

17 March 2014

Alara Resources

AUQ A\$0.10/share

Moving to control of Khnaiguiah

BUY

AUQ has successfully negotiated an increase in ownership of the Khnaiguiah zinc-copper project from 50% to 60%. This is an important milestone and enables AUQ to lead the project into development and production. Key terms are (i) the issue of 67M shares to JV partner Manajem and (ii) staged milestone payments of US\$8.35M. Legal paperwork is expected to be completed shortly and incorporated into an amended shareholder's agreement (SHA). Incorporating the transaction into our model sees NPV reduce slightly to A\$0.53/share (\$0.55). However, significant upside at Khnaiguiah exists via identified capex/opex savings and heavy media separation (HMS). We maintain our BUY recommendation.

Transaction details

- Project interest increased from 50% to 60%.
- Manajem to receive:
 - 60M AUQ shares (needs shareholder approval)
 - US\$0.6M upon execution of an amended SHA
 - US\$1.7M & 6.7M AUQ shares upon transfer of Mining Licence & grant of Environmental permit
 - US\$3.5M within 2 months after ML transferred
 - US\$0.15M to Mr Hatlani for land & water rights
 - US\$2.4M upon successful project financing
- AUQ is to receive US\$3.5M from KMC upon project financing as repayment of loans.

Road map ahead

Upon completion of the SHA, key steps comprise:

- Submit the finance application to the SIDF.
- SIDF may advance up to 75% of total capex.
- SIDF decision expected within 6-8 months.
- Secure concentrate offtake agreements.
- Secure non-SIDF funding - supplier/offtake partners.
- Complete DFS review – capex/opex savings identified.
- Complete HMS testwork – strong upside to feed grade.
- Finalise the EPC tender and contract.
- Hire a project director and recruit the owners' team.

Khnaiguiah DFS (April 2013) - recap

- EBITDA of A\$100Mpa (first 7 years).
- Free cashflow (after payback of capex) of A\$467M.
- Capex – US\$257M based on a fixed price (EPC).
- Three year capital payback with a 13 year mine life.
- First production estimated 2016.
- Production – 80-90ktpa Zn, 5.8ktpa Cu (years 1-7).
- Cash costs – US46c/lb (years 1-7) after copper credits.

Company Data

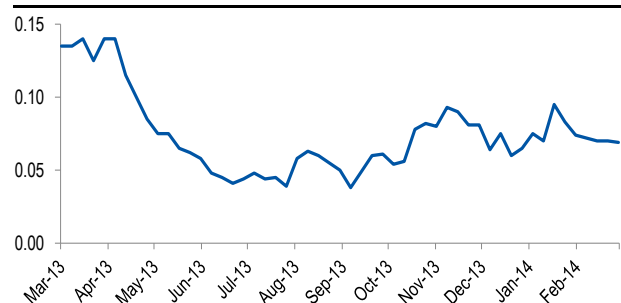
| | |
|--|-----------------|
| Shares – ordinary | 308.7M |
| Options (\$0.10-0.70/share – out of the money) | 36.8M |
| Market Cap | \$30.9M |
| 12 month low/high | \$0.04 / \$0.15 |
| Average monthly turnover | \$1.0M |
| Average monthly volume | 9.3M |

Financial Summary (fully diluted/normalised)

| Year end June | 2013A | 2014F | 2015F | 2016F | 2017F |
|------------------------|-------|-------|--------|-------|-------|
| Revenue (\$M) | 0.0 | 0.0 | 0.0 | 23.4 | 156.8 |
| Costs (\$M) | 6.9 | 5.8 | 6.3 | 18.3 | 85.0 |
| EBITDA (\$M) | (6.9) | (5.8) | (6.3) | 5.1 | 71.8 |
| NPAT (\$M) | (6.7) | (6.0) | (10.6) | (6.9) | 37.7 |
| EPS (¢ps) | (2.9) | (1.9) | (3.4) | (2.2) | 12.2 |
| EPS Growth (%) | na | na | na | na | >100 |
| PER (x) | na | na | na | na | 0.8 |
| Cashflow (\$M) | (3.6) | (6.0) | (10.6) | (4.8) | 61.2 |
| CFPS (¢ps) | (1.5) | (1.9) | (3.4) | (1.5) | 19.8 |
| PCFPS (x) | na | na | na | na | 0.5 |
| Enterprise Value (\$M) | 6 | 36 | 166 | 246 | 187 |
| EV / EBITDA (x) | na | na | na | 48 | 2.6 |

| Substantial Shareholders (FPO) | Shares (M) | (%) |
|--------------------------------|------------|-------|
| Acorn | 26.6 | 11.0% |
| Northcape | 21.8 | 9.0% |
| Antares | 17.2 | 7.1% |

AUQ – performance over one year



This report must be read with the disclosure and disclaimer on the final page of this document.

