



# Labrador Iron Mines Holdings Ltd.<sup>4</sup>

LIM-TSX: \$5.60

Target Price: **\$14.25**

Recommendation: **BUY**

## COMPANY BULLETIN

February 15, 2012

<b>Price</b>	\$5.60	Market cap. (\$mm)	\$ 302.8
<b>Shares O/S (mm)</b>	54.1	Net debt	(36.0)
<b>Avg. daily vol.</b>	336,649	Enterprise Value	\$ 266.8

	2010	2011	2012E	2013E
EPS (fully diluted)	0.03	(0.09)	(0.33)	1.22
CFPS	(0.07)	(0.08)	(0.26)	1.40
Book value / share	3.25	3.23	4.87	6.15

P/E	na	na	na	4.6
EV/EBITDA	na	na	na	2.3

Revenues	\$0.0	\$0.0	\$0.0	\$261.4
EBITDA	0.0	0.0	0.0	115.1
Net earnings	1.2	(4.0)	(17.6)	68.5

EBITDA margin	na	na	na	44.0%
Net margin	na	na	na	26.2%
Return on equity	1.0%	-2.8%	-6.8%	19.9%

Note: March 31<sup>st</sup> Fiscal Year-End; Currently in Fiscal Q4/12



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.

## Conference call highlights and revisions to estimates

Management hosted its fiscal Q3/12 conference call and we have incorporated their feedback and the Q3/12 results into our revised estimates.

### Impact

Neutral. Management provided new guidance for expected capital expenditures this year that was higher than we had been forecasting and we have made our revisions accordingly.

### Valuation

We believe LIM shares are attractively valued, trading at a 57% discount to our fiscal 2013E 10% DCF NAVPS of \$13.01 and at 4.6x, 4.0x, and 2.3x multiples to our fiscal 2013E EPS, CFPS, and EV/EBITDA estimates, respectively, compared to its peer group market-cap-weighted averages of 21.0x, 18.0x, and 8.9x, respectively.

Our \$14.25 target price is supported by 80/20 weightings of the average of our fiscal 2013 and 2014 10% DCF NAVPS of \$13.01 and \$16.00, respectively, and the 2012-2013 average of our comparable peer group market-cap-weighted multiples applied to our estimates for the Company. Exhibits 3-6 show our comparable universe of companies and our target price calculations.

### Recommendation

While the calendar 2012 capital budget is higher than expected, we believe that the Company remains attractively valued and is well-positioned to continue to grow its operations. As a result, we continue to rate Labrador Iron Mines a **BUY** with a \$14.25 target price.

### Conference call highlights

Management characterized 2011 as a year of learning that had identified a number of opportunities for improving operations. The first is to move towards using larger equipment in the mining operations to reduce unit costs.

This will become especially significant as the mining operations progress further away from the Silver Yards plant next year. Secondly, the completion of the Phase III expansion of the Silver Yards plant will allow for the production of an ultra-fine product and further improve recoveries. Thirdly, by erecting walls around the plant, Management hopes to extend the seasonal operating life and increase production. Fourthly, the Company has now purchased a total of 555 rail cars and expects to have three train sets running when shipments resume next April and a fourth train set operating by the end of next June. This should ensure that the iron products reach the port in a timely manner. Lastly, Management is expanding its team and most recently added a VP, Transportation to help with logistics as LIM transitions from development to operating company.

The near-term catalysts for the Company are the recently signed sales and marketing agreement with IOC that assures the logistics chain remains intact for the upcoming operating season, as well as receiving the permits and publishing a new resource estimate for the Houston deposit, both currently expected by the end of Q1/12. Lastly, the Company should declare commercial production in early fiscal Q1/13, which we have assumed in our forecasts.

The recent announcement by the Federal government of \$55 million in funding for a new multi-used terminal at Pointe Noire could resolve the Company's long-term shipping needs. In the interim, the Company will also maintain its access to the Port aux Basques terminal as well as evaluating its agreement with IOC for the next couple of years until the new multi-user port is finished, currently expected by the end of Q1/14.

With respect to the upcoming operating season, waste stripping is expected to resume in mid-March, with rail shipments to move inventory to the port beginning in April and the Silver Yards plant expected to resume in May. The development work on the Houston deposit should begin as soon as the necessary permits are received and the Company's exploration program will begin when weather conditions permit.

