

Labrador Iron Mines (LIM.TO)

Rating	OUTPERFORM* [V]
Price (15 Feb 12, C\$)	5.72
Target price (C\$)	(from 8.75) 8.40 [†]
52-week price range	14.82 - 4.67
Market cap. (C\$ m)	309.29
Enterprise value (C\$ m)	288.70

*Stock ratings are relative to the relevant country benchmark.
†Target price is for 12 months.
[V] = Stock considered volatile (see Disclosure Appendix).

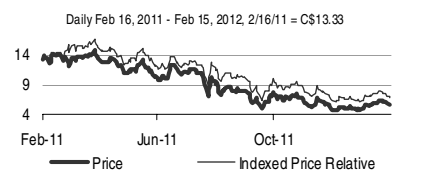
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COMPANY UPDATE

Iron ore knowledge base continues to grow and multiple short term catalysts

- **Key take-aways / insights from LIM.TO's DecQ11 result are** i) LIM is rapidly addressing our concern about there being a lack of iron ore expertise in the business, 2) the accounts provide an inclusive, and in our view potentially dangerous, level of insight into the IOC sales and marketing fee, and 3) near term balance sheet pressure is acknowledged by management and various options are being pursued to address it. Our target price is downgraded slightly to C\$8.40/sh (\$8.75/share).
- LIM.TO's admirable action oriented culture is quickly being supplemented with learnt ('on the job') and acquired (through key personnel hires) iron ore industry experience. We welcome the recent appointment of a VP Operations and VP Transport, and look forward to seeing what this team is capable of as management's focus and attention shifts from the current 3 – 6 month horizon to issues which are 3 – 6 years out.
- **Near term catalysts include** i) mine permitting progress on Houston, ii) March/April 2012: updated 43-101 resource statement (with a likely focus on the Houston deposit), iii) SepQ/DecQ12: ramp up to nameplate ~ 2.5mtpa production rate and iv) MarQ12: we expect to hear about a debt facility or pre-sales agreement to address short term working capital requirements.
- **The IOC sales & marketing fee is an important part of the valuation jigsaw puzzle**, but it remains confidential. We can derive an estimate of this marketing fee of anywhere between 10% and 29% of the FOB price (contrary to our earlier 'First Impressions' note), which is the difference between a C\$9.40/share and C\$7.50/share valuation. We have adopted the mid-point which generates a C\$8.40/share valuation and this supports our revised target price.

Share price performance



On 02/15/12 the S&P/TSX COMPS INDEX closed at 12362.03

Quarterly EPS	Q1	Q2	Q3	Q4
2011A	-0.02	-0.02	-0.02	-0.03
2012E	-0.09	-0.14	-0.04	-0.02
2013E	0.25	0.33	0.33	0.08

Financial and valuation metrics

Year	03/11A	03/12E	03/13E	03/14E
EPS (CS adj.) (C\$)	-0.09	-0.29	0.98	1.45
Prev. EPS (C\$)	—	-0.70	1.31	2.28
P/E (x)	-62.9	-19.9	5.8	3.9
P/E rel. (%)	-357.5	-141.6	46.8	36.1
Revenue (C\$ m)	—	—	250.4	391.8
EBITDA (C\$ m)	-4.9	-14.9	88.7	132.9
OCFPS (C\$)	-0.08	-0.34	1.51	1.90
P/OCF (x)	-173.5	-16.8	3.8	3.0
EV/EBITDA (current)	-58.4	-19.4	3.3	2.2
Net debt (C\$ m)	-6	-21	12	-24
ROIC (%)	-2.86	-11.63	32.01	33.60
Number of shares (m)	54.07	IC (current, C\$ m)	120.98	
BV/share (Next Qtr., C\$)	2.5	EV/IC (x)	2.5	
Net debt (Next Qtr., C\$ m)	-20.6	Dividend (Next Qtr., C\$)	—	
Net debt/tot cap (Next Qtr., %)	-13.5	Dividend yield (%)	—	

Source: Company data, Credit Suisse estimates.

DISCLOSURE APPENDIX CONTAINS IMPORTANT DISCLOSURES, ANALYST CERTIFICATIONS, INFORMATION ON TRADE ALERTS, ANALYST MODEL PORTFOLIOS AND THE STATUS OF NON-U.S. ANALYSTS. U.S. Disclosure: Credit Suisse does and seeks to do business with companies covered in its research reports. As a result, investors should be aware that the Firm may have a conflict of interest that could affect the objectivity of this report. Investors should consider this report as only a single factor in making their investment decision.

