

OM Holdings Ltd (OMH)

Recommendation: Buy

17 June 2008

Share split. Earnings outlook remains strong

- OM Holdings' 2:1 share split became effective on 3 June 2008 (whereby every ordinary fully paid share has been split into two fully paid ordinary shares). The share split is intended to increase the liquidity ahead of the proposed secondary listing on the Hong Kong Stock Exchange. The Global Offering Prospectus is expected to be published by 30 June 2008 and the secondary listing to be completed by 31 July 2008.
- The outlook for the year ahead "remains exceptionally strong" (OMH Chairman, 30 May 2008). The earnings outlook is highly dependent on the price outlook for high grade manganese ore (a change of US\$1.00/dmtu in our 2008 price assumption changes our 2008 earnings estimate by A\$25m). The manganese ore price CIF China 43-45% Mn has increased more than five-fold over the past 18 months. At this stage, the high grade manganese ore market seems likely to be in deficit for at least the next two years due to supply constraints and strong demand.
- Peter Toth, previously Marketing Director for BHP Billiton's Carbon Steel Materials business, will join the company as Joint CEO effective 3 September 2008.
- We retain a buy recommendation for OMH. However, following the 32% increase in the share price - since we initiated research coverage on 5 May 2008 at an adjusted price of \$1.85/share (or +40% since our PWW note, 2 May 2008) - we would now prefer to buy on share price weakness.

Share price:	\$2.45			
Market Capitalisation:	A\$1,147m			
Year to 31 December	2007	2008	2009	2010
	Act	Est	Est	Est
Reported Profit	57.3	165.1	163.5	158.1
Underlying Profit	49.4	165.1	163.5	158.1
EPS (cps)	10.3	34.4	34.0	32.9
P/E ratio (x)	23.8	7.1	7.2	7.4
DPS (c)	3.00	7.50	7.50	7.50
Franking (%)	100%	100%	100%	100%
Net Yield (%)	1.2%	3.1%	3.1%	3.1%
<i>Assumptions</i>				
\$A/US spot	0.788	0.892	0.940	0.895
Manganese ore 44% Mn cif (US\$/dmtu) ¹	5.35	12.05	11.20	10.00
Manganese ore production (mtpa)	0.516	0.730	0.760	0.760

¹ OMH received price is below reported prices for 44% Mn.

Manganese Market Update

Supply of high grade manganese ore has continued to tighten resulting in ongoing sharp price rises.

The price of manganese ore cif China 43-45% Mn has increased more than five-fold over the past 18 months. It has been reported that BHP has achieved a 30% price increase for 44% Mn manganese ore to US\$16.10-16.40/dmtu cif China for September

quarter shipments (up from US\$13/dmtu for the June quarter; and around US\$2.75/dmtu in the March Quarter 2007).

High grade manganese ore prices (reported by Asian Metal) are in a wide range depending on the origin, grade, quantity and end customer.

At this stage, the high grade manganese ore market seems likely to be in deficit for at least the

next two years due largely to supply constraints, but also strong demand. China produced 490mt of crude steel in 2007 and is scheduled to increase its output in 2008 to approximately 520mt. On this basis, China is estimated to require 7.5-8mt of imported manganese ore – OMH believes this will be a challenge in the current global market.

Industry factors restricting global ore supply include:

- Recent and ongoing consolidation within key market suppliers including Ukrainian ferroalloy producer Privat acquiring Ghana Manganese Company in March 2007 and Consolidated Minerals Ltd in December 2007;
- South African rail and port logistical facilities are already at full capacity which is impeding expansion from existing producers or entry of new producers;
- Brazilian production had been reduced due to Vale suspending production at its Azul mine for the latter half of 2007 to provide priority to transport its iron ore product.

In addition to strong global steel demand, there has also been some substitution of manganese for nickel in stainless steels. The ISSF Report, released around 7 April 2008, showed a shift in market share of 300 series austenitic stainless steel (with most Ni) from 65.7% in March Quarter 2007 to 50.7% in December Quarter 2007. The 400 series martensitic (little or no nickel) and 200 series manganese laden austenitic stainless steels increased share.

The international manganese alloys market has been impacted by the national power crisis in South Africa and a disruption to production at the Assmang smelting plant in South Africa creating a

shortage for manganese alloys. As a result, the prices of manganese alloys are now trading at all time highs. OMQ and OMS will benefit from this as its High Carbon Ferro Manganese (HC FeMn) is also exported internationally to East Asia, Europe and the US.

