

Krucible Metals (KRB.ASX)

Initiation – Qld based Phosphate developer and explorer

Thursday 17 December 2009

Introduction. Krucible Metals (ASX:KRB) is an Australian, ASX-listed phosphate developer and base/precious metal explorer focused in Qld. **The company has a 5mt @ 30.8% P₂O₅ JORC resource within a larger 19.3mt @ 19.0% P₂O₅ resource** located adjacent to Incitec Pivot's (IPL) Phosphate Hill deposit and fertiliser processing plant in Queensland. The higher grader grade component of the deposit is potentially amenable to sales to a domestic or foreign market without the need for beneficiation. KRB's 100% owned tenements contain additional phosphate zones that are yet to be properly explored and translated into a resource.

KRB holds approximately **6,000 km² of exploration permits in Qld concentrated solely in the Mt Isa and Diamantina regions.** KRB has discovered copper and gold in the Simpson Desert at Toomba, with surface assays of 2.77% Cu and 1.6g/t Au. KRB has recently completed a first pass shallow drilling program at Toomba. Results are considered to be very positive with intersections including 27m @ 0.40% Cu (including 3m @ 2.4%).

Investment view. KRB's phosphate deposit is high grade and located next to key infrastructure. Much of KRB's exploration ground is in an established mineral province while the Diamantina prospects are in a little explored area where experienced geologists have long viewed the district as highly prospective for large mineral deposits. Given the phosphate project is at a Scoping Study stage and initial economic parameters appear positive, we view KRB as having a favourable risk reward profile give its current low market capitalisation.

Consolidation opportunities. Given KRB's phosphate deposit is on Incitec Pivot's (IPL) doorstep and its extensive exploration tenement surrounding IPL's Phosphate Hill operations, we do not rule out an opportunistic takeover or assets purchase by IPL.

Favourable outlook. In our view the phosphate price spike in 2008 has led phosphate users to seek alternative sources of supplies rather than rely too heavily on traditional suppliers such as Morocco. We believe the concentrated supply base and the imposition of a 135% export tariff on Chinese phosphate production in 2008 will bode well for phosphate prices in the medium term. We are also of the view that China's current high levels of growth are underpinning continued strength in commodity prices and this will continue for some time.

Valuation. While we view KRB's phosphate project as potentially generating significant cashflows, we are reluctant to derive an NPV based valuation of the project until further results from the Scoping Study are made available which we expect in the new year. However, initial indications are the project could have very favourable economics potentially generating annual EBITDA in the order of tens of millions of dollars. Combined with KRB's Queensland based regional Cu-Au exploration ground, we view KRB as offering an excellent risk-reward balance for investors.

Recommendation. We initiate coverage on KRB with a **Speculative BUY** recommendation and a **price target of \$0.80/share**. We view the key catalysts to be:

- the Scoping Study for the Corella Bore Phosphate project; &
- further exploration success at the Diamantina Toomba and Isa Pilgrim projects.

Resources

Rating: **Speculative BUY**
(previous): na

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Share price: **\$0.37**

Price target: \$0.80
(Previous) na
NPV per share: na
Risk: High

Shares on issue (m): 61.4
Shares on issue (diluted) (m): 65.3
Free float: 100%
Average daily volume: 25,053

Market cap (\$m): 22.7
FY10 Enterprise value (\$m): 19.7
FY10 Net debt (\$m): -3.0
FY10 Gearing (ND/ND+E): nm
FY09 S'holders equity (\$m): 6.3
FY09 NTA per share (\$): 0.12

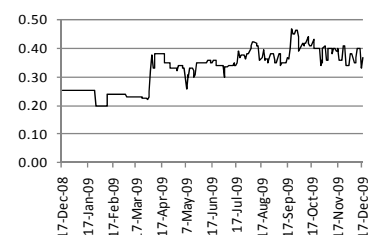
Forecast: 2010

Free cash flow (\$m): -3.0
Return on average equity: nm
Net interest cover: nm

Forecast: 2011

Free cash flow (\$m): nm
Return on average equity: nm
Net interest cover: nm

Share price (\$):



