

Date of issue

22.06.06

# Initiating Coverage

## INVESTMENT DATA

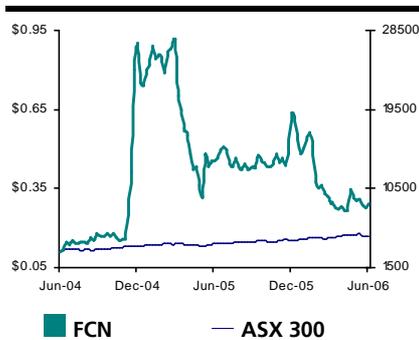
Share Price	\$0.255
Issued Capital	
Ordinary Shares	142.5m
Options	0.0m
Fully Diluted	142.5m
Market Capitalisation	\$36.3m
52 Week Low/High	\$0.225 / \$0.66
Liquidity (shares traded pa)	463m
Cash (no debt) (31 Dec 05)	\$5.0m
Major Shareholders	
Jubilee Mines Ltd	16.2%
Nic Paspaley	3.4%

Top 20 shareholders own 33% of Company

## PRELIMINARY ASSESSED VALUE

	\$M
Olympia Deposit 30% (DR 12%)	24.9
Collurabbie Exploration	12.5
Duketon JV (Newmont 64%)	10.0
Other Exploration - nominal	10.0
Corporate Overheads	-1.4
Debt	0.0
Cash (Dec 05)	5.0
<b>TOTAL</b>	<b>61.0</b>
Preliminary Assessed Value per share	\$0.43

Chart: FCN vs. ASX 300



## Falcon Minerals (FCN)

**Buy 2**

### Collurabbie a good base for further discovery

#### Attractive nickel-copper-PGMs discovery at Collurabbie

Falcon has a minority (30%) interest in the exciting Collurabbie joint venture base metals project in WA (with the other 70% held by BHP Billiton Ltd), at which attractive nickel-copper-platinum group mineralisation has been discovered. At this early stage, the Olympia deposit is the most promising discovery at Collurabbie with economic grades and relatively shallow mineralisation delineated over a significant strike and dip extent.

#### Emphasis of BHP work to date on scoping size of the deposits

We understand the emphasis of the BHP managed exploration to date has been on rapid 'broad brush' drilling to scope the size of the overall mineralisation to establish if the deposits have sufficient size to be a priority for further evaluation (with a low priority on infill drilling). In this regard the most recent deeper 'step out' drilling at the Olympia deposit has had mixed success intersecting sub-economic mineralisation. Nonetheless, in our view, the results to date suggest a significant near surface base metals deposit has been discovered at Olympia, and should underpin value in the Falcon share price.

#### High risks but with an acceptable risk-return profile

The Collurabbie project is still in the exploration stage and there are substantial risks involved, foremost being the delineation of a sufficient resource to justify development, favorable metallurgy to allow extraction of contained metals, uncertainty in relation to economic viability of project development and project funding. In addition there is significant uncertainty in relation to BHP's level of commitment to the project going forward, particularly following the mixed results of the most recent program of drilling. However, in our view the Collurabbie JV has first rate exploration potential and strategic value to both JV partner BHP Billiton and Falcon's major shareholder Jubilee Mines NL (which holds 16.2% of Falcon). In the event that an economic deposit is successfully delineated at the Collurabbie JV it would have substantial value to both BHP & Jubilee in view of the established infrastructure of their operations, approximately 180km to the west of the Collurabbie JV project.

#### Initiating coverage with a Buy 2 recommendation and valuation of \$0.43

Following a review of the Company's market releases and discussion with management we have a preliminary assessed value of \$0.43, which is based on a potential stand alone operation at Collurabbie and modeling of the Olympia deposit at the Collurabbie JV project. We emphasize this is a preliminary estimate based on limited drilling results. In the event that a favourable off-take and toll treatment agreement is negotiated with BHP or Jubilee, to treat ore at the Mt Keith or Cosmos operation, we estimate there may be a significant increase in underlying value. On balance, after weighing up the quality of the results to date and exploration potential, we regard the risk-return profile as sufficiently attractive to justify a Buy 2 recommendation. Furthermore, we would expect the share price to trade at a premium to assessed value in view of both the potential for further discovery and the strategic value of the Collurabbie JV project to BHP and Jubilee. We note however, that the stock may be appropriate for higher risk orientated investors only given its speculative nature.