### **Fiscal Q3/12 results**

The Company reported a Q3/12 loss of \$1.7 million or \$0.03 per share compared to our forecast of a loss of \$4.2 million or \$0.08 per share and the Bloomberg consensus of a loss of \$0.02 per share. The major variance between our forecast and the reported results was start-up costs of \$0.5 million compared to our forecast of \$3.0 million. The Company has yet to declare commercial production so there were no revenues or cost of goods sold reported in the income statement.

Other significant variances include a \$0.3 million foreign exchange gain that we didn't forecast as well as higher-than-forecast stock-based compensation and professional fees. Exhibit 1 below shows the variances between the reported results and our forecasts and the previous and year-ago quarters.



Exhibit 1: Fiscal Q3/12 income statement variances

Income Statement Variances (CAD; FYE Mar 31)	Reported Fiscal Q3/12	Octagon Fiscal Q3/12	Reported Fiscal Q2/12	Reported Fiscal Q3/11	Reported vs. Octagon Fiscal Q3/12	Reported Fiscal Q3/12 vs. Q2/12	Reported Fiscal Q3/12 vs. Q3/11
Expenses:							
Administrative	531,528	600,000	479,331	421,648	-11.4%	10.9%	26.1%
Corporate Expenses	0	0	0	363,581	na	na	na
Management Costs	123,432	100,000	229,522	101,270	23.4%	-46.2%	21.9%
Professional Fees	140,729	50,000	133,058	50,330	181.5%	5.8%	179.6%
Director's Fees	23,500	25,000	30,000	47,750	-6.0%	-21.7%	-50.8%
Interest Accretion	52,836	55,000	59,696	0	-3.9%	-11.5%	na
Asset Retirement Accretion	11,100	20,000	16,521	0	-44.5%	-32.8%	na
Depreciation	379,741	375,000	384,463	45,060	1.3%	-1.2%	742.7%
Stock-based Compensation	368,010	150,000	231,911	330,083	145.3%	58.7%	11.5%
Foreign Exchange	(335,362)	0	0	0	na	na	na
Startup Expenses	503,443	3,000,000	5,646,390	0	-83.2%	-91.1%	na
Total Expenses	1,798,957	4,375,000	7,210,892	1,359,722	-58.9%	-75.1%	32.3%
EBIT	(1,798,957)	(4,375,000)	(7,210,892)	(1,359,722)	-58.9%	-75.1%	32.3%
Interest Earned	120,939	150,000	217,611	85,372	-19.4%	-44.4%	41.7%
Interest Expense	0	0	0	0	na	na	na
EBT	(1,678,018)	(4,225,000)	(6,993,281)	(1,274,350)	-60.3%	-76.0%	31.7%
Income Taxes Paid	0	0	0	0	na	na	na
Future Income Tax Recovery	0	0	0	(279,150)	na	na	na
Net Income (Loss)	(1,678,018)	(4,225,000)	(6,993,281)	(995,200)	-60.3%	-76.0%	68.6%
Per Share							
Basic	(0.03)	(0.08)	(0.13)	(0.02)	-60.3%	-76.0%	36.2%
Fully-Diluted	(0.03)	(0.08)	(0.13)	(0.02)	-60.3%	-76.0%	36.2%

Source: Octagon Capital Corp.

## Revisions to estimates

We have revised our estimates based on the conference call and discussions with Management. The most significant revisions were to increase our capital expenditure forecasts in line with the new guidance. Total capital expenditures are now expected to total approximately \$107 million, comprised of \$15 million to complete the Phase III Silver Yards plant expansion, \$20 million for additional plant and minesite upgrades, \$35 million for the Phase I development of the Houston deposit, \$25 million for transportation upgrades and \$12 million for exploration. We would note that the Houston expenditures are dependent on receiving the necessary permits early enough this year to complete the planned work and that a portion of the transportation expenses may be re-negotiated to lengthen the term. The Company ended fiscal Q3/12 with \$21.8 million in cash, and Management indicated that they are evaluating alternatives for establishing a working capital facility to support the re-start of operations next March. As well, the majority of the proposed capital budget should be expended this summer after iron ore shipments begin replenishing cash balances next Spring. In any event, we believe that Management will continue to develop and expand its operations from operating cash flows, albeit with potentially utilizing flow-through financing for a portion of its exploration expenses.