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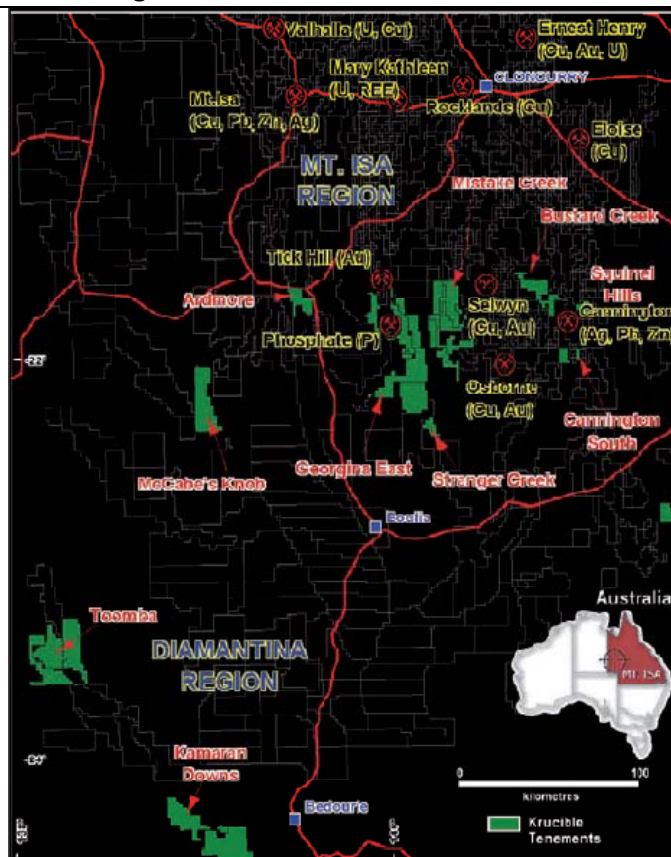
BACKGROUND AND INTRODUCTION

Krucible Metals (ASX:KRB) is an Australian, ASX-listed, phosphate developer and base/precious metal explorer focused in Qld. **The company has a 5mt @ 30.8% P₂O₅ JORC resource within a larger 19.3mt @ 19.0% P₂O₅ resource** located adjacent to Incitec Pivot's (IPL) Phosphate Hill deposit and fertiliser processing plant in Queensland. The higher grade and high purity component of the deposit is potentially amenable to sales to a domestic or foreign market without the need for beneficiation, while the lower grade material may be amenable to sales to the nearby Phosphate Hill plant without further beneficiation. KRB's 100% owned tenements contain additional phosphate zones that are yet to be properly explored and translated into a resource.

KRB holds approximately **6,000 km² of exploration permits in Queensland concentrated solely in the Mt Isa and Diamantina regions**. KRB has discovered copper and gold at Toomba, 350km south-south-west of Mt Isa in western Queensland, with surface assays of 2.77% Cu and 1.6g/t Au. The company recently completed a first pass drilling programme at Toomba, and results are considered to be very positive with intersections including 27m @ 0.40% Cu (including 3m @ 2.4%).

KRB had \$2.66m cash as at the end of September 2009. The company raised \$2.72m (before costs) in October 2009. Assuming an expenditure rate of \$750k/quarter we estimate KRB will have ~\$3m at 30 June 2010.

