



Labrador Iron Mines Holdings Ltd.

LIM-TSX: \$8.55

Target Price: **\$15.50**

Recommendation: **BUY**

COMPANY BULLETIN

August 29, 2011

Price	\$8.55	Market cap. (\$mm)	\$ 460.5
Shares O/S (mm)	53.9	Net debt	(85.5)
Avg. daily vol.	448,556	Enterprise Value	\$ 374.9

	2010	2011	2012E	2013E
EPS (fully diluted)	0.03	(0.09)	0.37	1.37
CFPS	(0.07)	(0.08)	0.43	1.60
Book value / share	3.26	3.24	5.55	6.97

P/E	na	(94.0)	23.3	6.2
EV/EBITDA	na	na	9.0	2.9

Revenues	\$0.0	\$0.0	\$95.9	\$337.0
EBITDA	0.0	0.0	41.8	129.4
Net earnings	1.2	(4.0)	20.0	75.8

EBITDA margin	na	na	43.6%	38.4%
Net margin	na	na	20.8%	22.5%
Return on equity	1.0%	-2.8%	6.6%	19.7%

Note: March 31st Fiscal Year-End; Currently in Fiscal Q2/12

	Revised Aug 26/11	Previous Aug 19/11	Change
EPS			
Q1/12a	(0.09)	(0.09)	0.000
Q2/12e	(0.01)	0.11	(0.125)
Q3/12e	0.42	0.37	0.051
Q4/12e	0.04	0.02	0.014
2012e	0.37	0.43	(0.061)
2013e	1.37	1.37	0.000
CFPS			
2012e	0.43	0.50	(0.068)
2013e	1.60	1.60	0.001



Labrador Iron Mines Holdings Ltd. is a mineral resource company focused on exploring, developing, and mining direct-shipping ore (DSO) from its iron ore properties in western Labrador and north-eastern Québec.

Schefferville site visit

Event

On August 25, 2011, we participated in a site visit to the Company's operations in the Schefferville region in Quebec and Labrador.

Impact

Mixed. The Company's mining operations are ahead of schedule. Approximately 90,000 tonnes of direct-shipping iron ore has been railed to Sept-Iles and an additional 150,000 tonnes has been stockpiled at the Silver Yards plant site. As well, approximately 250,000 tonnes of run-of-mine ore has been processed through the plant, resulting in approximately 125,000 tonnes of stockpiled lump and coarse sinter feed iron ore products.

The bottleneck in transporting this stockpiled material to Sept-Iles has been the lower-than-expected availability of rail cars. The Company is in the process of refurbishing its fleet of used rail cars, but currently only has 140 cars in service, limiting rail transport to a single train. There are 60 more rail cars being refurbished that should be in service in mid-September, when a second train begins hauling ore. The Company has an additional 200 rail cars yet to be refurbished, so the outlook for next year is unaffected.

Management expects the first shipment of its iron ore from Sept-Iles should take place in a couple of weeks at the earliest, and possibly not until mid- to late-September, depending upon IOC's shipping schedule. The Company will continue to capitalize its operating costs until the end of fiscal Q2/12 and will begin recognizing revenue starting October 1, 2011, when commercial production is declared. As a result, the net revenue from the initial shipment expected in September will be credited to mineral property interests. **This is an accounting issue that should have limited impact on valuation, but which we now forecast will result in a loss of \$0.01 per share for fiscal Q2/12 compared to our previous estimate of earnings of \$0.11 per diluted share.** This lower forecast has been partially offset by higher forecasts for fiscal H2/12, based on slightly higher shipments as well as our assumption that the initial shipment should represent the highest-cost tonnes produced. As a result, we have moderately lowered our unit cost of sales for fiscal H2/12. **Overall, our fiscal 2012 earnings forecast has declined to \$0.37 per diluted share from \$0.43 per diluted share.**

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Recommendation

The mining operations at the James pit are ramping up quickly and throughput at the Silver Yards processing plant is expected to increase once the installation of the hydrosizer circuit is complete in a few weeks. As a result, the Company's production capacity is now higher than its rail capacity until additional rail cars are refurbished. This has resulted in an inventory build and timing issue between production and sales; however, this inventory build will eventually work its way through the sales delivery chain. We believe that the declaration of commercial production and revenues only after the first ore sales is an accounting issue that doesn't significantly impact our valuation or longer-term outlook for the Company.