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Background

Successful negotiations reflect a combined effort to resolve issues and move the project forward.

In October 2010, Alara and Manajem entered into a 50:50 JV to develop the mineral resource and in turn complete a DFS on the Khnaiguiyah zinc-copper project in Saudi Arabia. This work concluded in April 2013 with the completion of the DFS showing a successful and robust project.

It was recognised by both parties the equity arrangement of 50:50 would be problematic relative to the project's next stages of development. Discussions between the parties to a possible change in the equity position had been ongoing for some time however prior operational and relationship issues coupled with project liabilities did not allow these discussions to progress with any success. In July 2013, the parties agreed to re-engage collaboratively to resolve issues and map the way forward. The successful negotiation announced today is a culmination of that and provides Alara with the required project leadership and equity position to lead the project into production.

HOA – Key Parameters

All legacy issues are effectively dealt with in the current HOA.

The key components of the agreement are as follows:

- Alara moves to 60% KMC equity position in the project
- Manajem moves to 40% KMC equity position and receives 66.7M shares in Alara
- Prior capital expenses are acknowledged by both parties under the current SHA with the differential (US\$3.4M) being allocated to the loan agreement between the parties
- Milestone payments will be paid to Manajem totalling US\$8.3M
- All legacy issues are effectively dealt with in accordance with the above payment items

Shareholders' Agreement (SHA)

Amended SHA expected to be formalised shortly.

The terms and conditions of the HOA will be used to amend the current SHA and update the KMC Articles of Association in readiness for final approval from the Alara shareholders and official lodgement with the Chamber of Commerce in the Kingdom of Saudi Arabia. This is expected to be completed shortly. Both parties are committed and have documented their mutual desire for a rapid conclusion of the legal formalities associated with the SHA amendment.

Khnaiguiyah Mining Company (KMC) – JV Company

HRH Prince Abdullah to Chair KMC.

The new KMC Board will comprise seven directors with Alara and Manajem having three nominees each and HRH Prince Abdullah bin Mosaad bin Abdulaziz Al Saud (also an Alara Non-Executive Director) being appointed as the inaugural Chairman. The KMC Board will appoint the CEO/Managing Director.

Nasser Ali Al Agel - CEO & Board Member of Manajem



"On behalf of the entire Manajem Executive Team, I would like to state how pleased I am that the parties have come to this aligned and progressive HOA. This agreement clears the way for an expedient update to the JV SHA and thus allows the parties to move the Khnaiguiyah zinc-copper project forward. This will ensure that all of the shareholders involved, benefit as the project moves forward. I look forward to the years ahead for the JV and operation."

Philip Hopkins – CEO & MD of Alara Resources



"The agreement between the parties is a key and critical milestone for both the JV relationship and the Khnaiguiyah zinc-copper project. Once the HOA has transitioned into the final amended SHA and is approved by Alara shareholders, the company will work closely with the Manajem executive team to take this project in the next stages of finance, development and ultimately production. It is exciting to have such a robust zinc-copper project with so much upside associated within what might be the best fiscal and technical regime in the world and as the zinc metal price cycle is forecast to reach new high levels. I, the Board and the entire company feel this project will add very significant value to all of the company's shareholders."

Analysis (fully diluted for transaction)

ALARA RESOURCES

(AUQ)