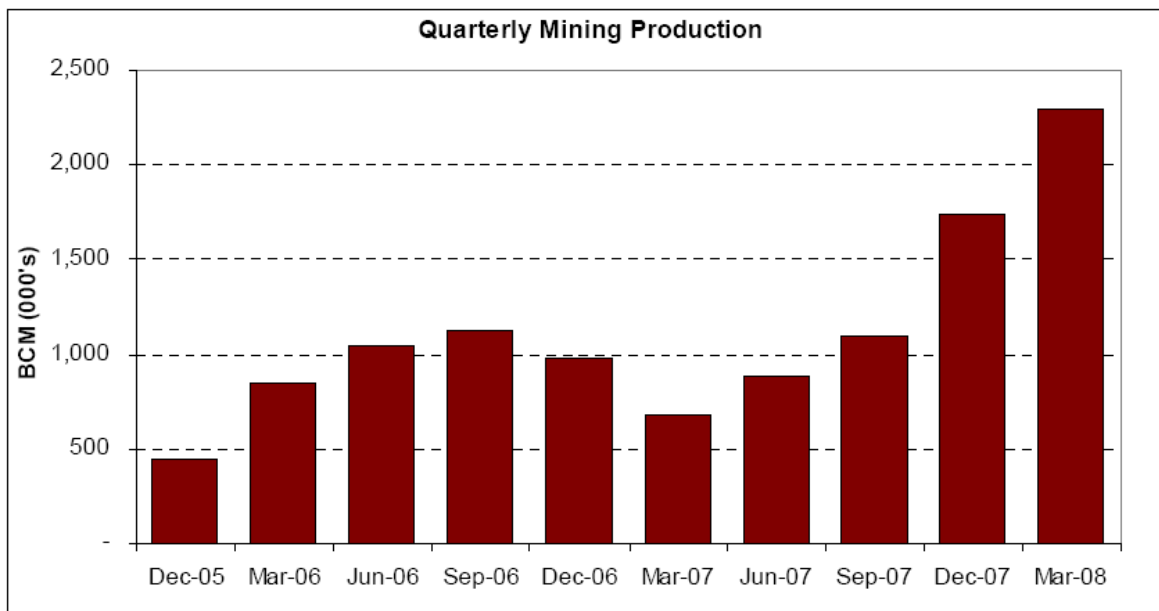
Footnote:

Manganese, in the form of HC FeMn and silicomanganese, is added to steels to increase strength and impact resistance.

March Quarter Update

In its March Quarter Update (released 1 May 2008), OMH had forecast a profit for the June half year of no less than A\$80m. The company's 100%-owned Bootu Creek Manganese Mine in the Northern Territory, the Qinzhou Smelter (in China) and the metal trading operations all exceeded quarterly operational milestones:

- Total manganese ore production from the Group's 100%-owned Bootu Creek mine increased by 48% quarter-on-quarter to 183,046 tonnes at 42.3% Mn – 34% above design capacity and 5% above the targeted 175,000 tonnes per quarter production rate for the Bootu Creek operation. Unit cash operating costs were A\$3.83/dmtu produced, compared with A\$4.16/dmtu for the December 2007 Quarter despite the effect of additional operational costs arising from accelerated mining activities. The processing plant continues to perform above design capacity following plant rectifications to materials handling.



- The Company's 100% owned **Qinzhou Smelter (OMQ) in Guangzi, China** also delivered record quarterly production of **10,291 tonnes of HC FeMn**, 17% above budget despite having only one furnace operating throughout the quarter. This represented a 16% increase on the December 2007 Quarter production of 8,898 tonnes. The OMQ operation achieved a record operating profit for the March Quarter – higher production and record manganese alloy prices more than offset increased ore material costs.
- OM Materials (OMS) Pte Ltd, the Group's 100%-owned **Singapore-based commodity trading operations**, delivered "an outstanding trading and financial result for the March Quarter", with ore and alloy tonnages traded increasing by 27% compared with the previous Quarter and the manganese price continuing to rise, reflecting strong demand and worldwide production shortages.

OMH expects the "outstanding" contributions from all business units in the March Quarter to be consistent and sustainable throughout the current year ending 31 December 2008. OMH is currently targeting manganese ore production at a rate of 700ktpa and forecasts record production of 41,200 tonnes of HC FeMn for 2008.

The smelting business has commenced a feasibility study in relation to construction of a dedicated sinter ore plant due to be completed end 2008. If all relevant approvals are obtained, the plant could be commissioned in the latter half of 2009.

As already discussed, the market outlook for manganese ore and alloys is very robust, underpinned by an ongoing global shortage of high grade manganese. OMH has secured record price levels for the June 2008 Quarter, continuing the trend over the past 18 months. The US\$ manganese price received per tonne for ore sold for the March 2008 Quarter was 31% higher than the prices for the December 2007 Quarter. OMH sales for 41-43% Mn are at a discount to BHP Billiton's reported sales prices.

Secondary listing on HKSE

The Company is actively progressing the proposed secondary listing on the Main Board of the Hong Kong Stock Exchange. The Global Offering Prospectus is expected to be published by 30 June 2008. The Company is expecting to complete the secondary listing by 31 July 2008.