**Stephen Thomas**

■stthomas@bellpotter.com.au

## Directors

Kerry Harmanis, Chairman

Richard Diermajer, Managing Director

Raymond Muskett, Non-Exec Director

Gary Lethridge, Non-Exec Director

## Company & Projects Background

### History of the Collurabbie Joint Venture Project

- Falcon has been actively exploring a portfolio of advanced projects in WA, South Australia and Queensland since the late 1990's. The lead project is the Collurabbie joint venture project, in WA.
- The Collurabbie joint venture (JV) project is located approximately 180km east of BHP Billiton Ltd's and Jubilee Mines NL's established Mount Keith & Cosmos nickel operations (located approximately 800km north east of Perth, in WA) (Figure 1).
- In 2001 WMC Resources Ltd (now owned by BHP Billiton Ltd) entered into a joint venture with Falcon at the Collurabbie project. Under the terms of the JV WMC agreed to fund \$0.4M of exploration to earn a 70% joint venture interest and become the JV project manager. In total approximately \$4.5M has now been spent at the Collurabbie project, with each JV partner now funding exploration and agreed budgets on a pro-rata basis.
- In 2003 WMC announced the discovery of an extensive zone of nickel, copper and platinum group metals (PGMs) sulphide mineralisation on its 100% owned tenements to the north west and adjacent to the tenements of the Collurabbie JV (Figure 2). PGMs principally comprise platinum, palladium and rhodium.
- In 2004 air core drilling on the Collurabbie JV tenements, along trend of the results on WMC's tenements, identified several zones of strongly anomalous Ni, Cu and PGMs mineralisation. Follow up drilling successfully intersecting massive sulphide mineralisation including 5.77m grading 3.0% Ni, 1.96% Cu & 5.3g/t PGMs and 8m grading 1.23% Ni, 1.62% Cu & 3.8 g/t PGMs. This zone of mineralisation has been named the Olympia zone, and has been the focus of exploration at the JV.

### The Jubilee Mines strategic investment in Falcon

- In early 2005 Jubilee acquired a strategic interest in Falcon by acquiring 20 million shares held by Falcon Directors and associates, giving Jubilee a 14.0% shareholding to become the largest shareholder in Falcon. Jubilee's Executive Chairman Kerry Harmanis and CFO Gary Lethridge joined the board of Falcon alongside MD Richard Diermajer and Technical Director Ray Muskett.
- The consideration to acquire the shares was 50c cash and 0.1389 Jubilee shares for every Falcon share, which equated to \$1.15 per Falcon share at that time. In mid 2005 through the underwriting of options expiring at that time Jubilee has increased its shareholding in Falcon to 23.0 million shares representing 16.2% of Falcon shares on issue (post exercise of options).
- We regard the involvement of Jubilee as a positive development in view of Jubilee's Ni exploration and mining expertise, as well as financial strength that may assist Falcon to progress it's interest in the Collurabbie JV.

## The Collurabbie Joint Venture Project

### Recent drill results and significance

- Drill results from the Olympia deposit at the Collurabbie JV project are tabulated below and their locations are illustrated in Figure 3. The results comprise the better results of the twenty two shallower holes drilled at the Olympia (numbered between CLD 120 & 176) and the two most recent deeper 'step out' drill holes at Olympia (CLD 178 & 179 and illustrated as two blue dots in Figure 3). Based on this drilling information we interpret the mineralisation as sitting on a conventional ultramafic-basalt contact, with a tabular, sub-vertical geometry, with economic sulphide mineralisation delineated over a substantial 400 metre strike length.