KRB's tenement holdings in Queensland



Source: Company

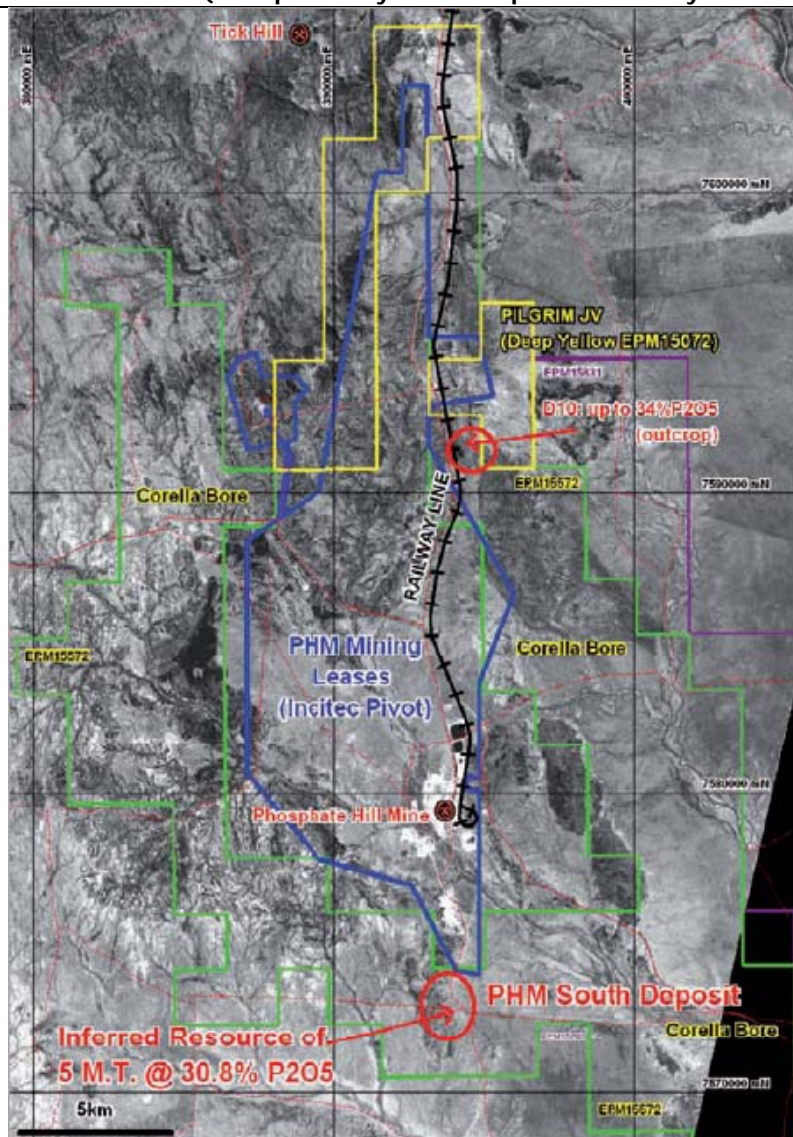
BUSINESS STRATEGY

KRB's strategy is to progress the Corella Bore Phosphate resource to production and continue the focused exploration on its Queensland base and precious metal tenements.

STRATEGICALLY LOCATED PHOSPHATE ASSETS

KRB is currently carrying out a Scoping Study on its 100% owned Corella Bore prospect to ascertain a range of economic parameters for mining and aims to produce ~ 3.6mt at around 32% P₂O₅ over a 6-7 year period. The Phosphate Hill Mine (PHM, 100% owned by IPL), located adjacent to KRB's deposit is Australia's only integrated mine and phosphate fertiliser operation. We understand PHM uses 2mt of phosphate rock per annum of around 23-24% P₂O₅ as the feedstock for the plant. While KRB could potentially sell some of its product to the PHM operation at some stage, its strategy is to export the phosphate through the port of Townsville. **The current resource occupies a very small proportion of the Corella Bore Exploration Licence** and KRB have already identified other prospects including the D10 prospect where trenching results were 15m @ 22.13% P₂O₅ and 4m @ 25.28% P₂O₅.

KRB's Corella Bore EPM (note proximity to IPL's operations & key infrastructure)



Source: Company

While details of the Scoping Study are yet to be released, the key benefits of the project we see are:

- Location next to key infrastructure including railway lines, power, road and operating mines;

- Potential low capital costs due to high grade nature of the deposit requiring little, if any beneficiation; &
- Reasonable operating costs dictated largely by mining.

The company has released some indicative financial figures indicating a break even cost of A\$130/t for the 600ktpa mining rate utilising contract mining and hauling. **KRB's estimated NPV for the project is \$56m using a 20% WACC and assuming a A\$200/t phosphate rock price.**

In our view, the company is being conservative on operating costs. However, the real key to extracting value from the project will be the ultimate sales price of phosphate rock. Given Australia is a net importer of rock phosphate we believe there are significant opportunities to exploit the domestic as well as the international market. Based on KRB's scoping study production rate of 600ktpa and assuming a \$50/t margin, we note **potential EBITDA from the project could be in the order of \$30m per annum or ~1.5x KRB's current market capitalisation.**

CU/AU EXPLORATION ASSETS IN QUEENSLAND

KRB's metal exploration is focused in two regions – Mt Isa and Diamantina.

KRB also has a number of Exploration Licences in the Mt Isa region considered highly prospective for base metal deposits. The EL's are in a region that hosts significant economic deposits including the Cannington Ag-Pb-Zn deposit, the Selwyn and Osborne Cu-Au deposits and the Tick Hill Au deposit (shown in Page 2 of this report).

A number of surface mapping and geochemical sampling programs as well as ground magnetic programs are being carried out on these leases to better define drill targets in 2010. Mt Isa style base metal mineralisation and Trekelano style mineralisation is being targeted at a number of these leases.