Exhibit 1: Financial Summary

Labrador Iron Mines (LIM)

Year ending 31 Mar

In CADmn, unless otherwise stated

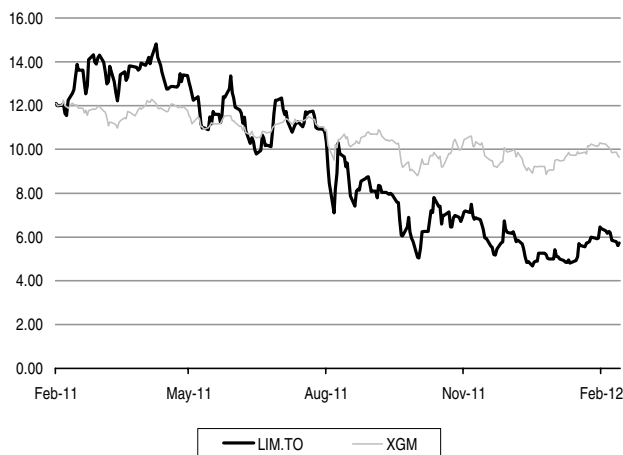
Profit & Loss	03/10A	03/11A	03/12E	03/13E	03/14E
Sales revenue	0.0	0.0	0.0	250.4	391.8
EBITDA	-2.7	-4.9	-14.9	88.7	132.9
Depr. & Amort.	0.1	0.0	1.6	15.2	23.6
EBIT	-2.8	-4.9	-16.4	73.5	109.3
Associates	0.0	0.0	0.0	0.0	0.0
Net interest	-0.1	-0.1	-0.5	0.0	0.3
Reported PBT	-2.7	-4.8	-16.0	73.6	109.0
Income tax	-3.9	-0.8	-0.5	20.6	30.5
Profit after tax	1.2	-4.0	-15.5	53.0	78.5
Minorities	0.0	0.0	0.0	0.0	0.0
Preferred dividends	0.0	0.0	0.0	0.0	0.0
Normalised NPAT	1.2	-4.0	-15.5	53.0	78.5
Analyst adjustments	0.0	0.0	0.0	0.0	0.0
Unusual item after tax	0.0	0.0	0.0	0.0	0.0
Reported NPAT	1.2	-4.0	-15.5	53.0	78.5
Balance Sheet	03/10A	03/11A	03/12E	03/13E	03/14E
Cash & equivalents	48.3	7.6	20.6	8.3	44.4
Inventories	0.0	0.2	0.0	12.3	16.3
Receivables	0.7	1.3	0.0	6.2	8.1
Other current assets	0.0	0.9	1.8	1.8	1.8
Current assets	49.0	10.0	22.4	28.6	70.7
Property, plant & equip.	7.9	36.7	96.8	182.6	216.8
Intangibles	0.0	0.0	0.0	0.0	0.0
Other non-current assets	153.1	137.6	22.0	22.0	22.0
Non-current assets	161.1	174.3	118.7	204.6	238.8
Total assets	210.0	184.3	141.1	233.2	309.5
Payables	2.1	14.9	0.0	5.1	6.8
Interest bearing debt	0.0	1.7	0.0	20.0	20.0
Other liabilities	32.3	3.1	4.7	4.7	4.7
Total liabilities	34.4	19.7	4.7	29.9	31.5
Net assets	175.6	164.6	136.4	203.3	278.0
Ordinary equity	161.5	164.6	136.4	197.2	269.8
Minority interests	0.0	0.0	0.0	0.0	0.0
Preferred capital	0.0	0.0	0.0	0.0	0.0
Total shareholder funds	175.6	164.6	136.4	203.3	278.0
Net debt	-48.3	-5.9	-20.6	11.7	-24.4
Cashflow	03/10A	03/11A	03/12E	03/13E	03/14E
EBIT	-2.8	-4.9	-16.4	73.5	109.3
Net interest	0.0	0.0	-0.2	1.2	-0.6
Depr & Amort	0.1	0.0	1.6	15.2	23.6
Tax paid	0.0	0.0	0.0	-18.5	-30.5
Working capital	-0.6	0.1	-5.0	13.3	4.3
Other	0.2	1.4	1.6	-3.2	-3.2
Operating cashflow	-3.1	-3.4	-18.4	81.6	102.9
Capex	0.0	0.0	-5.0	-101.0	-57.8
Capex - expansionary	0.0	0.0	-5.0	-90.0	-40.0
Capex - maintenance	0.0	0.0	0.0	-11.0	-17.8
Acquisitions & Invest	-14.4	-27.1	-99.2	-12.0	-9.0
Asset sale proceeds	0.0	0.0	0.0	0.0	0.0
Other	-2.1	-12.3	20.5	0.0	0.0
Investing cashflow	-16.5	-39.3	-83.8	-113.0	-66.8
Dividends paid	0.0	0.0	0.0	0.0	0.0
Equity raised	32.8	2.6	115.9	0.0	0.0
Net borrowings	0.0	0.0	0.0	20.0	0.0
Other	0.0	-0.5	-0.7	-0.8	0.0
Financing cashflow	32.8	2.1	115.2	19.2	0.0
Total cashflow	13.1	-40.7	13.0	-12.3	36.1
Adjustments	0.0	0.0	0.0	0.0	0.0
Net Change in Cash	13.1	-40.7	13.0	-12.3	36.1

