Desjardins Weekly Feature

Metals & Mining Weekly: Molybdenum is marvellous!

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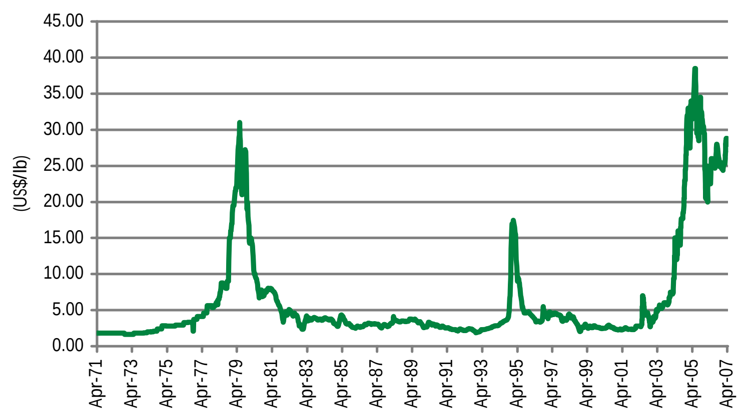
- Molybdenum to average US$30.00 per lb through 2008
- Low inventory levels, lack of new supply and growing demand—boosted by new applications
- Base metal prices continue to outperform equities

Strong outlook for molybdenum—prices to average US$30.00 per lb

Exhibit 1: Molybdenum price chart



Source: Platts

We expect molybdenum prices to average US$30.00 per lb through 2008. World demand should outstrip supply, driving inventories lower—see Exhibit 2.

Exhibit 2: Molybdenum supply—demand balance

(m lbs)	2003	2004	2005	2006	2007E	2008F
Demand						
Western Europe	123	130	124	132	139	144
(%)		*5.69*	*-4.62*	*6.45*	*5.30*	*3.60*
US	70	80	72	76	80	83
(%)		*14.29*	*-10.00*	*5.56*	*5.26*	*3.75*
Japan	59	60	65	70	73	75
(%)		*1.69*	*8.33*	*7.69*	*4.29*	*2.74*
China	41	50	55	60	65	70
(%)		*21.95*	*10.00*	*9.09*	*8.33*	*7.69*
Other	60	70	75	75	78	80
(%)		*16.67*	*7.14*	*0.00*	*4.00*	*2.56*
Total	353	390	391	413	435	452
(%)		*10.48*	*0.26*	*5.63*	*5.33*	*3.91*
Supply						
Primary concentrates						
Western World	50	52	60	68	70	75
China & other FCC	120	120	80	100	108	110
Sub total	170	172	140	168	178	185
By-product						
Western World	145	190	225	215	217	220
China & other FCC	20	20	20	20	20	20
Sub-total	165	210	245	235	237	240
Recovery from catalysts	10	10	10	10	10	10
Total	345	392	395	413	425	435
Market balance	-8	2	4	0	-10	-17
Inventory levels			124	124	114	97
Months of consumption			3.81	3.60	3.14	2.58
Price (US$/lb)	5.33	16.50	32.49	25.12	30.00	30.00

Source: Desjardins Securities

The molybdenum market should remain strong because of three main reasons:

- Low inventory levels
- Lack of new supply
- Growing demand—boosted by new applications, primarily from the energy sector

Our price forecasts, together with our long-term price for molybdenum, are shown in Exhibit 3.