17-Mar-14

| Year End 30 June | A\$ | | | | | |
|--------------------------|------------|---------------|---------------|----------------|---------------|---------------|
| PROFIT & LOSS | | | | | | |
| | | 2013A | 2014F | 2015F | 2016F | 2017F |
| Sales Revenue | \$M | 0.0 | 0.0 | 0.0 | 23.4 | 156.8 |
| Other Income | \$M | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Operating Costs | \$M | 3.9 | 5.8 | 6.3 | 18.3 | 85.0 |
| Exploration | \$M | 3.1 | 0.0 | 0.0 | 0.0 | 0.0 |
| Other | \$M | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| EBITDA | \$M | (6.9) | (5.8) | (6.3) | 5.1 | 71.8 |
| Dep. & Amort. | \$M | 0.0 | 0.0 | 0.0 | 2.1 | 18.4 |
| EBIT | \$M | (6.9) | (5.8) | (6.3) | 3.0 | 53.5 |
| Net Interest | \$M | (0.2) | 0.2 | 4.3 | 9.9 | 10.6 |
| Pre-Tax Profit | \$M | (6.7) | (6.0) | (10.6) | (6.9) | 42.9 |
| Tax | \$M | 0.0 | 0.0 | 0.0 | 0.0 | 5.1 |
| Minorities | \$M | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Net Profit | \$M | (6.7) | (6.0) | (10.6) | (6.9) | 37.7 |
| Abnormal | \$M | (0.2) | 0.0 | 0.0 | 0.0 | 0.0 |
| Reported Profit | \$M | (6.9) | (6.0) | (10.6) | (6.9) | 37.7 |
| Dividends | \$M | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Adjustments | \$M | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Retained Earnings | \$M | (29.3) | (35.3) | (45.9) | (52.7) | (15.0) |
| CASH FLOW | | | | | | |
| Revenue | \$M | 0.0 | 0.0 | 0.0 | 23.4 | 156.8 |
| Costs | \$M | (3.9) | (5.8) | (6.3) | (18.3) | (85.0) |
| Net Interest | \$M | 0.3 | (0.2) | (4.3) | (9.9) | (10.6) |
| Tax Paid | \$M | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Gross Cash Flow | \$M | (3.6) | (6.0) | (10.6) | (4.8) | 61.2 |
| Net Capex | \$M | (10.3) | (2.0) | (120.0) | (75.7) | (2.5) |
| Exploration | \$M | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Dividends | \$M | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Other | \$M | 0.0 | (6.4) | 1.3 | 0.0 | 0.0 |
| Free Cashflow | \$M | (13.9) | (14.3) | (129.3) | (80.5) | 58.7 |
| Equity Issues | \$M | 7.5 | 0.0 | 0.0 | 0.0 | 0.0 |
| Net Borrowings | \$M | 0.0 | 10.0 | 140.0 | 85.0 | (50.0) |
| Net Investments | \$M | 0.0 | 4.4 | 0.0 | 0.0 | 0.0 |
| Surplus Cash Flow | \$M | (6.4) | 0.0 | 10.7 | 4.5 | 8.7 |
| BALANCE SHEET | | | | | | |
| Cash | \$M | 4.5 | 4.5 | 15.2 | 19.7 | 28.4 |
| Other Current | \$M | 1.3 | 0.0 | 0.0 | 0.4 | 1.6 |
| Total Current | \$M | 5.8 | 4.5 | 15.2 | 20.2 | 30.0 |
| Fixed Assets | \$M | 29.5 | 31.5 | 151.5 | 225.2 | 209.3 |
| Exploration | \$M | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Intangibles | \$M | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Other | \$M | 5.7 | 12.1 | 10.7 | 10.7 | 10.7 |
| Total NC Assets | \$M | 35.3 | 43.6 | 162.3 | 235.9 | 220.1 |
| TOTAL ASSETS | \$M | 41.0 | 48.1 | 177.5 | 256.1 | 250.0 |
| Total Debt | \$M | 0.0 | 10.0 | 150.0 | 235.0 | 185.0 |
| Current Liab | \$M | 1.8 | 1.8 | 1.8 | 1.8 | 6.9 |
| Non Current Liab | \$M | 1.8 | 4.9 | 4.9 | 5.3 | 6.4 |
| TOTAL LIAB | \$M | 3.6 | 16.6 | 156.6 | 242.1 | 198.4 |
| NET ASSETS | \$M | 37.5 | 31.5 | 20.8 | 14.0 | 51.7 |
| SH/HLDRS FUNDS | \$M | 37.5 | 31.5 | 20.8 | 14.0 | 51.7 |
| RATIO ANALYSIS | | | | | | |
| EPS | ¢ | (2.9) | (1.9) | (3.4) | (2.2) | 12.2 |
| PER | x | na | na | na | na | 0.8 |
| EPS Growth | % | na | na | na | na | >100 |
| EBITDA per share | ¢ | (3.0) | (1.9) | (2.0) | 1.7 | 23.3 |
| EBITDA Multiple | x | (1.5) | (5.3) | (4.9) | 6.0 | 0.4 |
| EV/EBITDA | x | (0.9) | (6.3) | (26.4) | 48.2 | 2.6 |
| CFPS | ¢ | (1.5) | (1.9) | (3.4) | (1.5) | 19.8 |
| PCFR | x | na | na | na | na | 0.5 |
| DPS | ¢ | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Yield | % | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Franking | % | 0 | 0 | 100 | 100 | 100 |
| Payout Ratio | % | 0% | 0% | 0% | 0% | 0% |
| Gearing D/E | % | na | 17 | 647 | 1,541 | 303 |
| Interest Cover | x | 30.7 | na | na | 0.3 | 5.0 |
| EBITDA Margin | % | na | na | na | 21.8 | 45.8 |
| EBIT Margin | % | na | na | na | 12.9 | 34.1 |
| Return On Assets | % | (16.9) | (12.1) | (3.5) | 1.2 | 21.4 |
| Return On Equity | % | (17.9) | (19.0) | (51.0) | (49.2) | 73.0 |
| Eff Tax rate | % | 0 | 0 | 0 | 0 | 12 |
| OTHER DATA | | | | | | |
| Share Price | \$/sh. | 0.05 | 0.10 | 0.10 | 0.10 | 0.10 |
| Number of shares | M | 231 | 309 | 309 | 309 | 309 |
| Market Capitalisation | \$M | 10 | 31 | 31 | 31 | 31 |
| EV | \$M | 6 | 36 | 166 | 246 | 187 |