Share Price: C\$5.72	15/02/2012 20:32
Rating	OUTPERFORM
Target Price	C\$ 8.40
vs Share price	% 46.85



LIM.TO commenced production of a small hematite iron operation in 2H2011, and aims to ramp up production to 5mtpa through 2012 and 2013. The project includes around 20 satellite deposits that were once mined by IOCC, but were abandoned in the early 1980s

Earnings		03/10A	03/11A	03/12E	03/13E	03/14E
Equiv. FPO (period avg.)	mn	37.4	43.7	54.0	54.1	54.1
EPS (Normalised)	c	3.1	-9.1	-28.7	98.0	145.2
EPS Growth	%		-391.9	-216.0	441.1	48.1
DPS	c	0.0	0.0	0.0	0.0	0.0
Dividend Payout	%	0.0	0.0	0.0	0.0	0.0
Free CFPS	c	-8.4	-7.9	-34.1	130.5	157.4
Valuation						
P/E	x	183.7	-62.9	-19.9	5.8	3.9
EV/EBIT	x	-106.9	-61.4	-18.5	4.1	2.8
EV/EBITDA	x	-111.3	-61.4	-20.4	3.4	2.3
Dividend Yield	%	0.0	0.0	0.0	0.0	0.0
FCF Yield	%	-1.5	-1.4	-6.0	22.8	27.5
Price to Book	x	1.3	1.5	2.3	1.6	1.1
Returns						
Return on Equity	%	0.7	-2.4	-11.4	26.9	29.1
Profit Margin	%				21.2	20.0
Asset Turnover	x	0.0	0.0	0.0	1.1	1.3
Equity Multiplier	x	1.3	1.1	1.0	1.2	1.1
Return on Assets	%	0.6	-2.2	-11.0	22.7	25.4
Return on Invested Cap.	%	0.9	-2.6	-13.8	24.6	31.0
Gearing						
Net Debt to Net debt + Equity %		Net Cash	Net Cash	Net Cash	5.4	Net Cash
Net Debt to EBITDA	x	17.7	1.2	1.4	0.1	Net Cash
Int Cover (EBITDA/Net Int.)	x	30.2	35.4	32.6	-2,267.7	402.5
Int Cover (EBIT/Net Int.)	x	31.4	35.4	36.0	-1,879.3	331.0
Capex to Sales	%				40.4	14.8
Capex to Depreciation	%					