The Company proposes to issue up to 90 million ordinary shares (on the reconstructed basis post the share split) under the Prospectus. The funds raised are intended to be applied to:

- Enhancement of existing operations at Bootu Creek including assessing opportunities to **expand sustainable production from 700ktpa to 1,000ktpa, including re-treatment of rejects.** In addition, undertaking a feasibility study to assess the establishment of an additional new production facility supported by the **Renner Springs project** will be evaluated.
- **Expansion of exploration programmes** including Bootu Creek, Renner Springs and Helen Springs.
- Expansion options at the **Qinzhou ferro alloy processing facility**, particularly the standalone sinter ore plant to support the existing Qinzhou ferro alloy processing facility as well as develop a niche market for sinter ore supply to other third parties.
- Fund the evaluation and assessment of other international projects including merger and acquisition opportunities.
- General working capital (if required).

Territory Iron Ltd

OMH is the largest shareholder of Territory Iron Ltd (TTY, \$0.82) holding an 11% strategic interest.

Earnings Outlook

The outlook for the year ahead "remains exceptionally strong" (OMH Chairman, 30 May 2008). We agree with the chairman's assessment. We have left our manganese ore price assumption unchanged from our last research note. Our 2009 earnings estimate has dropped 7% due to increased \$A/US assumptions.

The earnings outlook is highly dependent on the price outlook for high grade manganese ore - a change of US\$1.00/dmtu in our 2008 price assumption changes our 2008 earnings estimate by A\$25m (all other assumptions remaining constant). The manganese ore price CIF China 43-45% Mn has increased more than five-fold over the past 18 months. At this stage, the high grade manganese ore market seems likely to be in deficit for at least the next two years due to supply constraints and strong demand.

Year Ending 31 December		
Profit/(Loss)	2006	2007
Total Revenue	183.8	290.5
Underlying EBIT	-32.2	72.6
EBIT - Profit from operations	-30.3	55.8
Net interest expense	-1.8	-1.9
Profit before tax	-32.1	54.0
Total tax expense	-0.7	-4.6
Attributable Profit	-32.8	49.4
Non-recurring items ¹	0.5	7.9
Adjusted Profit	-32.3	57.3

¹ 2007: Gain on sale of marketing rights

NPAT Segments (\$m)	2006	2007
Trading	3.2	42.2
OM Manganese	-33.0	7.7
OM Qinzhou	-1.6	11.7
OM Holdings	-1.1	-4.7
Total	-32.5	56.9

Summary Cash Flow	2006	2007
Operating cash flow	-15.1	43.9
Net interest paid	-1.0	-0.8
Tax paid	-0.7	-4.6
Available cash flow	-16.8	38.5
Capital expenditure	-19.7	-8.8
Exploration expenditure	-2.3	-3.6
Purchases of investments	0.0	0.0
Sale of fixed assets & investments	0.0	0.0
(Acquisitions) & disposals	0.0	0.0
Cash flow before divs, funding	-38.8	26.1
Dividends paid	-0.6	-4.7
Net cash flow before funding	-39.4	21.3

Summary Balance Sheet	2006	2007
Cash	11.6	24.4
Inventory	34.9	51.0
Property, Plant & Equipment	59.2	59.7
Other	42.7	83.9
Total Assets	148.4	219.0
Interest Bearing Liabilities	10.1	6.0
Provisions	0.3	0.3
Other	66.6	46.5
Total Liabilities	76.9	52.8
Net Assets	71.5	166.2
Net Debt/(debt+equity)	48.8%	14.7%
EBITDA interest cover	-17.0	38.6

F W Holst & Co. Pty Ltd

Rob Craigie

This publication has been prepared by F W Holst & Co. Pty Ltd ABN 67 006 545 660 ("HOLST") Australian Financial Services Licensee No. 247841 for its clients and must not be copied in any way or distributed to any other person without the written authorisation of HOLST. This publication provides general advice only and has not been prepared taking into account your financial situation, investment objectives and particular needs. Before acting on the general advice contained in this publication, you should obtain individual expert financial advice suitable to your needs and objectives. Nothing in this publication shall be construed as a solicitation to buy or sell or engage in or refrain from engaging in any transaction. The HOLST research analyst is responsible for the content of this publication and certifies that all of the views expressed reflect the analyst's personal views about the security at the time of writing. The opinions, forecasts and recommendations expressed are subject to change without notice. No part of the analyst's compensation was, is, or will be, directly or indirectly, related to the opinion, forecasts or recommendation expressed by the analyst in this report. HOLST, its directors and associates may hold an interest in financial products and may effect transactions, which may not be consistent with the recommendation in this publication. HOLST, its directors and associates may or has received brokerage, commission, fees or may receive other benefits on transactions and/or holdings in the financial products mentioned in this publication. HOLST has made every effort to ensure the information in this publication is accurate and takes no responsibility for any losses incurred as a result of any errors or omissions in data on which this document is based.

Rob Craigie and/or associated parties own or have an interest in the securities of OM Holdings Ltd and BHP Billiton Ltd.