



Vital Metals Limited

Date of Lodgement: 20/12/11

Title: "Company Insight – Watershed Tungsten Project Developments"

Highlights of Interview

- New MD and CEO Mark Strizek outlines the Watershed Tungsten Project's features and development trajectory
- Aiming for project construction in 2013, and open-cut and concentrate production in 2014
- Outlines deal with JOGMEC to finance Watershed's DFS
- Explains Watershed's low capital requirements and why - under his priorities - limited further exploration is required
- Explains and discusses the tungsten market generally

Record of interview:

Vital Metals Resources (ASX: VML, market capitalisation A\$16 million) has two main assets, the Watershed Tungsten Project in North Queensland and the Doulnia Gold Project in Burkina Faso.

In this interview, the new MD and CEO of Vital Metals, Mark Strizek, is interviewed about Watershed as it progresses through the Definitive Feasibility Study (DFS) stage.

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Would you give a brief background to the Watershed project and its main features?

Chief Executive Officer, Mark Strizek

Watershed is located about 150 kilometres north-west of Cairns, in a region that has seen a history of tungsten mining since the early 1900's, most notably, the Mount Carbine mine.

Watershed is a vein swarm deposit in which the tungsten metal is present as scheelite (Ca WO₄). This mineralogy is simple, and metallurgically it is capable of producing a clean tungsten concentrate via a simple gravity and flotation process.

Watershed also has a very favourable location - in cattle country with no real issues from landholders, who are supportive of the project. Further, native title has been dealt with, and is provided for in a soon-to-be registered native title agreement.

It is located off a sealed tar highway, about 3 hours' drive from Cairns, with only 24 kilometres of access road that needs to be upgraded. We can access grid power from lines on the highway, via an easement that has already been surveyed. Our infrastructure needs are very small, and we don't need to build a port or railway. The plant concentrates the product from the pit, upgrading it from about 0.3% to 65% WO₃. So, we will produce a relatively small tonnage of very high-value concentrate that can be trucked in semitrailer containers to port. Unlike bulk ore operations, transport costs have minimal impact on this project's economics.

The project is underpinned by a JORC resource of 15.1 million tonnes at 0.46% tungsten trioxide (undiluted) at a 0.1% WO₃ cut-off. The ore body is amenable to open-cut operations initially. Further, as the ore body deepens, the tenor of mineralisation increases and we believe that there is a good possibility of potential underground operations. This is something that we will address in the future.

We also have excellent support from government at both State and local levels for development in this part of far-north Queensland.

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What are the capital requirements to develop Watershed, and how do you envisage the capital costs will be financed?

Mark Strizek

Capital requirements will be finalised during the DFS, but I can say that the last feasibility study completed in 2009 had an overall cost of around A\$60 million for mine development, plant and infrastructure; and around A\$10 million for working capital. The combination of low capital costs, Japanese support, and a healthy straightforward project with rapid payback, means – subject to the DFS of course – that financing options other than equity should be possible.

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As far as tungsten projects go, Watershed is a relatively high tonnage operation. What are the project dimensions and parameters that the DFS will investigate?

Mark Strizek

In terms of known resource, Watershed is in the world's top 10 tungsten projects outside China. But unlike other projects, it does not face pressure from local communities opposed to the development, or face the significant capital costs of developing, say, near the Arctic Circle. We just don't have these impediments.

In fact, Vital received EIS approval from the Queensland Government to produce at a higher rate than considered in the 2009 feasibility study, so that means we have a free hand for our DFS study to address a scope of operations up to a project in the order of 1,000,000 tonnes per annum throughput, producing around 5,000 tonnes of concentrate. That is a very good outcome for us.

We had originally planned for the DFS study to investigate operational parameters of, 600,000 tonnes ore throughput, producing 3,000 tonnes of concentrate. Those initial scoping parameters, that we will be examining much more closely in the DFS work, involved overall costs including State Government royalties of about A\$66 per tonne of ore and generated a net operating cash flow of around A\$33 million per annum. That produced a payback within

2.5 years and an NPV - based on an exchange rate of US\$0.99, a concentrate price of US\$379 per tonne, and a discount rate of 12.5% - of about A\$65 million. Current prices for APT are around US\$430 per metric tonne unit.

There is clearly a lot more work to be done on the operations and those figures, and we will also be examining a range of project throughputs. But the point is that this is a very healthy project, and we should remember that Vital Metals' current market capitalisation is only A\$14 million for both Watershed and Burkina Faso.

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The Watershed DFS is being financed by Japan Oil, Gas and Metals Corporation (JOGMEC). Could you explain who JOGMEC is, and why they are interested in the Watershed Project?

Mark Strizek

JOGMEC is a Japanese Government organisation that outlays early-stage risk money on selected projects, on terms that allow Japanese corporations to obtain a stake in these projects once they are de-risked. We are working closely with JOGMEC to work up relationships with the companies that are potential longer-term partners, likely to be one of the large Japanese Corporations that are fully-integrated users of the many forms and applications of tungsten.