KRB's copper and gold Exploration interests in Diamantina (320km SSW of Mt. Isa) have also returned encouraging results with rock chip outcrop assays of 1.6g/t gold and 2.77% copper. The region is considerably underexplored and the mineralisation discovered to date is considered by the company to be an ideal location for IOCG mineralisation similar to Olympic Dam or Tennant Creek. Significant geochemical and geophysical exploration work has already been performed on a number of the Diamantina prospects with follow up drilling returning encouraging results including 27m @ 0.4% Cu from 9m (including 3m @ 2.4% Cu) at the Champ prospect.

More recently, KRB announced **rock chip samples from its Pilgrim Prospect containing up to 30.7% Cu, 0.28% Mo and 10.25g/t Au** in an area where there are no known previous workings. This prospect is located 5km south-east of the historic Tick Hill high grade gold mine and is close to a bitumen road along which copper/gold ore is currently being trucked to Barrick's Osborne Plant.

VALUATION AND RECOMMENDATION

Valuation. While we view KRB's phosphate project as potentially generating significant cashflows, we are reluctant to derive an NPV based valuation of the project until further results from the Scoping Study are made available which we expect in the new year. However, initial indications indicate the project could have very favourable economics potentially generating annual EBITDA in the order of tens of millions of dollars. Combined with KRB's Queensland based regional Cu-Au exploration ground, we view KRB as offering an excellent risk-reward balance for investors.

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PHOSPHATE MARKET

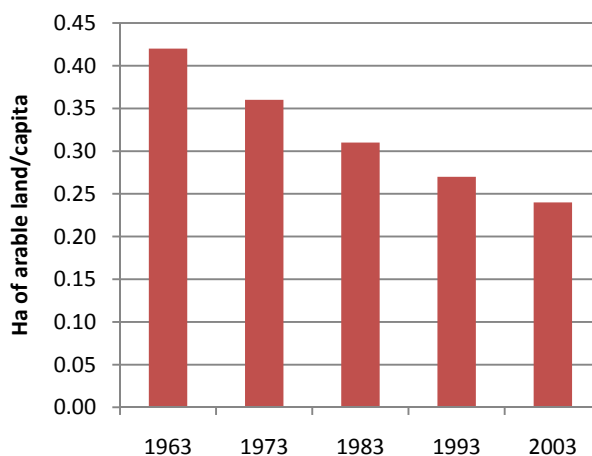
More than 90% of phosphate mined in the world is used in fertiliser production. It can be applied to soils as basic rock phosphate or combined with ammonia to produce common fertilisers such as mono ammonium phosphate (MAP) or diammonium phosphate (DAP).

Phosphate rock production was ~190mt in 2008 and is expected to increase to 248mt by 2030 assuming a number of larger planned projects come on stream. The percentage of P₂O₅ in the rock phosphate varies, with the lower grade rock phosphate usually further processed to MAP or DAP prior to exporting, where as phosphate rock greater than 30% P₂O₅ is usually considered viable for export. Phosphate is traded internationally with Morocco mining ~28mt in 2008 and exporting approximately half of that mined with a large proportion of the balance used for fertiliser production prior to exporting. China produced 35mt of phosphate rock in 2008 most of which was consumed internally in fertiliser production.

Phosphate's demand drivers are basically a growing world population and associated increases in demand for grains. With the world's arable land per capita decreasing, there is continued pressure on increasing the yield per unit of land. Fertilisers play a key role in achieving these goals. Phosphate rock production is currently dominated by Morocco and China, which have produced approximately two-thirds of global phosphate rock production in recent years. While China has been a small exporter of rock phosphate and phosphate based fertilisers historically, a 135% export tariff on rock phosphate imposed in 2008 and other tariffs on most fertilisers have virtually halted all exports from China for the foreseeable future.