| | | |
|-------------------------|-------|-------------------------|
| Share Price | (\$) | 0.10 |
| Iss. Shares | (M) | 308.7 |
| Iss. Options (unlisted) | (M) | 36.8 Ex @ \$0.10-\$0.70 |
| Equity | (M) | 308.7 |
| Mkt Cap. | (\$M) | 30.9 |



| RESERVES / RESOURCES | | 2013A | 2014F | 2015F | 2016F | 2017F |
|---|-------------|-------------|------------|--------------|--------------|---------------|
| Reserves | | | | | | |
| Tonnes | Mt | 29.99 | 29.99 | 29.99 | 29.59 | 27.42 |
| Copper | % | 0.24 | 0.24 | 0.24 | 0.24 | 0.23 |
| Zinc | % | 3.30 | 3.30 | 3.30 | 3.29 | 3.17 |
| Resources | | | | | | |
| Tonnes | Mt | 35.00 | 35.00 | 35.00 | 34.60 | 32.43 |
| Copper | % | 0.25 | 0.25 | 0.25 | 0.25 | 0.24 |
| Zinc | % | 3.10 | 3.10 | 3.10 | 3.09 | 2.98 |
| PRODUCTION (100%) | | | | | | |
| Khnaiguiyah | | | | | | |
| Tonnes | Mt | 0.00 | 0.00 | 0.00 | 0.40 | 2.17 |
| Copper | % | 0.00 | 0.00 | 0.00 | 0.35 | 0.40 |
| Zinc | % | 0.00 | 0.00 | 0.00 | 4.00 | 4.80 |
| Metal in concentrate (pre-charges) | | | | | | |
| Cu in concentrate | T | 0 | 0 | 0 | 1,246 | 7,812 |
| Zn in concentrate | T | 0 | 0 | 0 | 14,560 | 95,827 |
| ATTRIBUTABLE REVENUE (post smelter charges) | | | | | | |
| Project | | | | | | |
| Khnaiguiyah | A\$M | 0.0 | 0.0 | 0.0 | 23.4 | 156.8 |
| Other | A\$M | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Total | A\$M | 0.0 | 0.0 | 0.0 | 23.4 | 156.8 |
| Commodity | | | | | | |
| Copper | A\$M | 0.0 | 0.0 | 0.0 | 5.4 | 32.7 |
| Zinc | A\$M | 0.0 | 0.0 | 0.0 | 18.0 | 124.1 |
| Other | A\$M | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Total | A\$M | 0.0 | 0.0 | 0.0 | 23.4 | 156.8 |
| ATTRIBUTABLE COSTS (includes treatment charges) | | | | | | |
| Khnaiguiyah | A\$M | 3.4 | 3.3 | 3.8 | 15.8 | 82.5 |
| Corporate and Other | A\$M | 0.4 | 2.5 | 2.5 | 2.5 | 2.5 |
| Total | A\$M | 3.9 | 5.8 | 6.3 | 18.3 | 85.0 |
| Cash Costs (pre credits) | US\$/lb | 0.00 | 0.00 | 0.00 | 0.81 | 0.63 |
| Cash Costs (after credits) | US\$/lb | 0.00 | 0.00 | 0.00 | 0.53 | 0.38 |
| Cash Costs (all-in) | US\$/lb | 0.00 | 0.00 | 0.00 | 0.79 | 0.43 |
