning circuit at the minesite.

It is now likely that Stage 1 capital expenditures will be around $100m with a 12 month construction period. **We are also expecting a larger equity raising as part of the project funding.** We note that Ospraie, a New York based resource fund, now holds 10.2% of Gunson.

The Bankable Feasibility Study (BFS), completed in December 2004, used total indicated and inferred resources for the Amy Zone at Coburn of 710mt at an average heavy mineral (HM) grade of 1.4% at a 0.9% HM cut-off grade. Pit optimization studies on the 13km long southern portion of the Amy Zone resulted in a probable ore reserve of 230mt averaging 1.1% HM at a 0.82% HM cut-off grade and with a 0.3:1 strip ratio (waste:ore).

The planned mining method has been changed from the bucket wheel excavators/conveyor system to a modified version of the bulldozer trap technique being used at Consolidated Rutile's North Stradbroke Island mine in Queensland.

Based on the Stage 1 capital program, mining 14mtpa (for at least the first two years) will result in production of 120ktpa of heavy mineral concentrate (HMC). The Coburn Project, as defined by the pending environmental approvals and the likely investment in a second concentrator, is expected to have a 12-year life. We would expect the project life will ultimately be 25 years.

Table 1: Coburn Estimated Annual Production

	Years 1 to 5 (tonnes)	
Product	Years 1-2	Years 3-5
Zircon	30,000	60,000
Ilmenite	60,000	120,000
HiTi [1]	15,000	30,000

[1] All the recoverable leucoxene and rutile, containing 91.5% TiO_2.

The high zircon content of the heavy mineral assemblage in the Amy Zone differentiates the Coburn project from many others and is a key attraction of the

project. In comparison with other development projects, Coburn has a very favourable ratio of TiO_2 units:zircon at 1.6 (refer to Table 2). Zircon will represent around 63% of the initial stage revenue mix (from the first five years of mining) for the Coburn Project.

Table 2: Selected Development Projects

	TiO_2 Units (ktpa)	Zircon (ktpa)	TiO_2: Zircon
Under Construction			
Douglas (Iluka)	150#	100	3.5+
Moma (Kenmare)	354	52	6.8
Mindarie (Aust. Zircon)	50	30	1.6
Madagascar (Rio Tinto)	470	25	18.8
Kwale (Tiomin)	230	37	6.2
Completed BFS			
Senegal (Min Deposits)	11#	70	4.0+
Corridor (BHPB)	330	30	11.0
Coburn (Gunson)	**99**	**60**	**1.6**
In BFS Stage			
Tamil Nadu (Tata)	250	20	12.5

 # Ilmenite excluded + Ilmenite included
Source: Gunson Resources Ltd

Zircon Supply/Demand & Product Marketing

The supply/demand outlook for zircon remains favourable, despite some new zircon concentrate supply. Global demand growth in the ceramic and zirconium chemicals markets remains strong.

The Chinese market continues to be the major growth area. China imports around 90% of its zircon consumption and now accounts for 25% of world zircon demand. Gunson's Coburn Project can potentially supply 5% of the world zircon market.

Memoranda of Understanding were signed with two Chinese key consumers for 42% of the proposed 30ktpa initial zircon production.

The zircon offtake agreements provide for prepayments totalling $US6m, which will assist in funding the Coburn mine development. (The prepayments will be rebated progressively as refined product is supplied to both customers.) The pricing mechanism in both draft contracts is a cif China benchmark, currently above US$800/t.

Discussions with potential customers for the remainder of the zircon and the titanium dioxide mineral output (ilmenite and HiTi) are well advanced – Iluka may now be interested in treating the concentrate.

Mount Gunson Copper Project

The Mount Gunson Copper Project is located around 100km south of the Olympic Dam copper-uranium mine in SA. Targets include Olympic Dam style deposits in the basement and shallower deposits in overlying sediments. Drilling by Gunson in January 2006 at the **Chianti Prospect** revealed strong alteration and brecciation in granite, with pervasive hematisation – features that suggest proximity to a mineralising system.

Following Gunson's drilling and the earlier Carrapateena copper discovery, 20km east of Chianti, a joint venture was agreed with Noranda Pacific (earning 51% by spending $3.5m; and 75% by spending $10m). Subsequently, Xstrata plc took over Noranda Pacific's parent, Falconbridge Ltd.

Xstrata Copper confirmed their intention to fund a drilling program which is now planned to start early in 2007. Xstrata are also assessing the shallow, low grade suphide copper deposits around Mount Gunson, including the **Windabout prospect**, with an indicated resource at 70 metres depth of 18.7mt at 1% copper, 0.05% cobalt, and 10g/t silver.

Valuation of Gunson

Our estimated valuation range for Gunson has been reduced to 50-60 cents per share due to further likely increases in capital cost estimates for the Coburn Project, partially offset by higher zircon price assumptions and an increased notional value for the Mount Gunson Copper Project (given indicated resources, the joint venture terms and the recent market capitalisation attributed to Monax Mining ($27m).