While our fiscal 2012 estimates have declined modestly, iron ore markets remain firm and prices robust. Labrador Iron Mines Holdings is the newest emerging producer and should make its maiden ocean shipment in September. **We believe that rail-car availability should be resolved by the end of the year, leaving the Company well-positioned to re-start its operations next spring with full transportation capacity.**

As a result, we believe that the Company offers attractive exposure to iron ore and that the recent share price weakness offers an attractive entry point for investors. We are maintaining our **BUY** recommendation and \$15.50 target price.

Site visit highlights

On August 25, 2011, we participated in a site visit to the Company's operations in the Schefferville region in Quebec and Labrador. Our tour included the James pit mining operations, the Silver Yards processing plant, the tailing management area and the Redmond deposit, which is slated to go into production in 2013 (fiscal 2014).

James South pit

We visited the James South pit, where ore mining is taking place along two faces. The ore is free-digging and very little drilling and blasting has been required to date. Instead, benches are prepared by ripping using a dozer and grade control is achieved by digging trenches for sampling.

The ore is segregated into direct-shipping product, currently at approximately 65% Fe, and lower-grade material that is trucked to the Silver Yards processing plant. Exhibit 1 shows ore being loaded onto trucks and Exhibit 2 shows a free-digging face with a grade control trench at the top of the bench.

Total mine production is currently averaging 20,000 tonnes per day (tpd) and the stripping ratio is currently averaging the life-of-mine (LOM) average of 1:1, or about 10,000 tpd of ore. Mining rates have recently reached as high as 25,000 tpd, and management believes that the maximum capacity is currently at 30,000 tpd.



Exhibit 1: Ore loading at the James South pit



Source: Octagon Capital Corp.

Exhibit 2: Free-digging ore face and grade-control trench



Source: Octagon Capital Corp.

A total of approximately 240,000 tonnes of direct-rail ore has been mined from both the James South and James North pits, of which approximately 90,000 tonnes has been transported by rail to Sept-Iles. Exhibit 3 shows the direct-shipping ore stockpile that contains approximately 150,000 tonnes of ore. Due to the lack of rail-car availability, mining operations are now running ahead of transportation capacity, and ore inventories should continue to build through the end of this year's mining season. Exhibit 4 shows a locomotive



adjacent to the coarse sinter feed stockpile and one of the Company's refurbished rail cars behind it. The refurbishment of the Company's used rail cars consists of having new brakes installed and metal crossbars removed in order to facilitate loading and unloading ore. Management expects to exit fiscal Q3/12 (December 31, 2011) with 1.2 million tonnes of ore for either direct-rail or processing next spring.

Exhibit 3: Direct-shipping ore stockpile



Source: Octagon Capital Corp.

Exhibit 4: Locomotive and rail cars at the Silver Yards plant



Source: Octagon Capital Corp.



Silver Yards plant

The first phase of the Silver Yards processing plant was completed last June and throughput is currently running at approximately 6,000 tpd. The run-of-mine ore is first crushed and then split into two streams before being washed in two tumblers and then screened. Exhibits 5 to 7 show the primary crusher, washing tumblers and the primary and secondary wet screens, respectively.

Exhibit 5: Primary crusher



Source: Octagon Capital Corp.

Exhibit 6: Dual washing scrubbers



Source: Octagon Capital Corp.



Exhibit 7: Primary and secondary wet screens

Source: Octagon Capital Corp.

Management is targeting increasing throughput to 10,000 tpd and is currently installing a hydrosizer circuit to reduce the loss of fines to the tailings stream. Exhibit 8 shows the coarse sinter feed stacker and, in the background, the installation of the hydrosizer circuit. The bottleneck is the secondary wet screens where the size passing through the screens has been reduced to 300 microns from 600 microns in order to reduce the loss of fine ore to the tailings impoundment. The hydrosizer and pan filters will capture the finer material and produce a sinter fines product while allowing the processing rate to increase at the same time as improving recoveries. The installation of the hydrosizer is expected to be completed in a few weeks.

Exhibit 8: Coarse sinter feed stacker and hydrosizer installation

Source: Octagon Capital Corp.



For next year, management is expecting to complete its third phase of expansion at the plant with the installation of a wet high intensity magnetic separator (WHIMS) circuit, which will be housed in a new building. The WHIMS circuit will allow for an ultra-fine product suitable for pellet feed to be recovered and will increase overall recoveries to approximately 80%. The Company also intends to install a third processing line in order to process lower-grade, higher-silica material. This ore typically grades 50% Fe or less, and between 14% to 18% silica. Management noted that there are significant waste dumps containing this type of material from when IOC mined the district and didn't have the processing plant to produce a saleable product. The potential resources in these dumps haven't been fully evaluated, but should augment the low-grade, high-silica material contained in the current mine plans. The capital budget for all of the plant upgrades is approximately \$30 million, which is moderately higher than our previous forecast of \$25 million.