Hole ID	Thickness	From	Ni%	Cu%	Total PGM g/t
CLD122	0.08	200.18	2.93	2.66	2.24
CLD125	8.00	64.00	1.23	1.62	3.82
CLD127	4.00	82.00	1.00	0.55	0.97
CLD136	1.10	184.9	3.67	3.12	7.78
CLD136	1.90	176.00	3.64	2.77	6.95
CLD137	2.00	36.00	2.85	1.77	2.52
CLD139	12.86	131.65	1.33	0.95	2.69
CLD159	5.77	279.43	3.00	1.96	5.29
CLD178	3.80	459.60	0.45	0.18	0.41
CLD178	3.00	545.00	0.61	0.29	0.64
CLD179	5.00	527.00	0.71	0.41	0.81

- On a preliminary basis we estimate the Olympia deposit contains around 1Mt of relatively shallow sulphide mineralisation grading 1.87% Ni, 1.49% Cu and 4.51 g/t PGMs. We need to emphasize these estimates of tonnes and grade are a preliminary 'manual polygonal' type estimate based on the limited drilling carried out to date (tabulated above) and will require extensive infill drilling to confirm the continuity, size and grade of mineralisation, which may well be substantially different to our own estimates.
- The standout features of the mineralisation at Collurabbie, relative to other 'typical' Western Australian Ni sulphide mineralisation, is the anomalously high Cu & PGMs content, and the discovery suggests a new province of combined base metal and significant PGMs mineralisation has been discovered. In our view, this provides significant strategic value to established Ni producers in the region such as BHP Billiton and Jubilee Mines.
- The most recent JV drilling comprised the two deeper 'steep out' holes at Olympia and have had mixed results (CLD 178 & 179). These deeper holes suggest there is not a down dip continuation of the shallower economic mineralisation delineated. Although the deeper intersections did not have economic grades we are encouraged by the significant grades of base metal mineralisation suggesting the contact is still 'live' at a substantial distance from known mineralisation. Furthermore, down hole geophysical surveys (DHEM) have detected a number of conductors in proximity to the holes. These conductors or 'anomalies' may represent sulphide mineralisation and warrant further testing.

## **The Collurabbie Joint Venture Project**

### **Collurabbie regional exploration**

- Detailed magnetic and geochemistry surveys have identified a significant number of targets within, and along strike, of the Collurabbie JV (Figure 2). Preliminary drilling at the Rhodes prospect, 4km to the south of Olympia, has had more limited success with the best intersection of 4m grading 1.34% Ni, 0.24% Cu & 0.58g/t PGM. A number of promising electromagnetic anomalies are being drill tested at the Rhodes prospect. The most recent drilling of these anomalies has returned 0.3m grading 0.96% Ni, 0.33% Cu & 1.2g/t PGMs in CLD 182.
- The favorable terrain that hosts the Collurabbie mineralisation continues into the ground immediately to the south of the Collurabbie JV. This ground is held in JV between Newmont Mining (64%), Falcon (20%) and Regis Resources NL (16%). Falcon has a free carried interest and this ground holding is also of significant strategic value as we understand pre-emptives are in place for the JV partners.
- Following the completion of the deeper drilling and assessment of results at Olympia, and testing of electromagnetic targets at the Rhodes and Paros prospects at Collurabbie, further work is being assessed by the JV partners. No further proposals for work have been put forward by the JV partners at this stage.

### **Other Falcon Exploration Projects**

- Falcon has a number of promising copper-gold and gold prospects in Queensland (the Racehorse/Mount McDonald prospects, which comprise a prominent gravity anomaly) and in South Australia (the Palthrubie prospect).

## **Valuation**

### **Our View on Underlying Value**

- We have a preliminary assessed value of \$0.43, which includes a discounted cash flow valuation of a standalone project at Collurabbie (using a 12% discount rate). It is based on a small open pit and underground mining operation based on the Olympia deposit (which we estimate contains 18,500t Ni, 15,000t Cu, 145,000oz of PGMs & 8,000oz Au) with a treatment plant constructed at site at a total capital cost of approximately \$55M. In view of the high Cu & PGMs content we factor in reasonable by-product payment terms.
- In our assessed value we assume Ni, Cu and platinum prices peak at US\$7.50/lb, US\$2.72/lb and US\$1,200/oz respectively during FY07 and then trend down to long term prices at US\$4.50/lb, US\$1.30/lb and US\$800/oz respectively by FY011.

### **Unique copper and PGMs content represents significant value uplift**

- In normal circumstances when smelters treat a conventional Ni sulphide concentrate the smelter generally pays standard terms for the contained Ni metal and only a nominal amount of contained Cu and frequently none of the contained PGMs. In view of the high Cu & PGMs contents we assume a separate Cu concentrate is produced, where smelters will pay for most of the contained Cu metal, and pay for a significant proportion of the PGMs contained in the Ni concentrate.

