

Base Iron Ltd (BSE)

21 June 2010

Base Iron Ltd (BSE) is a Western Australian based mineral exploration company on the brink of completing the purchase of the "world class" Kwale Mineral Sands Project (Kwale project) in Kenya.

We believe BSE is **Undervalued** and value the company at \$0.34 (undiluted).

Key Points

- BSE is currently completing a US\$3m purchase of the Kwale project near Mombasa in southern Kenya with final shareholder approval expected on 30 June 2010;
- Successful completion of the transaction will result in BSE acquiring 100% of the 139Mt Kwale project from Tiomin Resources Inc ("Tiomin") along with options to acquire a further three exploration projects, Mambrui, Kilifi and Vipingo in the surrounding area;
- The project represents an advanced development opportunity with a full Definitive Feasibility Study (DFS) having been completed and all material development approvals, permits and licences in place;
- External technical reviews confirm a "world class" project with a projected cash margin that would place it in the best performing quartile of the global mineral sands industry;
- The acquisition of the Kwale project is motivated by a strongly held view that the project is well positioned to take advantage of a forecast sustained opportunity in the mineral sands market;
- BSE has received the official consent of the Government of Kenya ("GoK"), through the commissioner of Mines & Geology;
- The company has engaged RFC Corporate Finance to underwrite a 1 for 1 rights issue and arrange a placement to raise a total of \$8m. The offer is set to close on 1 July 2010 and upon completion the company will have 129.6m shares on issue; and
- Our valuation is based on a DCF model of the Kwale project assuming capital development costs of US\$177m and an 11 year mine life commencing early 2013.

Potential News Flow

- Jun 2010: Final shareholder approval for the Kwale project purchase;
- Jun 2010: Announcement of the completion of the \$8m capital raising;
- Jul 2010: Final settlement of the Kwale acquisition; and
- Sep – Jan 2011: Updated BFS completed.

Undervalued

Undiluted value: \$0.34

Ticker: BSE
Sector: Materials

Current Price: \$0.09
Market Cap: \$3.4m
Shares: 38m
Options: 9m
Cash (est.): \$1.0m
EV: \$2.4m

As at 18 June 2010 (prior to raising)
Source: BSE & ASX

Chart 1: 12 month price chart



Source: ASX

Contact Details:

James Doyle
Cygnet Capital
Tel: (08) 9226 5511
jd@cygnetcapital.com.au

Company Snapshot

Background

- BSE listed on the ASX in Oct 2008 focusing on iron ore exploration in the Mid West iron ore region of Australia;
- At the time of listing the company had a portfolio of six early stage iron ore projects located in the Mid West iron ore region;
- In mid 2009, following indifferent results from its early iron ore exploration, the company announced that it was actively evaluating acquisition opportunities in commodities other than iron ore;
- On February 26, 2010, BSE announced its intention to acquire 100% of the Kwale project located 50km south of Mombasa in Kenya;
- The company believe the acquisition represents an opportunity to secure a significant scale asset that provides exposure to the mineral sands market in a time a time of forecast supply shortfall;
- BSE's near term strategy will see the company focus on the development of the Kwale mineral sands project; and
- Experienced mineral sands executive Colin Bwye is set to join BSE in July. Colin has over 20 years experience in the minerals sands industry and is currently the Managing Director at Doral Mineral Industries Ltd.

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Options: 9m
Current Price: \$0.09
Market Cap: \$3.4m

Major Shareholders:

Deck Chair Holdings 11%
 R.M. Brooks 9%
 Mahsor Holdings 5%
 Kea Holdings 5%

As at 18 June 2010 (prior to raising)

Source: ASX & BSE

Board of Directors

Tim Carstens Managing Director
 Andrew King Non-Executive Director
 Sam Willis Non-Executive Director
 Winton Willesee Non-Executive Director

Key Resource Summary

Table 1: Acquisition resource summary

	Measured (Mt)	Indicated (Mt)	Inferred (Mt)	THM (%)	Ilmenite (%)	Rutile (%)	Zircon (%)
Kwale + North Dune¹	38.5	216.3	-	3.5	173	0.41	0.21
Kilifi²	-	809.7	148.4	3.2	na	na	na
Mambui²	-	301.4	129.3	5.1	na	na	na
Total	38.5	1,327.4	277.7	na	na	na	na

1. The North dune is NOT in the initial Kwale development plan due to lower grade of resource.

2. Subject to uptake of option agreements with Tiomin

Source: BSE

Kwale Mineral Sands Project

Kwale is a robust project with a timeline and scale to take advantage of a forecast supply shortage in the mineral sands market. We forecast an after tax operating cash flow of ~US\$540m over an 11 year mine life.