Our higher CapEx forecasts have resulted in modestly higher depreciation expense in future years, which has slightly lowered our earnings estimates. We have made no changes to our iron ore pricing, production or operating cost forecasts. The revisions to our estimates are shown in Exhibit 2.



*Exhibit 2: Revisions to estimates*

	Revised Feb 15/12	Previous Jan 16/12	Change
<b>EPS</b>			
Q1/12a	(0.09)	(0.09)	0.000
Q2/12e	(0.13)	(0.13)	0.000
Q3/12e	(0.03)	(0.08)	0.047
Q4/12e	(0.08)	(0.08)	0.000
2012e	(0.33)	(0.38)	0.048
2013e	1.22	1.24	(0.014)
<b>CFPS</b>			
2012e	(0.26)	(0.33)	0.068
2013e	1.40	1.40	(0.000)
<b>EBITDA</b>			
2012e	0	0	0
2013e	115,123,605	115,123,605	0
<b>10% NAV</b>			
2012e	10.75	11.45	(0.70)
2013e	13.01	14.19	(1.17)
<b>8% NAV</b>			
2012e	12.09	13.46	(1.37)
2013e	14.96	16.12	(1.16)
<b>Gross Revenue</b>			
2012e	0	0	0
2013e	261,423,605	261,423,605	0

Source: Octagon Capital Corp.

*Exhibit 3: Comparable universe*

Iron Ore Comparables		Feb 14/12 Closing Price (CAD)	Basic Shares O/S (MM)	Market Cap (CAD MM)	Net Debt (CAD MM)	EV (CAD MM)
<b>Company</b>	<b>Symbol</b>					
Atlas Iron Limited <sup>1</sup>	AGO	3.52	894.8	3,150.7	(407.3)	2,743.4
Bellzone Mining PLC <sup>2</sup>	BZM	0.46	741.3	339.9	237.2	577.1
Gindalbie Metals Limited <sup>1</sup>	GBG	0.74	1,247.5	918.4	(383.0)	535.5
Grange Resources <sup>1</sup>	GRR	0.62	1,154.4	714.4	(179.6)	534.8
Labrador Iron Ore Royalty	LIF.UN	37.80	64.0	2,419.2	(69.2)	2,350.0
MMX Mineracao e Metalicos SA <sup>3</sup>	MMXMY	4.93	619.8	3,057.6	244.3	3,301.9
Mount Gibson Iron Limited <sup>1</sup>	MGX	1.38	1,082.6	1,495.9	(353.2)	1,142.7
Northland Resources SA	NAU	1.31	226.5	296.8	(121.2)	175.6
<b>Labrador Iron Mines<sup>4</sup></b>	<b>LIM</b>	<b>5.60</b>	<b>54.1</b>	<b>302.8</b>	<b>(36.0)</b>	<b>266.8</b>
<b>Totals</b>				12,695.8	(1,068.1)	11,627.7
<sup>1</sup> Listed in Australia						
<sup>2</sup> Listed in London						
<sup>3</sup> Listed in the U.S.						
<sup>4</sup> LIM's 2012 and 2013 estimates are for fiscal 2013 and 2014, respectively.						
<sup>5</sup> "na" indicates less than 3 analysts' estimates						

Source: Bloomberg News, Octagon Capital Corp.



*Exhibit 4: Consensus estimates*

Iron Ore Comparables <sup>5</sup>	2012E	2012E	2012E	2013E	2013E	2013E
	EBITDA (CAD MM)	EPS (CAD)	CFPS (CAD)	EBITDA (CAD MM)	EPS (CAD)	CFPS (CAD)
<b>Company</b>						
Atlas Iron Limited <sup>1</sup>	324.6	0.24	0.32	532.5	0.38	0.52
Bellzone Mining PLC <sup>2</sup>	101.2	0.04	na	118.6	0.07	na
Gindalbie Metals Limited <sup>1</sup>	36.2	0.01	0.01	267.3	0.09	0.18
Grange Resources <sup>1</sup>	228.4	0.10	0.17	233.9	0.07	0.13
Labrador Iron Ore Royalty	235.6	3.73	2.11	282.8	4.61	3.27
MMX Mineracao e Metalicos SA <sup>3</sup>	242.7	0.16	0.30	544.8	0.37	0.59
Mount Gibson Iron Limited <sup>1</sup>	553.9	0.28	0.38	864.5	0.47	0.55
Northland Resources SA	(5.0)	(0.13)	(0.09)	82.0	0.04	0.15
<b>Labrador Iron Mines<sup>4</sup></b>	<b>115.1</b>	<b>1.22</b>	<b>1.40</b>	<b>173.2</b>	<b>1.76</b>	<b>2.18</b>