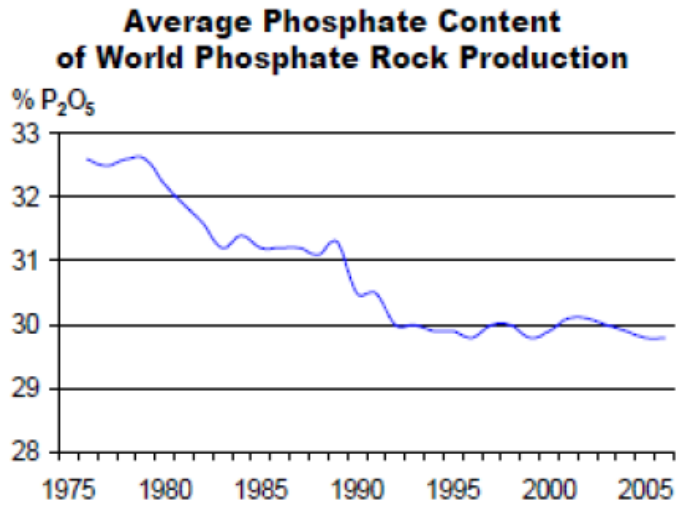
In general, the phosphate rock market is relatively opaque and regionalised. Current rock phosphate prices FOB Morocco are ~US\$90/t, significantly off their recent highs in 2007 when spot prices exceeded US\$400/t. Landed prices in Asia are expected to be ~US\$40/t higher due to the significant freight costs. Further, there are differences in prices due to the P₂O₅ content and the varying levels of impurities. KRB's phosphate is considered low in key impurities such as cadmium, with levels less than 3ppm versus Moroccan phosphate with cadmium levels generally above 100ppm. Ultimately the price received for KRB's phosphate will be key in driving the company's value and, despite the variations in regional prices, **we view the fundamentals for global fertiliser demand are supportive of higher long term phosphate prices.** Further, given Australia is a net importer of both rock phosphates and fertilisers, combined with its proximity to Asia, there is potential for KRB to achieve sales prices significantly above Moroccan FOB prices over the longer term.

Arable land per person



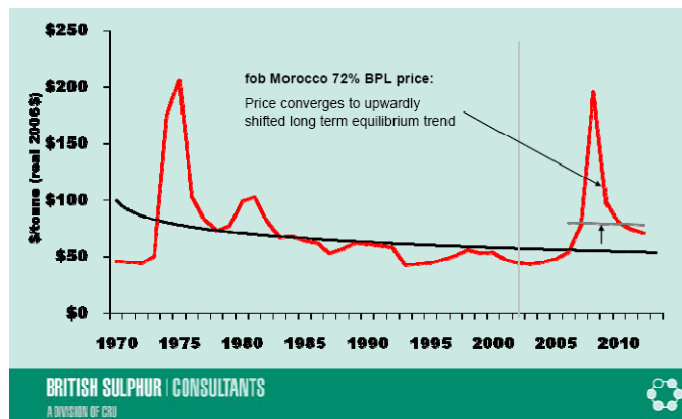
Source: FAO, UN

Phosphate content of phosphate rock production



Source: Legend International

Long term rock phosphate price – FOB Morocco – actual and CRU forecasts



Source: CRU

KEY RISKS

- **Phosphate price downturn.** We believe the likelihood of a significant short or medium term fall in phosphate prices is low, given the increasing cost base of the industry and the growing requirement for fertilisers worldwide. We view the price spike of 2008 as having the effect of phosphate customers want to divest their purchasing base and believe this bodes well for providing price support for new suppliers into the market. **We view this risk as low.**
- **Commodity price downturn.** Our current view is that copper and gold ore prices will remain firm in 2010 as China's current high levels of growth continue in the medium term. **We view this risk as medium.**
- **Inherent project risk.** Exploration, by its nature is a high risk-high reward proposition. There is no guarantee that KRB's projects will result in a mining operation being developed. Further, mining projects have inherent technical risks associated with construction, commissioning and operating projects. Given the very early stage of KRB's projects there is still significant risk to the cost and timing of the KRB's projects. With regard to the Phosphate project, KRB is applying proven mining and processing techniques in its Scoping Study and, at this stage, does not intend to apply new technologies that are more prone to higher execution and scalability problems. **We view these risks as high.**
- **Market and funding risks.** Many of KRB's projects are yet to be proven and will require significant development if proven to be viable. Mining projects generally require high levels of capital expenditure and there is no guarantee the required funding will be forthcoming. However, we believe markets will be more stable going into 2010 than in the previous 12 months and there will be increased support for resource projects as long as markets remain buoyant. **We view these risks as medium.**

BOARD

Marcus Harris – Non-Executive Chairman. BSc (Hon), FAIG, FSEG, FAusIMM

Marcus Harris is a geologist with 40 years of Australian and international experience specialising in mineral commodities including gold, nickel, base metals and uranium. He was the founding Director and CEO of Dalrymple Resources from 1987 and remained with the company until it merged with LionOre in 2003. Marcus is a fellow of the Australian Institute of Geoscientists and takes a keen interest in supporting geoscientists especially in mentoring undergraduate students. He is also a fellow of the Society of Economic Geologists and of the Australian Institute of Mining and Metallurgy.

