GUNSON RESOURCES LIMITED

Company Insight
the intelligent market update

Gunson Resources Limited **Date of Lodgement: 26/9/12**

Title: "Company Insight – Coburn Zircon Development"

Highlights of Interview

- **Discusses POSCO's strategic interest in zircon and the Coburn Project, and the terms of its joint venture involvement**
- **Explains the detailed and thorough work on the Coburn Project over the past 10 years, now effectively complete including capital costs**
- **Capital costs settled at A$192 million, giving the Coburn Project a 22% IRR and A$211 million NPV (8% pre tax real)**
- **Gunson's 60% share has a pro rata NPV of A$126.4 million**
- **Reviews current status of funding discussions expected to be concluded by the end of calendar 2012, with construction starting in early 2013 and production in 2014.**

Record of interview:
With David Harley Managing Director of Gunson Resources Limited (ASX: GUN) market capitalisation ~A$25 million.

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POSCO announced recently that it would proceed with its investment in the Coburn Zircon Project in Western Australia. Why is POSCO interested in zircon?

Managing Director, David Harley
POSCO is the most competitive steel producer in the world, a position attained from a long term investment in market-focused research and development and state-of-the-art processing facilities. They want to leverage this business model to other materials, providing exposure to different markets and creating greater diversity of their revenue base. An initial focus is on 'advanced materials' such as rare earths and zirconium, for which they see significant long-term market growth with high potential returns from research and development of new products and processing methods. For example, processing of zircon sand worth about $US2,400 per tonne, into zirconium sponge worth about $US32,000 per tonne, yields a value-add of well over ten times. POSCO has recognised the importance of a long-term secure supply of quality raw materials (i.e. mineral feedstock) for such businesses, and hence its interest in the Coburn Zircon Project.

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What are the main details of POSCO's investment proposal?

David Harley
POSCO, along with a Korean resources investment fund will form a special purpose investment vehicle, the POSCO SPV, to take a minority 40% stake in the Coburn Project joint venture. Gunson will have the majority 60% stake and will manage the Project. Each party is entitled to its proportional share of production and will contribute its respective share of mine development expenditure. Material decisions will require the approval of both parties.

POSCO and the Korean fund will separately finance the POSCO SPV, and we will finance our share of the Coburn joint venture. Importantly, though, the POSCO SPV is contributing $28 million of Gunson's share as a farm-in, to initiate the joint venture. They pay us $7 million upfront, and then another $21 million, both going towards our 60% share of mine development costs.

Thus, with the estimated Project capital cost of $192 million – as announced last week - our 60% share requires $116 million and will be funded by POSCO as to $28 million, leaving Gunson to fund only the balance of $88 million. We are deciding the extent to which this requirement will be supported by debt and equity and our discussions are well-advanced.

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How advanced is the project work for Coburn?

David Harley
We have done a lot of pre-development work over the last 10 years, and it is effectively complete. That work is extensive, detailed and thorough; and we look forward to beginning construction in 2013.

In terms of work done, we have drilled out reserves and resources sufficient to last 23 years, and completed all the metallurgical testwork, environmental baseline studies and permitting including meeting the requirements of the 2005 public environmental review (following which we obtained a Ministerial Statement from the WA Environment Minister setting out the conditions on which the mine can be developed). The issue was that we're next to the Shark Bay World Heritage Property. But that's in the past - we have addressed and met these pre-construction conditions, producing numerous management plans that meet the standards required of us - fire, dust, flora, fauna, groundwater – you name it we've done it! These are all done, settled and approved.

We've also substantially advanced work on the most appropriate and beneficial mining method, the engineering work including the plant, the 45 kilometres of road, a village housing 130 people, the provision of natural gas supply via a 110 kilometre lateral from the Dampier to Bunbury Pipeline. This lateral pipeline will allow Cummins to generate power via gas turbines rather than diesel. The depth of the work is considerable - we have done an enormous number of engineering studies. The final work on settling the capital costs has been performed by Sedgman Limited who are excellent professional engineers. It is extremely detailed and has given both us and the POSCO SPV a very high level of confidence.

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What returns are being projected from the Coburn project?

David Harley
All this detailed work has fed into our calculations of value and returns.

The Project has an IRR of 22% and a net present value of A$211 million, calculated on a pre-tax and pre-financing basis. The operating costs include the 5% State royalty, and the discount rate used is 8% real before tax and financing. Because zircon is not an exchange-traded commodity, we first constructed an accurate historical perspective based on the expert views of TZMI in Perth, who use shipping data obtained from the customs authorities of exporting countries as their factual basis, and so we know our starting perspective is accurate. We then constructed projections which vary from year to year but broadly speaking, we've used a long-term zircon price of US$1,715 per tonne fob – which compares with the current price of approximately US$2,400. In our announcement last week, we used Bloomberg consensus exchange rates of US$ to A$ of 0.95 in 2014, 0.93 in 2015, 0.9 in 2016 - and 0.85 from 2017 onwards based on ten-year bank swap rates.

Our capital cost is an extremely hard number now. The estimates are detailed and thorough, and I'll talk about them later on.

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What key features do you think make the Coburn Project return so attractive?