JOGMEC's involvement in the project is an important endorsement because tungsten has major strategic importance. It is indispensable to automotive and aircraft production, construction, electronics manufacturing and oil and gas drilling. Much of the world's tungsten supplies are located in China and likely to be earmarked for Chinese consumption. But for Japan, the US and EU, tungsten supplies have strategic value because manufacturing industries rely on it for long-lasting/dependable machining.

The JOGMEC link allows us to create relationships with the end-user, and even more importantly, opens an avenue to finance the project's development. The tungsten market works on the basis of relationships and bilateral contracts, and so we believe we are well on the way to establish markets with reliable customers - who see strategic value in securing important tungsten supplies - and are also equipped to fund the project. The off-taker obtains security of supply for the project, and we obtain a very reliable and well-funded partner.

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What are the details of JOGMEC's earn-in agreement for Watershed?

Mark Strizek

JOGMEC's arrangement is at the project level, and they will earn a 30% project interest, vesting after they've spent A\$ 5.4 million to finance completion of the DFS.

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How will you progress your exploration of the Watershed ore structure from here?

Mark Strizek

We are focussed specifically on getting the Watershed project up and running. But we do have known mineralisation at depth with some very attractive intersections, and our model suggests increased grades as the deposit deepens, which is typical of tungsten mineralisation elsewhere. We have a very good tenement base of around 600 square kilometres and know the existing tungsten mineralisation forms part of a relatively unexplored larger structure. We will

therefore be consolidating our tenement position in the region, and we will be doing some further drilling.

But as exciting as that may be, drilling will be relatively limited. We are focused squarely on investor returns and meeting our commitment obligations. So, first, attractive and nearby surface and near-surface production targets will be addressed in the DFS, especially since bigger tonnage open-cut operations are now possible. Secondly, our drilling suggests strongly that Watershed's underground potential is typical of deposits elsewhere, where thicknesses become wider and grades richer. When allocating our available cash resources, we are keenly aware that focussed investigation can add substantially to project life and value. While Watershed's development is more than adequately justified by the size and quality of the current resource base, some additional drilling is warranted, because solid results would enhance the development's financing, especially the ability to raise debt.

But it is very much one-step-at-a-time where our key focus is to develop the project.

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What are the timing parameters for your development plans?

Mark Strizek

Our broad targets are that the DFS will be completed by the end of 2012, with construction beginning in the first half of 2013, and first concentrate being produced in 2014.

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Tungsten as a commodity is not well understood. Could you outline how the tungsten market operates, how the pricing of tungsten works, and how you see future trends in supply, demand and pricing?

Mark Strizek

The market tends to work through off-take agreements rather than spot markets. Producers and tungsten users usually negotiate term off-takes; pricing is usually reflected in the trading of intermediary products such as APT (Ammonium Para Tungstate), and there may be mechanisms to dampen upward or downward spikes. Pricing benchmarks differ but there is growing transparency in pricing, which will reflect the impact of underlying aggregate demand, and of tungsten supply and demand.

Prices had gone up to levels of about US\$480/mtu and are now down to about US\$430 to US\$440/mtu. The Chinese are getting very comfortable at these price levels and there is no real impetus for prices to come down. Essentially, they are seeking to redirect product from exports to their own domestic consumption, and like in iron ore, we expect that China will be both the biggest producer but also the biggest importer, as their own internal demand increases. Increasingly, they are looking to remove the high cost or polluting producers and as their higher grade deposits are being used up, they will be mining lower grade deposits.

Since the tungsten price has doubled since 2008, people have tried to reduce their usage as far as possible, but use reduction and substitution are difficult and the natural limits of these strategies have been reached.

Tungsten is also a relatively small component of the cost of say, drill bits or machine tools, so there are not the same sensitivities found with bulk commodities such as iron ore and coal.

Tungsten also has strategic importance. It is important for customers to secure supply, and so there is less emphasis on price relative to 'having supply'.

Broad industry trends show the tungsten market increasing at a rate of 5-6% per annum, with current production of between 70-80,000 tonnes of metal forecast to increase beyond 100,000 tonnes by around 2016, even with Western demand softening. Asian industrialisation and modernisation is strong, and tungsten carbide use in cutting tools is likely to increase from current levels of 40% to more normal levels of 60%. Every new car factory in China will need to have tungsten carbide bits.

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How would you summarise the impact on Vital Metals of the recent developments at Watershed?

Mark Strizek

Our strategy is to target low-cost extraction, which will contain Watershed's project capital requirements and give our investors good returns. Watershed's strong emerging value is clearly not reflected in our current market capitalisation of A\$14 million. Moreover, tungsten's growing strategic importance, based on increased tungsten intensity in Asia gives us great confidence. While demand and supply are reasonably evenly balanced at present, demand is forecast to grow and it just isn't easy to develop new projects. That is where we are fortunate with our development.

Watershed has intrinsic and location advantages, and our JOGMEC relationship provides not just DFS funding but a potential basis for off-take agreements and alternative, possibly better, development financing options. Finally, the JOGMEC deal allows Vital Metals to maintain its interest in Watershed which is now a valuable and advanced project; while still allowing financial resources to be available for gold exploration in Burkina Faso.

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Thank you, Mark.

In the next interview, we will talk with Mark Strizek on Vital Metals' Doulnia Gold Project in Burkina Faso.

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