Source: Company data, Credit Suisse estimates

Earnings changes

Exhibit 2: Earnings changes

Profit & Loss		FY12			FY13			FY14				
		Old	New	% change	Old	New	% change	Old	New	% change		
Sales	C\$mn	58	-	-100.0%	272	250	-8.0%	367	392	6.8%		
Schefferville	C\$mn	58	-	-100.0%	272	250	-8.0%	367	392	6.8%		
Gross Operating Profit	C\$mn	-	33	-	144	93	-35.6%	159	137	-14.0%		
Schefferville	C\$mn	-	33	-	144	93	-35.6%	159	137	-14.0%		
EBITDA	C\$mn	-	46	-	15	89	-36.6%	155	133	-14.4%		
Depreciation & Amortisation	C\$mn	4	2	-59.2%	15	15	0.0%	24	24	0.0%		
EBIT (reported)	C\$mn	-	50	-	16	74	-41.0%	132	109	-16.9%		
Net Interest	C\$mn	-	0	-	0	-	98.4%	-	5	0	107.3%	
NPBT	C\$mn	-	50	-	16	74	-42.2%	136	109	-19.9%		
Taxation	C\$mn	-	11	-	0	21	-42.2%	38	31	-19.9%		
NPAT (operating)	C\$mn	-	39	-	16	53	-42.2%	98	78	-19.9%		
NPAT (reported)	C\$mn	-	39	-	16	53	-42.2%	98	78	-19.9%		
EPS	C cps	-	0.73	-	0.29	0.98	-42.2%	1.81	1.45	-20.0%		
DPS	C cps	-	-	-	-	-	-	-	-	-		
Cash Flow Statement & Balance Sheet												
Operating Cash Flow	C\$mn	-	52	-	18	82	-37.2%	123	103	-16.5%		
Capex	C\$mn	-	12	-	5	101	-53.1%	-	45	58	-29.9%	
Net Debt	C\$mn	2	-	21	-	62	12	118.9%	-	141	24	82.6%
Operational Assumptions												
Key Macro assumptions												
62% Index Fines	US\$/t CFR dry	164	158	-4.2%	143	151	5.8%	125	131	4.9%		
USDCAD		1.00	1.00	0.0%	0.98	0.98	0.0%	0.95	0.95	0.0%		
Volumes	mt	0.39	0.39	0.0%	1.90	1.90	0.0%	2.95	2.95	0.0%		
Total Costs (incl royalty and marketing fee)	US\$/mt	87	86	-1.6%	68	83	22.8%	69	84	22.8%		

Source: Company data, Credit Suisse estimates

We have revised our earnings forecasts to reflect:

- Removal of all sales and operating expenses in FY12 (ending 31 March 2012) from the P&L. We had previously included pre-commercial production in the accounts in order to provide some clarity on these figures, however we have not adopted a modeling approach more consistent with LIM's reporting.
- Higher capital cost forecasts, now more in line with guidance
- Higher operating costs forecasts, driven principally by a higher assumption for the IOC sales and marketing fee. We assume that the current port arrangements with IOC persist until the multi-user berth is completed at Sept 11es. We do not see this occurring before 2015.

DecQ11 Financials

We believe that the most insightful read-throughs from the DecQ11 accounts relate to:

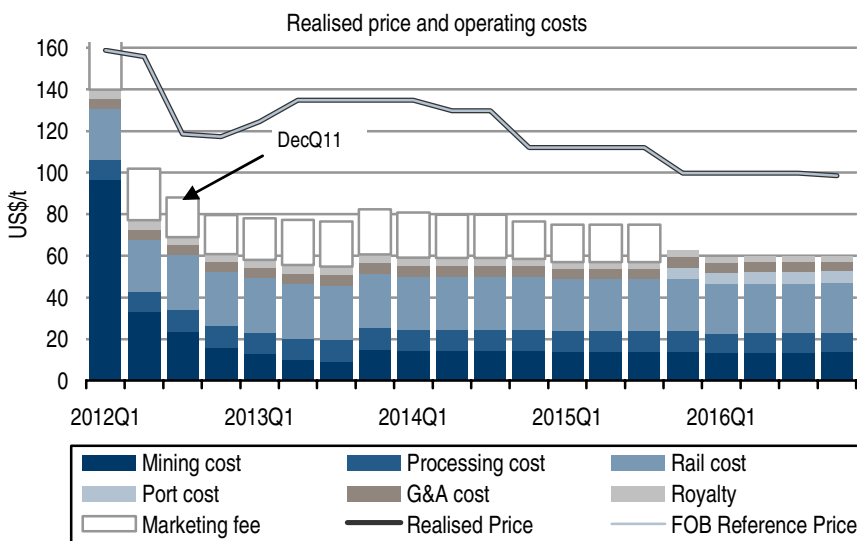
- 1) Cash costs – these appear to be in line with previous guidance at just over \$65/t
- 2) The IOC sales and marketing fee. We have derived a 10% estimate (of the 62IODEX) previously, but the DecQ11 suggest a figure closer to 22% (or \$34/t)
- 3) The balance sheet pressure in 1H 2012 is manageable

1) Cash costs appear in line with previous guidance

Cash costs were not explicitly reported, but our derived estimate of the DecQ11 cash cost appears consistent with previous guidance.