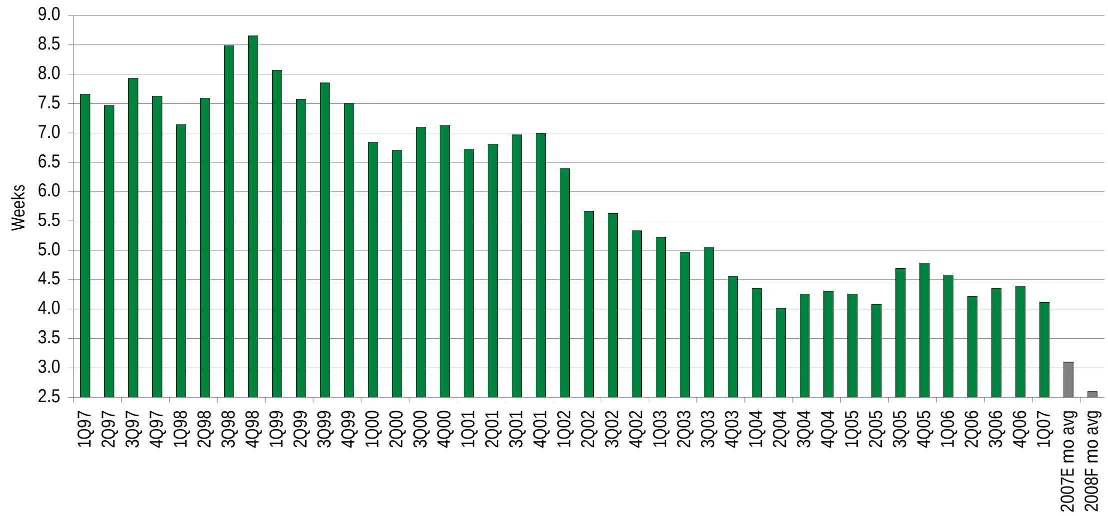
Exhibit 3: Price forecast

Molybdenum average price forecast	2006	2007E	2008F	Long-term price
Price (US$/lb)	25.12	30.00	30.00	18.00

Source: Desjardins Securities, Reuters

Low inventory levels. As shown in Exhibit 4, molybdenum inventories have fallen to historically low levels in recent years. We estimate that total inventories now represent roughly four months of consumption (compared with seven months in mid-2001) and should fall to 2.6 months by the end of 2008. With such a low 'safety net' for the industry (needed to meet unexpected surges in demand and production losses), the risk for prices is on the upside.

Exhibit 4: Molybdenum inventory



Source: Desjardins Securities, CRU

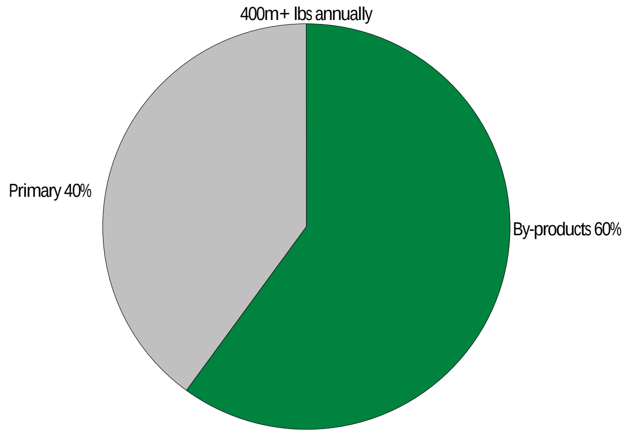
Limited supply growth. As shown in Exhibit 5, we expect a limited build-up in new mine supply through 2010 (note we expect World demand to grow by roughly 20m lbs per annum). Furthermore, several producers expect to see production fall at existing operations, particularly this year. According to the Commodities Research Unit, in 1H07 production at several large producers should fall significantly year-over-year: Codelco down 5.4% to 30m lbs, Kenecott down 12.4% to 17m lbs, and Antamina down 7.3 % to 7.6m lbs. This is mainly because, in recent years, many copper/molybdenum mines have targeted high molybdenum grade ore (as prices have risen). Most of these high grade areas have been depleted. As shown in Exhibit 6, roughly 60% of molybdenum production is a by-product of copper mines.

Exhibit 5: New molybdenum production

		Incremental production			
Projects	Country	2007E	2008F	2009F	2010F
Climax	US			5	15
Davidson	Canada		0.1	4.4	
Golden Phoenix	US	2.0			
Roca	US	2.0	0.5		
Ruby Creek	Canada				3
Mount Hope	US			5	15
Spinifex Ridge	Australia			5	10
Mineral Park	US			3	3
Cerro Verde	Peru	4.0			
Total		8.0	0.6	22.4	46.0

Source: Desjardins Securities, CRU, Teck Cominco Limited

Exhibit 6: World molybdenum production



Source: Company reports

Note that, as shown in Exhibit 2, we expect production from China and other former Communist countries to increase 8.0% to 108m lbs in 2007. There is much discussion in the molybdenum market at present as to the level of Chinese exports the government will license. We have assumed that any surplus supply in China will be made available to the broader market. Furthermore, we do not envisage a worldwide 'roaster bottleneck', ie there will be sufficient roaster capacity brought onstream through 2011 to process incremental molybdenum supply. Below, in Exhibit 7, is a list of proposed roaster projects.