<sup>1</sup> Listed in Australia  
<sup>2</sup> Listed in London  
<sup>3</sup> Listed in the U.S.  
<sup>4</sup> LIM's 2012 and 2013 estimates are for fiscal 2013 and 2014, respectively.  
<sup>5</sup> "na" indicates less than 3 analysts' estimates

Source: Bloomberg News, Octagon Capital Corp.

*Exhibit 5: Forecast multiples*

Iron Ore Comparables <sup>5</sup>		2012E	2012E	2012E	2013E	2013E	2013E
		EV/EBITDA	P/E	P/CF	EV/EBITDA	P/E	P/CF
<b>Company</b>							
Atlas Iron Limited <sup>1</sup>	AGO	8.5	14.9	11.1	5.2	9.2	6.8
Bellzone Mining PLC <sup>2</sup>	BZM	5.7	12.4	na	4.9	6.6	na
Gindalbie Metals Limited <sup>1</sup>	GBG	14.8	92.0	92.0	2.0	8.4	4.1
Grange Resources <sup>1</sup>	GRR	2.3	6.3	3.7	2.3	8.7	4.6
Labrador Iron Ore Royalty	LIF.UN	10.0	10.1	18.0	8.3	8.2	11.6
MMX Mineracao e Metalicos SA <sup>3</sup>	MMXMY	13.6	30.3	16.4	6.1	13.2	8.3
Mount Gibson Iron Limited <sup>1</sup>	MGX	2.1	5.0	3.7	1.3	3.0	2.5
Northland Resources SA	NAU	na	na	na	2.1	34.5	8.9
<b>Labrador Iron Mines<sup>4</sup></b>	<b>LIM</b>	<b>2.3</b>	<b>4.6</b>	<b>4.0</b>	<b>1.5</b>	<b>3.2</b>	<b>2.6</b>
<b>Mkt Cap-Weighted Averages</b>		<b>8.9</b>	<b>21.0</b>	<b>18.0</b>	<b>5.0</b>	<b>9.5</b>	<b>7.2</b>

<sup>1</sup> Listed in Australia  
<sup>2</sup> Listed in London  
<sup>3</sup> Listed in the U.S.  
<sup>4</sup> LIM's 2012 and 2013 estimates are for fiscal 2013 and 2014, respectively.  
<sup>5</sup> "na" indicates less than 3 analysts' estimates

Source: Bloomberg News, Octagon Capital Corp.



*Exhibit 6: Target price calculations*

<b>LIM Target Price Implied By Cap-Weighted Average Multiples</b>					
		Ave. ex-LIM Multiples			
2012E EPS:	1.22	21.0	25.68		
2012E CFPS:	1.40	18.0	25.22		
2012E EV/EBITDA:	115.1	8.9	19.67		
			<b>23.52</b>		
2013E EPS:	1.76	9.5	16.84		
2013E CFPS:	2.18	7.2	15.67		
2013E EV/EBITDA:	173.2	5.0	16.58		
			<b>16.36</b>		
Target Price Weighting:	<b>20%</b>		<b>19.94</b>		
		2012E (Fiscal 2013E) 10% DCF NAVPS:	<b>13.01</b>	2013E (Fiscal 2014E) 10% DCF NAVPS:	<b>16.00</b>
Target Price Weighting:	<b>80%</b>	Share Price:	<b>5.60</b>	Share Price:	<b>5.60</b>
Implied Target Price:	<b>15.60</b>	Discount to NAVPS:	<b>57.0%</b>	Discount to NAVPS:	<b>65.0%</b>
Target Price:	<b>14.25</b>				
Implied Return:	<b>154%</b>				

Source: Bloomberg News, Octagon Capital Corp.





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