- Saleable product reported in inventories of \$11.718mn consist of (i) treated ore stockpiled at port and (ii) direct railable ore stockpiled at port, carried at cost.
- Dividing \$11.718mn by previously reported Port Product Inventories of 177,669 tonnes suggests that the cash cost of building this stockpiled material C\$65.95/t.
- C\$65.95/t captures mine, plant, rail and G&A costs only. It does not include the port/handling fee payable to IOC, nor the marketing fee (also payable to IOC) and royalties.
- C\$65.95/t is a weighted average of the beneficiated material (which LIM misleading calls DSO) and the unbeneficiated material (which LIM has invented the term DRO for).
- LIM has previously indicated that CY11 cash costs would be \$65/t (up from \$55/t earlier in the year). If our crude maths is correct, it would appear that cash costs are in line with previous guidance.
- We model LIM's cost base in a lot more detail than the company provides, and our outlook for total costs is summarised below. Note that with a MarQ end, the DecQ 2011 is LIM's Q3FY12 in the chart below.

Exhibit 3: Schefferville realised pricing and operating costs



Source: Company data, Credit Suisse estimates

2) IOC Sales & Marketing fee

Separate to the DecQ11 financials, LIM has also announced a new Sales & Marketing agreement with IOC (Iron Ore Company of Canada). The mechanics of the new agreement are the same as the 2011 deal, which basically saw IOC purchase the unloaded iron ore at the Port of Sept Iles. Shiploading, freight, sales and marketing are all IOC's responsibility and will not appear on LIM's accounts.

We had anticipated LIM to use a different shiploading arrangement in 2012 through Point Au Basques, but as this is not the case it is worth spending a little more time on the 2011 numbers as they are now relevant to 2012 as well.

We can derive an IOC sales and marketing fee ranging from 10% to 29%, the range representing the difference between a \$9.40/share and \$7.50/share valuation.

A 10% estimate is derived as follows:

- During our August 2011 site visit, management indicated that using IOC as a marketing agent and having access to its capesize facilities was roughly economically equivalent to doing the marketing themselves but having to use smaller vessels with higher freight.
- The difference between a panamax and capesize vessel Canada to China is roughly \$10-12/t. The panamax option uses a different berth, and requires transshipping, adding perhaps \$3/t. $11 + 3 = 14$.
- The spot price of iron ore in August, when this deal was announced, was roughly \$175/t CFR China, or perhaps \$145/t FOB. $14 \text{ divided by } 145 = 10\%$.

A 29% estimate is derived from the DecQ11 accounts as follows:

- Step 1: Using the reported 62% Index as a starting point, we can estimate the CFR China revenue that IOC would generate from selling LIM's ore into the spot market in China at US\$49mn. We believe that the unprocessed nature of the Direct Rail Ore (October shipment) would offset any grade premium this product might otherwise attract. We apply a \$4/t per 1% premium to the processed sinter fines - a grade adjustment similar to that used by Vale.
- Step 2: We can remove an assumed freight cost to convert the IOC revenue from CFR China to FOB Canada. This brings the revenue figure down to US\$37.3mn.
- Step 3: We know that LIM generated C\$26.6mn in revenue from the sale of these two shipments, so the unknown for which we then solve ($\$37.3 - 26.6 = \11.7mn) is attributable to the IOC sales & marketing fee. \$11.7mn is equivalent to 29.2% of FOB revenue, or US\$34 per dry tonne.

These three steps are illustrated in Exhibit 4.

We have assumed the mid-point at 20%

- We have assumed the 2012 Sales and Marketing agreement with IOC is maintained until the new multi-user berth is commissioned at Sept Iles (perhaps 2015, noting that 2014 guidance is not realistic). Beyond this point we remove the marketing fee but replace it in part with a new port fee which would be payable to the Port of Sept Iles for using the multi-user berth.
- The fee structure paid to IOC is not actually a fixed %. Rather there is a \$/t component and a % price participation component beyond a certain level. We talk about a fixed % arrangement for convenience sake only and in order to avoid adding even more unknowns to the equation.

- The sample size (2 shipments) is small in 2011, which may be distorting the 29% derived outcome. IOC produces concentrate and pellets, so handling of LIM's Sinter Fines and Direct Rail Ore would require a product handling premium. We suspect that the less refined Direct Rail Ore is more complicated for IOC to handle (this is the stuff which is currently frozen in stockpile at the port) and so probably costs more to handle than the Sinter Fines. In 2011 the Direct Rail Ore was ~50% of our sample, but going forwards it will be 20-25%.
- The sales and marketing agreement probably has a fixed / variable cost component, such that there are some economies of scale to be realised as LIM's tonnages increase.