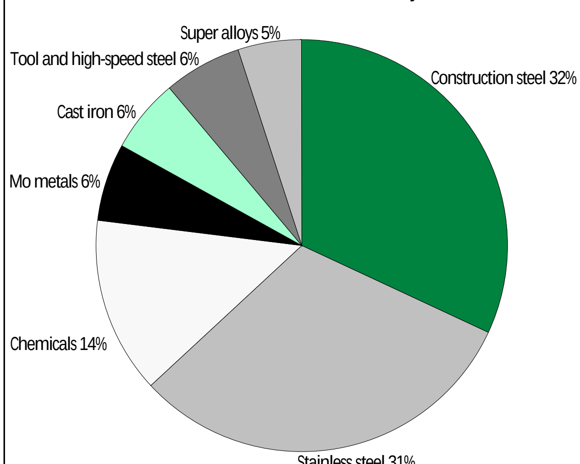
Exhibit 7: Molybdenum roasting projects

Company	Location	Project	Capacity (Kt/yr Mo)	First year at designed capacity
Sadaci (MOLYMET)	Ghent, Belgium	Roasting plant expansion	2.3	2006–2009
MOLYMET	Nos, Chile	Roasting plant expansion	20.0	2006–2009
Amerigo Resources	Santiago, Chile	New roasting plant	0.5	2006
Soyuzmetallresurs	Ziriken, Chita, Russia	New roasting plant	3.0	2006
Hunan Shizhuyuan	Shizhuyuan, China	Process plant expansion	1.0	2007
Idaho General	Mount Hope, Nevada, US	New roasting plant	15.4	2011

Source: Roskill Report

Growing demand. Growth in molybdenum demand should be fuelled by two factors: the relentless rise in stainless steel production and several new applications. The breakdown of end markets for molybdenum is shown in Exhibit 8.

Exhibit 8: Estimated World demand for molybdenum

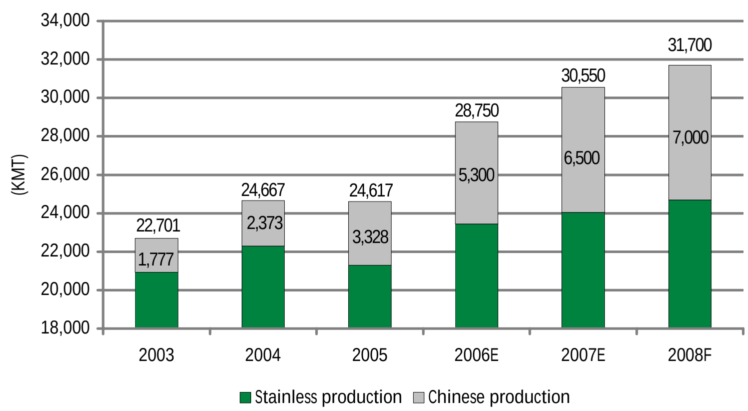


Source: Company reports

Main growth areas

Stainless steel. This end use accounts 31% of molybdenum consumption. In turn, roughly 10% of stainless steel contains molybdenum. We forecast stainless steel to grow by 6.3% in 2007, followed by 3.8% in 2008—see Exhibit 9.

Exhibit 9: Stainless steel growth



Source: Desjardins Securities, CRU

We would expect the molybdenum-containing component of stainless steel to grow slightly faster than the total. This is because of growing applications in desalination plants, oil rigs and nuclear plants.

Construction steel. This end use accounts for 32% of molybdenum consumption. We believe the main growth area for this material is oil and gas pipelines. It has been estimated that 1,200 km of pipe requires 1.9m lbs of molybdenum. Currently, there are roughly 80,000 km of pipelines planned worldwide.

Chemicals. This end use accounts for 14% of molybdenum consumption. The main growth of molybdenum in the chemical sector should be catalysts for the desulphurisation of diesel fuel. About 95% of refiners use either a nickel-molybdenum catalyst or a cobalt-molybdenum catalyst for the production of ultra-low sulphur diesel.

Given the overall potential of these applications, we would describe our forecast increase in demand of 5.3% in 2007, and 3.9% in 2008, as conservative.

Long-term average price—US$18.00 per lb

We have based our long-term price on three criteria:

- The quality of future projects and the speed at which they can be brought onstream
- Projected capital costs—assuming roughly 60% of molybdenum is produced as a by-product at copper mines. Currently, capital costs at new copper mines amount to US$7,000 per tonne of annual copper capacity)
- Power costs (copper production requires roughly US$8.00 MWh per tonne)

Exhibit 10: Leverage

Company	Commodity	Sensitivity
Blue Pearl Mining	Molybdenum	A US$1.00/lb change in the molybdenum price impacts earnings by US$0.10/share
Freeport-McMoran	Molybdenum	A US$2.00/lb change in the molybdenum price impacts earnings by US$0.24/share.