Project Background

- In February 2010, BSE announced its intention to acquire the Kwale project from Tiomin for an initial consideration of US\$3m on settlement and an ongoing 2% royalty on project revenue.
- The Kwale project covers an area of 56km² and is located 50km south of Mombasa, Kenya. The deposits lie within the Magarini sands formation and the three mineralised zones, Central, South and Northern occur as unconsolidated dunes.
- Initial development of the Kwale project is based on the JORC compliant resources of 69Mt at the Central dune and 70Mt at the South dune.
- The Kwale project is set to experience a two tiered production profile. The company estimates an initial 6yrs production from the Central dune at 330ktpa, 80ktpa and 35ktpa of ilmenite, rutile and zircon respectively before declining to average 190ktpa, 55ktpa and 25ktpa for the subsequent 5 years from the South dune.
- BSE estimates the Kwale project will have a capital development cost of US\$177m with feasibility completed on an 11 year mine life commencing in early 2013.
- The Kwale project represents an advanced development opportunity with all material project approvals, permits and licences in place. In addition a full DFS has previously been completed by Tiomin.
- In addition to the Kwale project, BSE has a four year option to acquire three further exploration projects, Mambrai, Kilifi and Vipingo, from Tiomin.
- Historically the Kwale project has experienced a slow progression to development following the initial exploration licence in 1997. The company believes previous impediments to development have now been removed.

Table 2: Kwale resource summary

Dune	Classification	Resource (Mt)	THM (%)	HMC (Mt)	Ilmenite (%)	Rutile (%)	Zircon (%)
Central	Measured	38.5	6.8	2.6	4.0	0.9	0.5
Central	Indicated	30.2	4.5	14	2.5	0.6	0.3
South	Indicated	70.1	3.5	2.5	14	0.4	0.2
North ¹	Indicated	16.0	2.1	2.4	10	0.2	0.1

1. The North dune is NOT in the initial Kwale development plan due to a lower grade.

Source: BSE

Location: Mombasa, Kenya
Ownership: 100%
Phase: BFS update
Product: Ilmenite
 Rutile
 Zircon
Capex: US\$177m
Mine Life: 11 years

Initial Resource:
Measured 38.5 Mt
Indicated 100.3Mt

Acquisition Conditions:
 Due Diligence – COMPLETE
 GoK consent – COMPLETE
 Shareholder Approval – 30 Jun
 Complete \$8m raising – 01 Jul
 Source: BSE

Image 1: Kwale location



Source: BSE

Kwale Mineral Sands Project

Mining and Mineral Processing

- The Kwale dunes are considered amenable to a continuous mining technique, with a bucket wheel excavator and overland conveyors considered in initial feasibility. Lower capital cost alternatives are set to be explored in the updated Bankable Feasibility Study (BFS).
- During the first four years the mine will operate at a rate of 8.8mtpa before increasing to 12.5mtpa to counter lower grades.
- Two separate pilot plant operations have confirmed the ore is suitable for processing using traditional mineral sands separation techniques.

Products

Ilmenite

- Kwale ilmenite is suitable for sulphate route TiO₂ pigment manufacture;
- The impurity profile is generally favourable although the company has suggested that the product may incur a price discount of ~\$US10/t to account for reduced TiO₂ content.

Rutile

- Testing has revealed that Kwale rutile meets the specification of "premium" grade with the exception of slightly higher iron oxide content; and
- The impurity profile is generally favourable although company modelling suggest small grain size may incur a slight pricing penalty.

Zircon

- The company has indicated that zircon production is premium quality and should be suitable for ceramic applications; and
- Due to a comparatively low radionuclide (uranium and thorium) content the company believes that Kwale zircon may attract a premium of ~\$US50/t.