Exhibit 4: Revenue reconciliation

		3/10/2011	2/11/2011		Comment
		Early October	Early November	DecQ11 total	
Shipment	Wet tonnes	167,167	172,743	339,910	As reported
Shipment	Dry tonnes	155,465	160,651	316,116	
Product		Direct Rail Ore	Sinter Fines		As reported
Grade	%	64.90%	64.90%		As reported
62% Fe Index	US\$/t CFR China	176	121		As reported
Premium	US\$/t per 1% Fe	0	4		CS assumed
LIM price	US\$/t CFR China	176	133		Source: Platts
Revenue	US\$mn CFR China	27	21	49	Calculated
Freight	US\$/wt	34	33		CS assumed
Freight	US\$mn	5.7	5.7	11.4	CS assumed
IOC Revenue	US\$/dt	140	97	118	
IOC Revenue	US\$mn	21.69	15.60	37.3	
IOC sales & marketing fee	% of 62IODEX	29.2%	29.2%		CS assumed
IOC sales & marketing fee	US\$/dt	41	28	34.4	CS assumed
IOC sales & marketing fee	US\$mn	6.8	4.9	11.7	CS assumed
LIM Revenue	US\$/dt FOB	89	62		CS assumed
LIM Revenue	US\$mn FOB	14.9	10.7	25.6	CS assumed
LIM Revenue	C\$mn FOB	15.7	10.9	26.6	

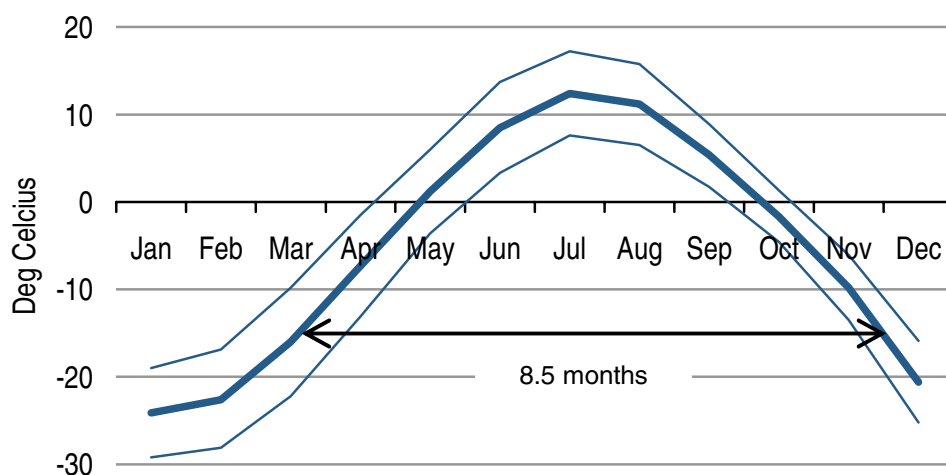
Source: Company data, Credit Suisse estimates

3) Balance sheet

LIM's JunH 2012 balance sheet will be tight, but it is manageable.

- DecQ11 end cash balance of \$22mn will have already been boosted by receipt of proceeds from the December 2011 shipment of perhaps \$5mn.
- The next sales receipt will not be until likely May, when temperatures rise enough to be able that the wet material (about 7% moisture) does not freeze. A longer winter might extend this to June or even July.
- The 178kt stockpile of frozen ore at the port might be worth \$15-20mn when eventually sold.