David Harley
First, because of the products involved. Estimated revenue is 65% from zircon, 20% from chloride ilmenite, and 15% from a mixture of rutile and leucoxene. With respect to zircon, Iluka, Rio Tinto and Tronox (formerly Exxaro Mineral Sands) control about70% of the world's market – so when Chinese demand fell late last year and in 2012, Iluka became a swing producer and pulled back production to keep prices high. There's a good place for a producer such as Gunson, which will provide only 2½% of world output, in a market such as this.

Over recent years, there have been only two large new greenfields projects financed, both in Africa, representing very little additional production compared with the considerable depletion from a lot of existing mines now running down, such as North Stradbroke Island near Brisbane.

Pricing structures for the mineral sands industry have changed for the better. Low fixed titanium dioxide mineral prices increasing only by the US producer price index are no longer a feature of the market. The old cap and collar "legacy" contracts for titanium dioxide minerals have mostly expired and the producers won't do them any more. It's now quarterly to annual price adjustments. Urbanisation of the third world is driving these changes, and with our long-term resource, we have reason for confidence.

Secondly, it involves simple mining. It is an old sand dune system behind a fossil beach and removal of overburden is quite easy.

Finally, we don't use chemicals – we just use water and exploit the differences in physical properties to separate the heavy minerals. It is very benign from an environmental point of view during production, and we will maintain the standards of the mineral sands industry in the area of rehabilitation.

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How firm is the capital cost estimate of $192 million, and what impact do you see the cost pressures in the WA economy having on this figure?

David Harley
This is a very firm estimate because it is based on competitive tenders received a month ago and backed up by the careful and detailed work that has been put in over 10 years, with large amounts of money spent on the various engineering studies. Sedgman has compiled the capital cost to a P90 level and has included contingencies. It is very thorough and we have critically examined and intelligently challenged the assumptions involved. At the same time, there are still healthy profits for those who will do the work – in other words the project development is sensible, practical and

commercially workable. The quality of the people involved has been very high, and we've had many firms look at our work – the best available – including Sedgman and Mineral Technologies (formerly Roche).

We've done this first, for our own reasons; and secondly, to satisfy incoming partners and financiers. During due diligence – involving a number of potential partners of which POSCO was just one – who've looked at the Project and subsequently made offers - they have all challenged our work and found it to be thorough. That's at all levels - ore reserves and resources, assays, mining, metallurgy, engineering, other technical, marketing, environmental permitting and legal.

POSCO has looked at everything - the geology, the drilling, the metallurgy, the environment, the marketing, the legals, the engineering, mining methods and so on - using people from all over the world. POSCO's due diligence processes are complete.

Finally, cost pressures in the current WA market are abating rapidly, so the construction cost estimate is very unlikely to be undermined by cost inflation.

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How does Gunson propose to finance – in terms of debt and equity – its share of Coburn's estimated $192 million capital cost?

David Harley
Our project funding requirement is $88 million after the POSCO SPV has contributed its $28 million of our funding share. We are considering various funding alternatives and haven't settled the exact contributions from debt and equity. The cashflow position is comfortable with our 60% project share predicted to produce a $23 million operating margin annually. This provides scope for a reasonable level of gearing.

We don't want to borrow too much money but this is simple mining, our revenue assumptions are conservative and these are bankable cashflows. We already have DuPont as an offtake party for our ilmenite and have had extensive discussions with customers for our other production. We're looking to structure something acceptable to financiers but still give us the capacity to pay dividends. Using longer repayment terms gives us scope to open up payment of dividends, something we'd like to do.

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What steps have been taken to advance discussions with Gunson's potential project financiers, and do you have any indications of potential parameters?

David Harley
Talks are very advanced. We've been in discussions for a number of years now and we have an extremely good understanding of the funders and funds that are available. We're just fine tuning, and are in the final stages. Detailed proposals have been received for several different debt funding structures, with key parameters that will drive our decision including the repayment term, flexibility on the product marketing side and the implied cost of the available funds. These parameters in turn flow through to the risks and returns for our shareholders, which is what we are focused on.

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POSCO's participation is dependent on formal approval of the Korean fund that is co-investing in the POSCO SPV. When is the formal approval due and do you foresee any issues with this?

David Harley
That approval is due by early October. No – we don't see any issues with obtaining it, especially after POSCO has already approved its investment after an intensive examination, review and due diligence. First, POSCO has had many consulting groups contribute to its due diligence; secondly, the investment proposal went to its Investment Committee who recommended it to the POSCO Board; thirdly a Board Sub-Committee reviewed and recommended it; and finally POSCO's Full Board reviewed it and said 'yes'. That is a substantial process and so we have good reason to think the Korean fund's formal approval is imminent. The fund is essentially just doing due diligence on POSCO's due diligence.

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What are the next steps in the Coburn Project's development? Are there any significant hurdles and what is the likely timeline?

David Harley
The Korean fund is due to give its approval by early October; following which the joint venture agreement – already substantially agreed between POSCO and Gunson - will be signed. We will then raise the debt, followed by an appropriately structured equity raising. Completion of the fund raising is expected by the end of the year. There are many resource funds looking for projects to invest in - they're not too keen on iron ore and coal projects at the moment – and there are very few opportunities in mineral sands.

By the end of calendar 2012 we expect to have the funding done, which means the construction period – which Sedgman has estimated at 77 weeks – can start in early 2013 and we'll be producing in 2014.

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Thank you David.

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