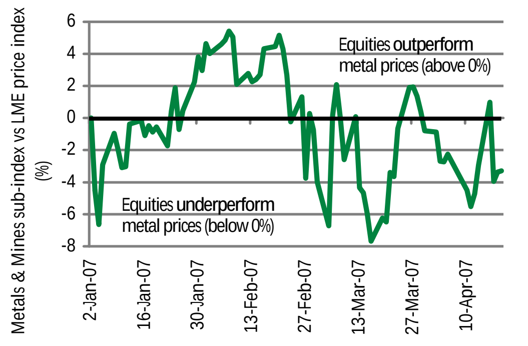
Source: Desjardins Securities, company reports

Equity vs commodity price race—commodities winning

Metals equities vs commodities—underlying base metals commodities continue to outperform. A review of the relative trading levels and direction of prices for base metals commodities, when compared with the direction taken by the equity share prices of TSX-based mining companies, can help identify periods of relative undervaluation or overvaluation for the Mines and Metals sub-index in the TSX.

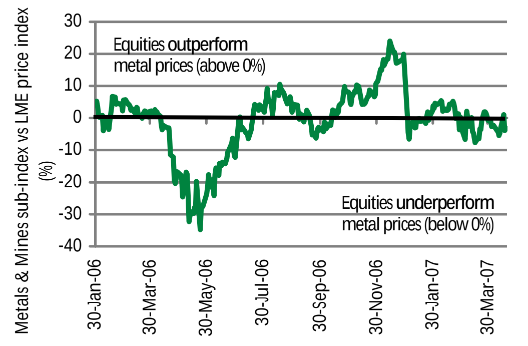
During the majority of the past six weeks, movements of the share prices of Canadian mining companies have underperformed changes in the underlying base metals commodities on a year-to-date basis. This is evidenced in the two graphs below, which illustrate the relative performance of metal prices vs equity share prices of mining companies over the past year (Exhibit 11a) and over the past 16 months (Exhibit 11b).

Exhibit 11a: Year-to-date reflects underperformance of metal equities vs underlying metal prices



Source: Reuters

Exhibit 11b: Metal equities compare favourably today when compared with the majority of the past 16 months



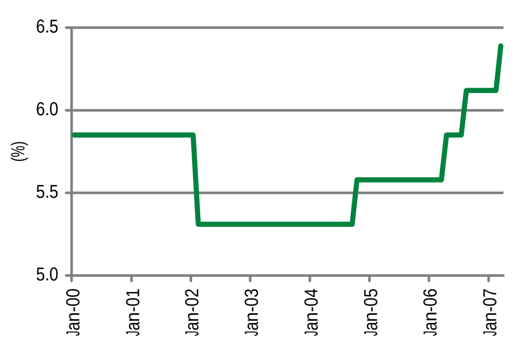
Source: Reuters

Shanghai stock exchange slips on interest rate fears—what does this mean for metals? Mid-last week, China's Shanghai stock exchange index (SSE) declined 4.5% during one day. The dip brought back bad memories of March 1, 2007, when the same index experienced a single-day decline of 8.8% after Chinese authorities threatened to reduce speculation on the exchange. This event acted as a catalyst to driving world stock exchanges down 2–3%, with fears that the Chinese economy was slowing.

The big fear—rising interest rates in China. The key factor to pushing the SSE lower last week was the fear of an overheated Chinese economy. Last week, Chinese authorities announced a 1Q07 economic growth rate of 11.1% as measured by GDP vs a consensus expectation of 11%. In addition, the country posted a consumer inflation rate of 3.3% vs a consensus of 2.8%. Strong economic growth combined with growing inflation renewed fears of a higher interest rate in China. Heard all this before? Sure we have, several times over the past 2–3 years.

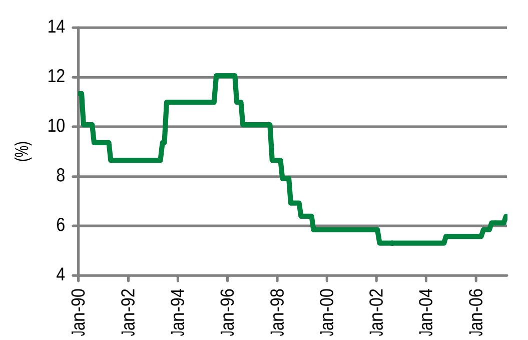
Exhibits 2 and 3 highlight trends of the Chinese benchmark lending rate on a year-to-date basis and over a longer six-year timeframe. Currently, the benchmark lending rate in China is 6.39%. The Chinese have increased interest rates on four occasions since March 2002—each time by 0.27 points. Market expectations are for two further increases to be announced during 2Q07 and 3Q07. This would bring the benchmark lending level to 6.93% by the end of September 2007.

Exhibit 12a: Chinese interest rates up 4x in past five years…



Source: China Metals

Exhibit 12b:…following downtrend through the 1990s



Source: China Metals

Impact on metal prices—past interest rate increases in China. In the past, rising interest rates in China have had little or no impact on LME metal prices. Likewise, the massive decline in Chinese interest rates experienced during the 1996–2000 period also had zero impact on the price levels of LME metals.

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