Exhibit 5: Schefferville max, average and minimum monthly temperatures

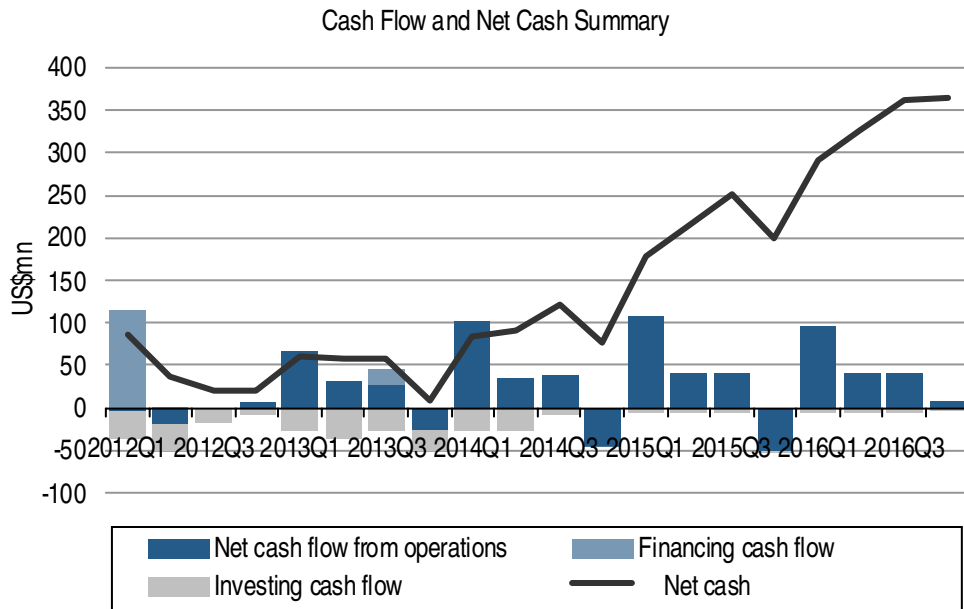


Source: www.climate.weatheroffice.gc.ca

- Corporate costs are expected to continue at \$1 – 1.5mn per quarter
- 2mt production at a cash cost of say \$65/t suggests full year operating expenditure of \$130mn. Over an 8.5mth target operational window, this is an opex burn rate of around \$15mn per month or \$45mn per quarter.
- 2012 capital costs are expected to total \$107mn in 2012. Again, spreading this over an assumed 8.5 month construction window suggests an average monthly burn rate of \$12.5mn per month.

It is fairly easy to see how LIM could consume its current cash balance before its next sales receipt. Balance sheet buffers are being evaluated, and would likely include putting debt facility in place or perhaps a forward sales agreement (even a combination of the two). We do not believe that LIM will issue equity in order to address near term working capital requirements.

Exhibit 6: Cash Flow and Net Cash Summary



Source: Company data, Credit Suisse estimates

Valuation

Exhibit 7: Net Present Value and CS Valuation

Projects & Mines	Net Present Value			CS Valuation	
	C\$m	C\$/sh	multiple	C\$m	C\$/sh
Schefferville	612	11.33	0.75 x	459	8.49
Sub-Total	612	11.33		459	8.49
Corporate	C\$m	C\$/sh	multiple	C\$m	C\$/sh
Net Cash / (debt)	21	0.38	1.00 x	21	0.38
Corporate	-26	-0.48	1.00 x	-26	-0.48
Sub-Total	-5	-0.10		-5	-0.10
Total	607	11.23		454	8.40

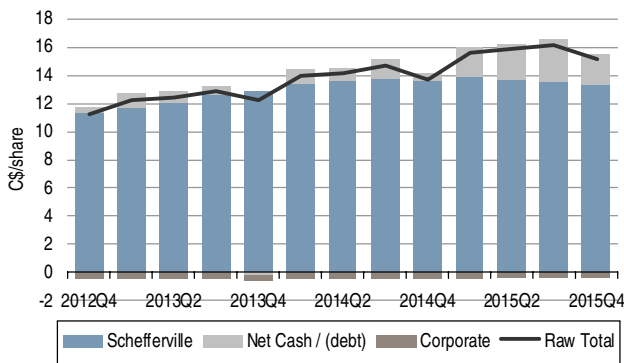
Notes:

- Shares on issue (mn)	54.1	- Current share price	5.72
- Target P / NAV	0.75 x	- Current P/NAV	0.51 x
- WACC (nominal)	10.0%	- Valuation upside	47%

Source: Company data, Credit Suisse estimates

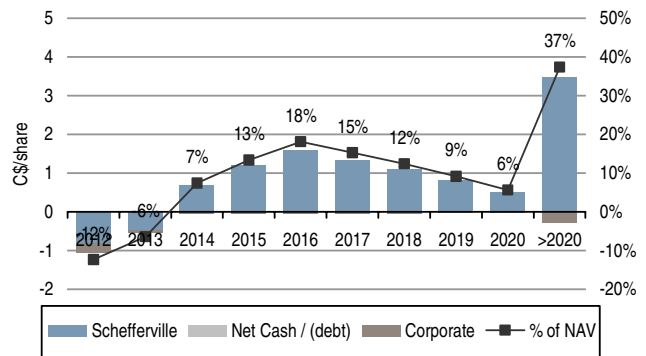
We continue to use a risk-weighted NPV as the basis of our target price, which following our DecQ11 update falls from \$8.75/sh to \$8.40/sh.