Proposed Workplan to FID

The following outlines the indicative workplan proposed by BSE:

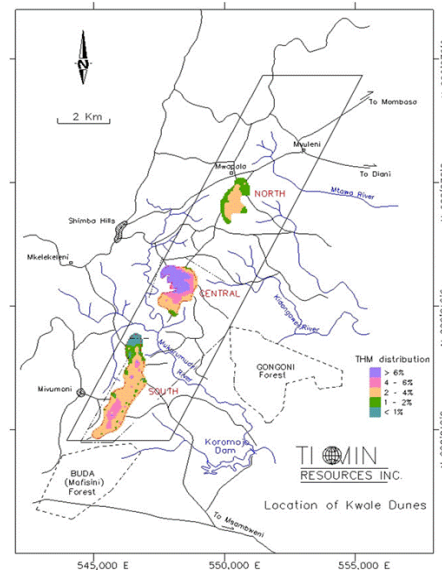
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| Jul – Sep 2010 | Completion of enhancements to the 2006 BFS following a review by Ausenco. Confirmatory drilling to be completed and phase 1 social infrastructure to commence; |
| Sep – Jan 2010 | Value engineering to be completed by Ausenco. BSE to negotiate off-take agreements and funding arrangements; |
| Jan – April 2011 | Finalisation of funding arrangements; and |
| April 2011 | Final Investment Decision. |

Location: Mombasa, Kenya
Ownership: 100%
Phase: BFS update
Products: Ilmenite
 Rutile
 Zircon
Capex: ~US\$177m
Mine Life: 11 years

Initial Resource:
Measured 38.5 Mt
Indicated 100.3Mt

Acquisition Conditions:
 Due Diligence – COMPLETE
 GoK consent – COMPLETE
 Shareholder Approval – 30 Jun
 Complete \$8m raising – 01 Jul
 Source: BSE

Image 2: Kwale site overview



Source: BSE

Valuation

We believe BSE is Undervalued and value the company at \$0.34 (undiluted).

Table 3: Kwale valuation

	Resource (Mt)	Unrisked DCF (A\$m)	Risked Value (A\$m)	Risked Value (A\$/s)	Unrisked Value (A\$/s)
Kwale	139	188	38	0.29	1.45
Corporate Expenses		(11)	(2)	(0.02)	(0.08)
Cash		9	9	0.07	0.07
Total NPV (Base case)		186	45	0.34	1.44

Assumes share capital 129.6m (post \$8m raising)

Source: Cygnet estimates

Table 4: Price assumptions

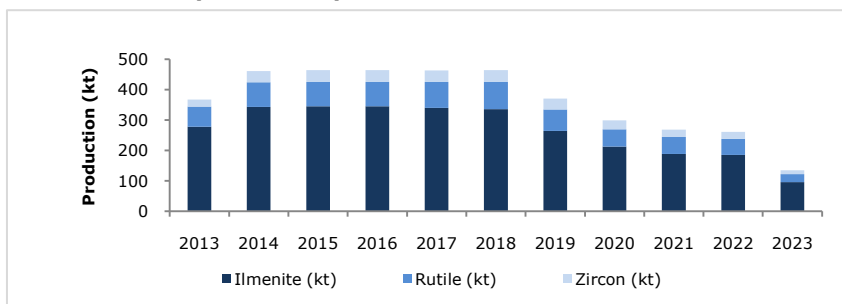
	FY10A	FY11E	LT
FX Rate (US\$/A\$)	0.85	0.80	0.80
Sulphate Ilmenite (US\$/t)	98	101	115
Rutile (US\$/t)	549	574	635
Zircon (US\$/t)	836	925	1150

Source: TZMI, Cygnet estimates

- Our valuation is based on a DCF model of the Kwale project with production commencing early 2013.
- Our base case scenario assumes the Kwale project will produce an average of 330ktpa, 80ktpa and 35ktpa of ilmenite, rutile and zircon respectively for the first 6 years of production before declining to average 190ktpa, 55ktpa and 25ktpa for the subsequent 5 years.
- We have assumed an initial capital development cost of US\$177m and mine life of 11 years as per company guidance.
- As a stand alone project we forecast the Kwale project will produce a life of mine net after tax cash flow of ~US\$540m resulting in a project NPV of ~US\$134m or US\$1.03 per share (post raising).
- In calculating our valuation we have assumed BSE will fund the project with a mix of debt and equity funding and under this scenario our unrisked NPV per share is \$1.44.
- The key risk factor is the company's ability to secure necessary funding. We have applied an 80% risk discount to our valuation of the Kwale project. Under this assumption our risked NPV for BSE is \$0.34 per share.