| ATTRIBUTABLE CAPEX | | | | | | |
| Khnaiguiyah | A\$M | 8.8 | 2.0 | 120.0 | 75.7 | 2.5 |
| Other | A\$M | 1.5 | 0.0 | 0.0 | 0.0 | 0.0 |
| Total | A\$M | 10.3 | 2.0 | 120.0 | 75.7 | 2.5 |
| ATTRIBUTABLE DEPRECIATION & AMORTISATION | | | | | | |
| Khnaiguiyah | A\$M | 0.0 | 0.0 | 0.0 | 2.1 | 18.4 |
| Other | A\$M | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Total | A\$M | 0.0 | 0.0 | 0.0 | 2.1 | 18.4 |
| HEDGING | | | | | | |
| Copper hedged | t | 0 | 0 | 0 | 0 | 0 |
| Currency hedged | A\$/US\$ | 0 | 0 | 0 | 0 | 0 |
| Hedged price | US\$/lb | 0 | 0 | 0 | 0 | 0 |
| Hedged price | A\$/lb | 0 | 0 | 0 | 0 | 0 |
| Sales hedged | % | 0% | 0% | 0% | 0% | 0% |
| Ave.price deliv.-Cu | US\$/lb | 3.47 | 3.21 | 3.10 | 2.88 | 2.75 |
| Ave.price deliv.-Cu | A\$/lb | 3.39 | 3.54 | 3.54 | 3.42 | 3.33 |
| Zinc hedged | t | 0 | 0 | 0 | 0 | 0 |
| Currency hedged | A\$/US\$ | 0 | 0 | 0 | 0 | 0 |
| Hedged price | US\$/lb | 0 | 0 | 0 | 0 | 0 |
| Hedged price | A\$/lb | 0 | 0 | 0 | 0 | 0 |
| Sales hedged | % | 0% | 0% | 0% | 0% | 0% |
| Ave.price deliv.-Zn | US\$/lb | 0.87 | 0.88 | 0.93 | 0.93 | 0.95 |
| Ave.price deliv.-Zn | A\$/lb | 0.85 | 0.97 | 1.06 | 1.10 | 1.15 |
| ASSUMPTIONS | | | | | | |
| Exchange Rate | A\$/US\$ | 1.02 | 0.91 | 0.88 | 0.84 | 0.83 |
| Zinc | US\$/lb | 0.87 | 0.88 | 0.93 | 0.93 | 0.95 |
| Lead | US\$/lb | 0.97 | 0.95 | 0.94 | 0.92 | 0.90 |
| Copper | US\$/lb | 3.47 | 3.21 | 3.10 | 2.88 | 2.75 |
| Gold | US\$/oz | 1595 | 1312 | 1300 | 1263 | 1238 |
| Silver | US\$/oz | 28.82 | 20.55 | 20.00 | 20.00 | 19.00 |
| 90 day Bank Bills | % | 3.15 | 2.61 | 2.55 | 2.63 | 2.88 |
| 10 Yr Bond rate | % | 3.29 | 4.01 | 3.75 | 3.38 | 3.38 |
| Int. Rate Charged | % | 4.29 | 5.01 | 4.75 | 4.38 | 4.38 |
| VALUATION | | | | | | |
| Khnaiguiyah - Saudi | | | | | 176.9 | \$0.57 |
| Washihi - Oman | | | | | 7.5 | \$0.02 |
| Exploration | | | | | 5.0 | \$0.02 |
| Corporate and Other | | | | | (21.4) | \$ (0.07) |
| Net Cash (Debt) | | | | | (5.5) | -\$0.02 |
| Total | | | | | 162.5 | \$0.53 |

Source: Petra Capital

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