## Valuation

### Level of future BHP involvement represents upside

- In our view, a major lift in project economics would result if BHP looks to take a more active role in project development, as this may allow toll treatment of Collurabbie ore at BHP's established Mount Keith operation, 180km to the east. It may also allow the Collurabbie JV to benefit from BHP's (Nickel West) infrastructure, including the Ni smelter at Kalgoorlie 400km to the south. In this event there would be a significant saving and trade off in savings on site capital expenditure at the expense of increased operating costs of trucking ore directly to the BHP Mt Keith operation.
- We believe BHP has significant size requirements for this type of deposits with the emphasis of drilling the scoping of the size of overall mineralisation (with a low priority on infill drilling). However, in our view and subject to successful infill drilling confirming continuity of the near surface mineralisation delineated at Olympia to date, there may well be sufficient mineralisation delineated to support an operation.

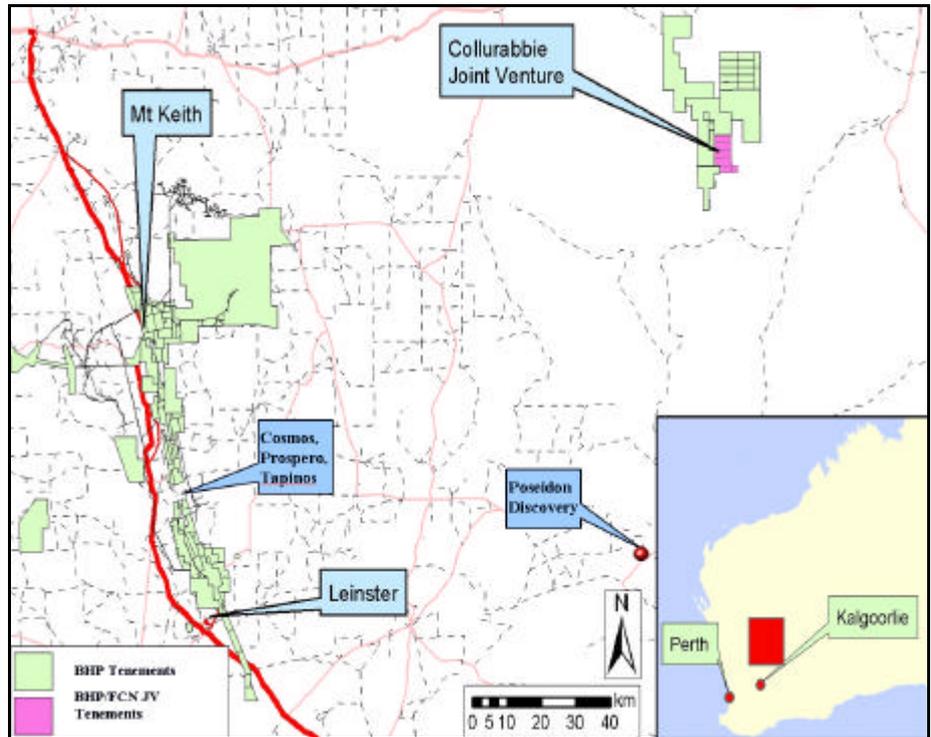
## Risks

- In view of the exploration stage of the Collurabbie JV there are significant new project risks involved and include resource, metallurgy, viability and funding risks. The present uncertainty in relation to the future commitment of BHP Billiton is also a key factor.
- Falcon's project spending 'burn rate' of \$1-1.5M per annum is adequately funded by cash reserves at \$5m at 31 December 2005.