Anthony (Tony) Alston – Managing Director. BSc., MAusIMM, MAIG,

Tony Alston has over 30 years experience in the resources industry since gaining a Diploma of Applied Geology from the Ballarat School of Mines in 1972. He is a member of the Australian Institute of Mining and Metallurgy and a member of the Australian Institute of Geologists.

He worked at Senior Geologist level in both Queensland and Western Australia for Penzoid Inc. and Battle Mountain Inc from 1981 to 1987. He held the position of Exploration Manager in Queensland for MetaNa Minerals NL (1987 to 1992), Dominion Mining Ltd (1992 to 1995) and Matrix Metals Ltd (2004 to 2006). He was Executive Director-Exploration for Glengarry Resources Ltd (both Queensland and Western Australia) from 2004 to 2006. During his career to date, Tony has been involved in a number of significant mineral discoveries.

Dennis Lovell – Non-Executive Director and Company Secretary, CA

Dennis Lovell is a member of the Australian Institute of Chartered Accountants with more than 40 years experience in corporate financial and general management in a range of industries in Australia and overseas.

Dennis moved to Perth from South Africa in 1983 with his wife and two children and took up Australian citizenship two years later. He established and operated an accounting practice in Perth, Western Australia from 1983 to 1997, where clients included a number of ASX listed companies in the mining and mineral exploration industry, earthmoving contractors, solicitors and superannuation funds. He has acted as Company Secretary and Financial Director for a number of publicly listed companies and was involved in a number of ASX listing and capital raising projects. Dennis moved to Brisbane in 1998 and has consulted to clients in the coal mining, mineral exploration, steel processing and glass manufacturing industries (including operations in Papua New Guinea) over the past nine years.

Ray Koenig – Non-Executive Director, AusIMM Chartered Professional, FAusIMM

Ray has 40 years experience in the mining industry both in managerial roles in operations and in the engineering and construction business. These roles have included the development of a number of major projects from greenfield to on-going operations in base metals, gold, industrial minerals, coal and iron ore.

Ray recently retired from the position of Global Manager for Mining and Resources for GHD and in the last 5 years has built up the mining capabilities to enable a sustaining business in this area. The mining work at GHD now amounts to \$100 million in revenue a year.

Prior to joining GHD, Ray was the General Manager for Australian Magnesium Corporation at Gladstone in Central Queensland and was engineering manager for QMAG from feasibility to production of refractory magnesia, the only one of its type operating in Australia. During the 1980's Ray was the Chief Metallurgist for Fluor Australia and projects on which he worked included feasibility studies and design and developments for Olympic Dam, Selwyn Copper, Hilton lead zinc concentrator and developments at Robe River and Channar iron ore.

TOP TWENTY SHAREHOLDERS

Top 20 shareholders as at 30 September 2009

Name	Number of shares held	%
A J Alston	5,603,600	10.50%
Southern Reaches Pty Ltd	4,650,000	8.71%
L E Pretorius	3,400,000	6.37%
Cryptodome Pty Ltd	2,280,000	4.27%
R J & T J Poli <Ramon Poli A/C>	2,197,000	4.12%
Waramboo Holdings Pty Ltd	2,050,000	3.84%
Wythenshawe Pty Ltd	2,050,000	3.84%
Leanda Drilling (QLD) Pty Ltd	1,750,000	3.28%
Sewad Investments Pty Ltd	1,176,500	2.20%
Terra Search Pty Ltd	1,050,000	1.97%
L B & B Tegg <Tegg Family Super Fund A/C>	977,100	1.83%
K Marriot and C Marriot	647,450	1.21%
I & M & K Burston <Burston Super Fund A/C>	591,400	1.11%
Nalmor Pty Ltd	510,000	0.96%
D Cannam <Cannam Super Fund>	500,000	0.94%
Florin Mining Investment Co Ltd	500,000	0.94%
ASR Investments Pty Ltd <Rowe Family Disc A/C>	341,650	0.64%
FWMI Pty Ltd	338,850	0.64%
J A & K L Treacy <Treacy Family Super Fund>	335,000	0.63%
Dawes Management Pty Ltd	318,915	0.60%
Total Top 20	31,267,465	
Total Ordinary Shares on issue	53,359,100	

Source: Company 2009 Annual Report

Note: A capital raising post 30 September 2009 raised \$2.7m (gross) and increased the total shares on issue to 61,359,100.

FOSTER STOCKBROKING CONTACTS

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