Redmond deposit

The last leg of our tour consisted of a visit to the Redmond deposit located approximately 10 km south of the James mining area. The Redmond deposit and the Houston deposit – located approximately 10 km further south – contain about 3 million and 22 million tonnes of iron ore resources, respectively, that are scheduled for mining beginning in mid-2013 (fiscal 2014). The mining of these deposits will include the construction of a second processing plant, which will be located adjacent to the Redmond deposit in an area that has already been disturbed by historic mining activity. Management estimates that the capital cost for this plant will be approximately \$35 million, as well as \$15 million for a new road extending to the Houston deposit and related infrastructure. We had been forecasting the \$35 million for the plant, but have now included the additional \$15 million in our estimates. We would note that there are significant waste dumps at the Redmond deposit from the historic IOC mining operations that potentially contain a significant resource of low-grade (<50% Fe), high-silica (14%-18%) ore that could extend the life of this plant beyond our forecasts by producing an ultra-fine pellet feed product. Management is currently evaluating the potential for these waste dumps, but has not yet included any contribution to the resource estimate.

IOC sales agreement

Management addressed the recent agreement with IOC for the shipping and marketing of its fiscal 2012 iron ore products. The major benefit of this agreement is that IOC's port facilities at Sept-Iles can handle capesize vessels, compared to the Company's Pointe Aux Basques facilities, which are limited to panamax vessels. This should allow for significantly lower shipping costs to Chinese customers in the order of \$10-\$12 per tonne, which will be shared by both parties. From a marketing perspective, IOC and majority owner Rio Tinto will sell mainly into the Asian spot market at their discretion. The Company won't be able to directly choose its customers, which will likely be drawn from a preferred list determined by Rio Tinto.

Management will be monitoring the sales process as closely as possible in order to secure as much customer feedback as is feasible. However, if the iron products are sold to traders, then they will likely be blended and the blast furnace characteristics and value-in-process feedback will be impossible to ascertain. Management indicated that extending the current



shipping and marketing deal with IOC for next year is possible, but they are prepared to consider alternatives based on customer feedback and the emergence of potential long-term customers for its products.

Revisions to estimates

Based on our site visit and discussions with management, we have adjusted our estimates accordingly.

We had been forecasting ore shipments to customers of 200,000 tonnes for fiscal Q2/12, but have reduced this to 160,000 tonnes, or one capesize vessel. We have assumed that the net revenue from this shipment will be approximately \$7.2 million, which will be credited to mineral property interests as \$6.5 million in fiscal Q2/12 and \$0.7 million in Q3/12.

We have assumed that the cost of sales for this maiden shipment will be the highest-cost tonnes shipped during the start up of commercial production. We had been forecasting unit cost of sales of \$85 per tonne, but have calculated our net revenue from the maiden shipment based on \$100 per tonne. As such, we have reduced our unit cost of sales for H2/12 to \$80 per tonne to maintain the weighted average of \$85 per tonne for fiscal 2012. Because the net revenue from the maiden shipment has been capitalized, our fiscal Q2/12 earnings estimate has been reduced from \$0.11 per diluted share to a loss of \$0.01 per share.

For fiscal Q3/12 and Q4/12, we have increased our customer shipments to 575,000 tonnes and 65,000 tonnes, respectively, from 550,000 tonnes and 50,000 tonnes, respectively. The fiscal Q4/12 forecast now represents a single panamax vessel shipment of lump ore next January from stockpiles at Sept-Iles. The net impact has been to increase our fiscal Q3/12 and Q4/12 earnings to \$0.42 per diluted share and \$0.04 per diluted share, respectively, from \$0.37 per diluted share and \$0.02 per diluted share. Overall, our fiscal 2012 earnings have declined to \$0.37 per diluted share from \$0.43 per diluted share. We have left our total customer shipments forecast of 800,000 tonnes for fiscal 2012 unchanged. We have increased our capital expenditure estimate for fiscal 2013 and 2014 by \$20.0 million based on management guidance of the cost to complete the Silver Yards plant upgrades and construction of the Redmond processing plant.

We are maintaining our **BUY** recommendation and \$15.50 target price.





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