Exhibit 8: Rolling NPV model



Source: Company data, Credit Suisse estimates

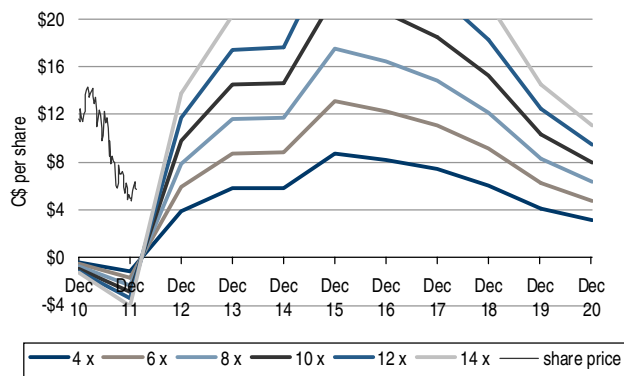
Exhibit 9: Annual contributions to today's NAV



Source: Company data, Credit Suisse estimates

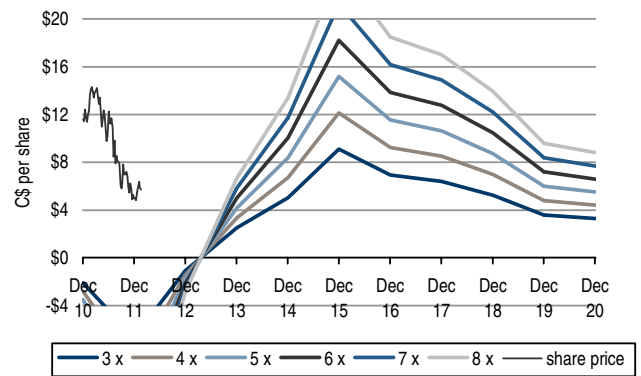
LIM's is a 'here and now' valuation story, with a low 37% in the DCF tail.

Exhibit 10: Price to Earnings bands



Source: Company data, Credit Suisse estimates

Exhibit 11: Price to Free Cash Flow bands



Source: Company data, Credit Suisse estimates

A very modest 6x PER supports a \$9 – 13/sh valuation range on a medium term view.

Companies Mentioned (Price as of 15 Feb 12)
 Labrador Iron Mines (LIM.TO, C\$5.72, OUTPERFORM [V], TP C\$8.40)

Disclosure Appendix

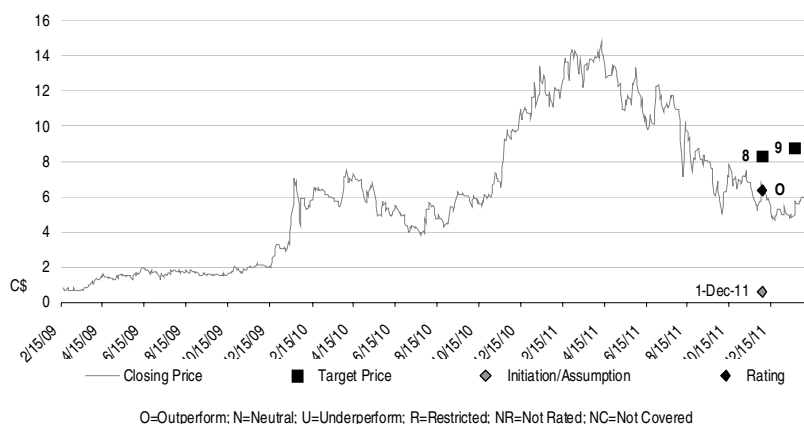
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3-Year Price, Target Price and Rating Change History Chart for LIM.TO

LIM.TO	Closing Price (C\$)	Target Price (C\$)	Rating	Initiation/Assumption
12/1/11	6.35	8.3	O	X
1/17/12	4.92	8.75		



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Method: Our C\$8.40 target price on LIM.TO is set using a DCF sum of parts with a 0.75x P/NAV multiple applied to the operational assets and balance sheet items added at par. A 10% discount rate, and Credit Suisse commodity price / FX forecasts have been used.

Risks: The risks associated with our C\$8.40 target price on LIM.TO realisation include, but may not be limited to: project execution and ramp up risk, infrastructure risk, and resource growth / conversion risk

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