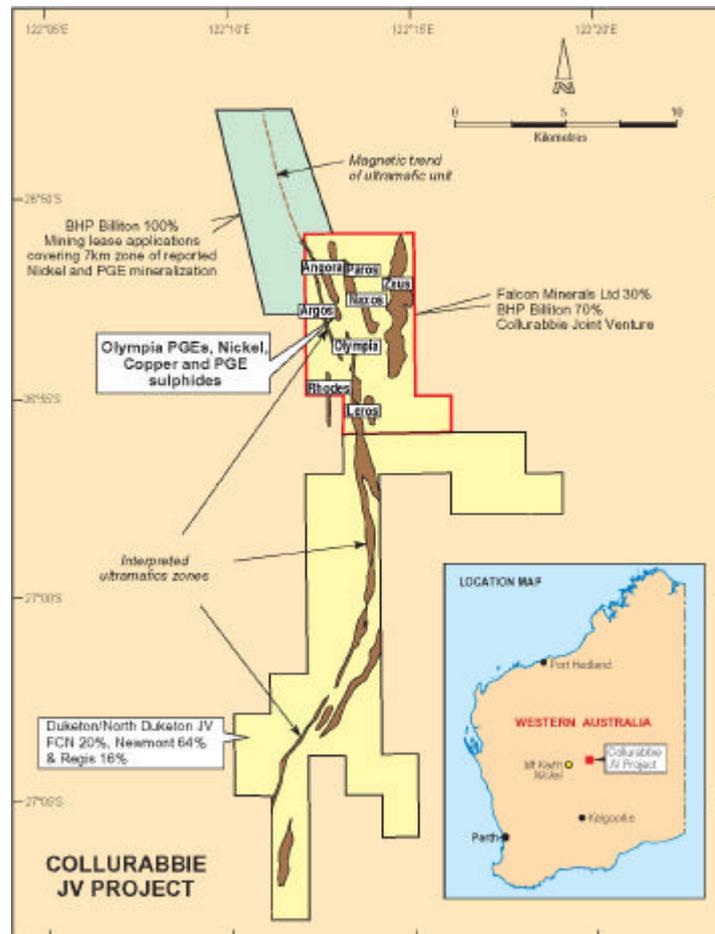
## Conclusions & Recommendation

- We regard the Collurabbie JV as an exciting new base metals discovery, with significant exploration upside and the added attraction of significant PGMs value. In our view, the mixed results of the most recent deeper drilling at the Olympia deposit and uncertainty in relation to BHP Billiton's future commitment to the project, in light of these drill results, has affected share price performance in the near term.
- At present price levels we have a Buy 2 recommendation on Falcon, with value underpinned by our preliminary assessment of the Olympia deposit at the Collurabbie project, WA. We would expect the share price to trade at a premium to our assessed value at \$0.43 in view of the discovery potential and the strategic value of the Collurabbie JV project to established producers in the area such as BHP and Jubilee. We note however, that the stock may be appropriate for higher risk orientated investors only given its speculative nature.

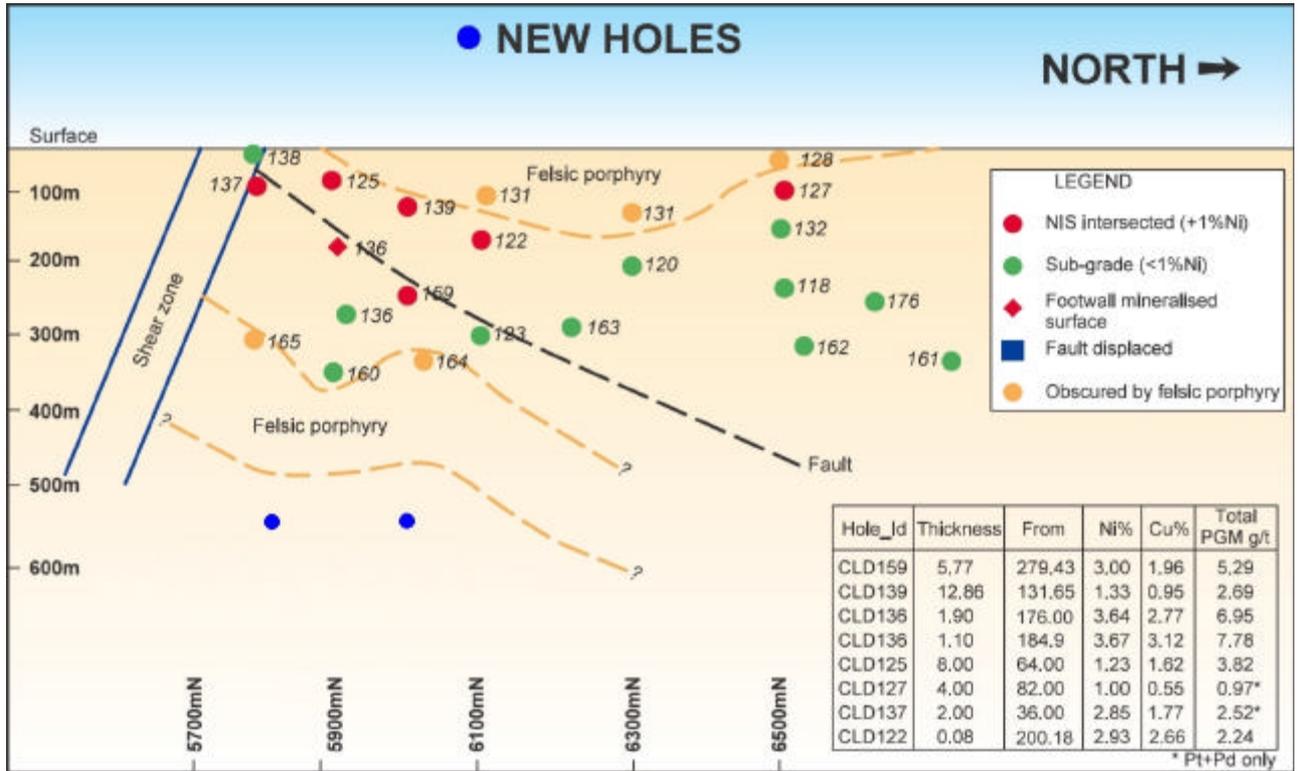
**Figure 1: Location of Collurabbie JV**