Kwale Production Profile

Chart 2: Kwale production profile



Source: BSE

Valuation

Valuation Risks

Project development and funding risk

- The Kwale project is expected to have a capital development cost of approximately \$US177m. The company's ability to secure the necessary funding looms as the major risk to the development of the project.
- It is important to note that Tiomin had previously secured funding for the Kwale project. In 2006 Tiomin secured ~US\$150m debt facility with Standard Chartered, WestLB and African Development Bank along with raising C\$60m in equity.

Mining in Kenya

- The Kwale project represents the first major mining project to be developed in Kenya.
- Risk is mitigated slightly due to a firm commitment and strong ongoing government support for both the Kwale project and BSE. In particular the GoK is currently heavily committed to developing a domestic mining industry and as result the Kwale project is viewed as a project of "national significance".

Infrastructure risk

- Access to reliable infrastructure is deemed to be a minor risk to the Kwale project as the bulk of the key infrastructure components have been secured.
 - Power: BSE have been issued a power production permit. In addition there is a "first world" 132kv substation located 18km from site;
 - Water: BSE have received authorisation to construct a dam in the Mukurumudzi river which runs between the Central and South dunes. It is understood this measure will provide sufficient water to the project and will be supplemented by a bore field;
 - Transport: The Kwale site is located 50km south of existing port facilities at Mombasa and 10km inland from Kenya's major coastal highway; and
 - Port: The company has secured a dedicated port site at Mombasa.

Mineral sands prices & currency risk

- Severe fluctuation in mineral sands prices and the US dollar represents a risk to the valuation of the Kwale project; and
- Industry expert, TZMI, has forecast prices to continue to grow in all three products driven by significant supply deficits from 2013.

Production risk

- There is minimal production risk in the Kwale project which will utilise the relatively straight forward bucket wheel excavator mining techniques.

Mineral Sands Products & Markets

Products & Market

Ilmenite, Rutile and Leucoxene

- Approximately 90% of all mined ilmenite, rutile and leucoxene is used as the feedstock for the production of TiO₂ pigments which are mainly used in the production of paint and coatings.
- In addition Rutile and leucoxene are also raw materials for flux coated electrodes and flux core welding wire.
- Approximately half of the worlds titanium is currently supplied by Iluka Resources, Rio Tinto, BHPB, and Exxaro Sands.
- Given end use applications are heavily linked with building activity, overall pigment demand is closely linked to GDP per capita.

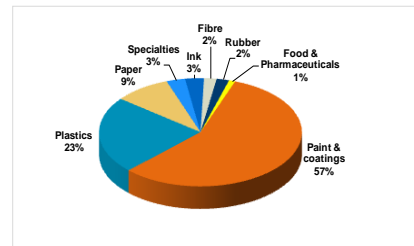
Zircon

- The majority of zircon produced globally is milled into a fine flour for use in tiles and other ceramic applications.
- In addition to ceramic applications small amounts of zircon are used in feedstock for zirconium chemicals and metal production.
- Approximately two thirds of worlds zircon is currently supplied by Iluka, Rio Tinto, BHPB and Exxaro.
- Given that demand for floor and wall tiles is linked to economic development and urbanisation, China and Asia are key markets.

Key Themes

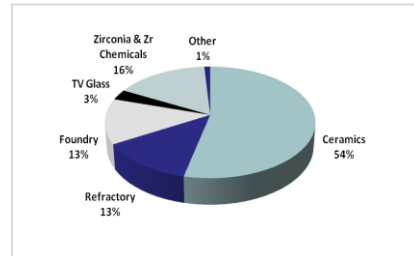
- Demand is currently influenced by urbanisation & increased per capita consumption in developing economies, especially China; and
- TZMI has forecast supply deficits in all three Kwale products from 2013. This is primarily due to a severe demand reduction in 2009 and limited production being induced at reduced prices.

Chart 3: 2008 Pigment consumption



Source: BSE

Chart 4: 2008 Zircon consumption



Source: BSE

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