**Figure 2: Collurabbie JV**



**Figure 3: Olympia Long Section, Looking West**



## BELL POTTER OFFICES

[www.bellpotter.com.au](http://www.bellpotter.com.au)

[info@bellpotter.com.au](mailto:info@bellpotter.com.au)

TOLL FREE 133 788

ABN 25 006 390 772

AFS Licence No. 243480

### ADELAIDE

LEVEL 6, DA COSTA BUILDING  
68 GRENFELL STREET  
ADELAIDE SA 5000  
TEL: 08 8224 2722  
FAX: 08 8224 2799

### BRISBANE

LEVEL 17, 10 EAGLE STREET  
BRISBANE QLD 4000  
TEL: 07 3295 2600  
FAX: 07 3295 2688

### CAIRNS

CNR SPENCE & GRAFTON STREETS  
CAIRNS QLD 4870  
TEL: 07 4047 4188  
FAX: 07 4047 4199

### GEELONG

LEVEL 2, 10 MOORABOOL STREET  
GEELONG VIC 3220  
TEL: 03 5229 2016  
FAX: 03 5222 8073

### GOLD COAST

LEVEL 8, 50 CAVILL AVENUE  
SURFERS PARADISE QLD 4217  
TEL: 07 5554 4333  
FAX: 07 5554 4399

### HOBART

LEVEL 9, AMP BUILDING  
86 COLLINS STREET  
HOBART TAS 7000  
TEL: 03 6231 1677  
FAX: 03 6231 3744

### MACKAY

CITY COURT, 78 VICTORIA STREET  
MACKAY QLD 4740  
TEL: 07 4957 6996  
FAX: 07 4951 4114

### MELBOURNE

LEVEL 29, 101 COLLINS STREET  
MELBOURNE VIC 3000  
TEL: 03 9256 8700  
FAX: 03 9256 8787

### MORNINGTON

UNIT 3, 307 MAIN STREET  
MORNINGTON VIC 3931  
TEL: 03 5975 6666  
FAX: 03 5975 8939

### PERTH

LEVEL 37, EXCHANGE PLAZA  
2 THE ESPLANADE  
PERTH WA 6000  
TEL: 08 9326 7666  
FAX: 08 9326 7676

### SYDNEY

LEVEL 33, 225 GEORGE STREET  
SYDNEY NSW 2000  
TEL: 02 9255 7200  
FAX: 02 9255 7277

### TOOWOOMBA

3 DUGGAN STREET  
TOOWOOMBA QLD 4350  
TEL: 07 4638 5988  
FAX: 07 4639 2608

### WOLLONGONG

LEVEL 1, 166 KEIRA STREET  
WOLLONGONG NSW 2500  
TEL: 02 4228 0390  
FAX: 02 4228 1073

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