

19 OCTOBER 2017

AUSTRALIA (NT)

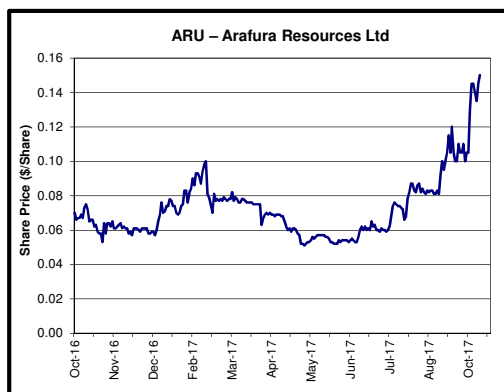
RARE EARTHS (NdPr), PHOSPHORIC ACID

FEASIBILITY STUDY

EXCHANGE: ASX:ARU

CAPITAL PROFILE

Share price (A\$)	0.135
52 week range (A\$/share)	0.05 to 0.155
Number of shares (M)	546.9
Options and warrants (M)	8.4
Converting notes (M)	0.0
Fully diluted (M)	555.3
Market capitalisation (undiluted) (A\$M)	73.8
Debt (A\$M) - Sep 17F	0.0
Enterprise value (A\$M)	61.6
Major shareholders: JP Morgan Nominees (21.3%) East China Min Expl & Devel Bureau (ECB), (20.1%)	
Avg monthly volume (M)	18.8
Cash (A\$M) - Sep 17F	12.2
Price/Cash (x)	2.5
Price/Book (x)	0.4
Listed company options:	No



DIRECTORS

Ian Kowalick (Chairman)
Gavin Lockyer (MD)
Chris Tonkin (Non Exec Dir)
Terry Grose (Non Exec Dir)
Quansheng Zhang (Non Exec Dir)

Mr Gavin Lockyer
Managing Director
Arafura Resources Limited
Tel: +61 8 6210 7666
Perth, WA, Australia
www.arultd.com

Analyst: Dr Tony Parry
tonyparry@rcresearch.com.au

ARAFURA RESOURCES LIMITED

Recent strong price rises and predicted supply shortages confirm that magnet metals should benefit from the very strong projected future growth in electric vehicles. ARU presents a prime opportunity for exposure to the anticipated upside in this sector.

Share Price: A\$0.135

Speculative Buy

The recognition of the impending electric vehicle revolution in the global automotive industry is creating strong investor interest in sectors with upside leverage. The lithium sector has been the main beneficiary, but recently strong rises in NdPr magnet metals prices have resulted in an awakening of investor interest in this sector, which we think is only the beginning. Company valuations in the development space are still very low. In relative terms ARU looks the most under-valued, despite recent share price gains.

INVESTMENT POINTS

- ◆ A looming major supply deficit of magnet feed NdPr looks likely, due to increased demand mainly from the impending electric vehicle (EV) revolution.
- ◆ After years of low magnet metal prices, we are now seeing strong price rises for NdPr oxide which will stimulate investment in new non-Chinese production and is definitely stimulating investor interest in the sector.
- ◆ Lynas Corporation (ASX:LYC) owns the only magnet metals mining and processing project in operation outside China. LYC's revenues have more than doubled in the past year, and the share price is up by >400%, a sure sign that the sector is moving back into favour.
- ◆ The world's EV component suppliers will want increased secure, stable NdPr supply established in low geopolitical risk regions outside China.
- ◆ We think ARU's Australian-based Nolans Rare Earths Project is competitively positioned to become one of the new generation suppliers of NdPr. It is one of only a handful of projects that is well advanced in the feasibility study process.
- ◆ Nolans is underpinned by a world-class long-life NdPr resource which will ensure a mine life in excess of 30 years.
- ◆ Projected unit costs per kg of NdPr are lowest in class for development projects, while ARU's ratio of enterprise value to forecast NdPr production suggests significant under-valuation relative to peers.
- ◆ Our forecasts predict ARU will achieve revenues of A\$428M per annum and EBITDA of A\$238M per annum when the Nolans Project reaches full capacity.
- ◆ To achieve those metrics a gold company would need to produce ~240kozpa at an all-in sustaining cost of US\$632 per ounce.

COMPANY STATISTICS

Year End June	Jun-17a	Sep-16F	2016a	2017a	2018F
Exploration and evaluation (A\$M) *	1.78	1.62	5.64	6.07	8.82
Administration and Corporate (A\$M)	0.66	0.61	3.23	1.75	2.45
Exploration/(Expl.+ Corporate) (%)	73	73	64	78	78
Funding duration at current burn (years)			1.3	1.6	0.3
Shares on issue (pr end) (M shares)	546.9	546.9	441.3	546.9	546.9
Drilling - RAB (M) **	0	0	0	0	0
Drilling - RC/Diamond (M) **	0	0	0	0	0
Land holding ('000 ha) ^	187	187	187	187	187
Capital raisings (A\$M)	3.1	0.0	0.0	6.8	0.0
Funding from JV partners (A\$M)	0.0	0.0	0.0	0.0	0.0
Cash (A\$M)	12.5	12.2	11.5	12.5	3.8
Cash backing (Ac/share)	2.3	2.2	2.6	2.3	0.7
Net asset backing (Ac/share)	15.7	15.9	18.0	15.7	15.6

* Includes reported staff costs

** Drill metres are RCR estimates

^ Tenements held or under application

COMPANY COMMENT

Overview: ARU's flagship is the advanced Nolans Rare Earths Project (Northern Territory (NT), Australia). The Nolans deposit is 135km NNW of Alice Springs, and has Measured and Indicated JORC resources of 34.9Mt @ 2.79% total rare earth oxides (TREO) and 12.1% phosphate (P_2O_5). This is equivalent to over 970,000t of contained TREO. The current mine plan supports a mine life of >30 years at a production level of 14ktpa equivalent TREO. The project is world scale, and strategically important with a high content of potentially critical magnet metal rare earths (REs) neodymium ("Nd") and praseodymium ("Pr") which will drive the economics.

Electric Vehicles and Wind Turbines to Drive RE Demand.

When we talk of RE demand we are really focusing on one key RE component – NdPr oxide ("NdPr") which is a critical raw material input to permanent magnets that are essential in the development of permanent magnet synchronous motors found in most hybrid, plug-in hybrid and battery electric vehicles (EVs) and generators for wind turbines. NdPr magnets are about three times stronger and one tenth of the weight of conventional magnets, and there is no known substitute to achieve similar performance.

As much as the lithium sector has been ignited by the projected rapid demand growth for lithium in relation to lithium-ion battery energy storage for the impending EV revolution, we see similar demand potential for NdPr being driven by the same revolution in EVs – cars, light duty vehicles, mass transit vehicles and bikes. Demand growth of 8% CAGR looks readily achievable, which means that demand for NdPr oxide could increase by around 30,000tpa in the next 7-8 years. Typically, new magnet metals development projects are expected to each supply around 3,000-5,000 tpa of NdPr oxide (ARU's Nolans Project is 3,600 tpa) so to avoid a major supply shortfall quite a few magnet metals projects will need to come online in the next decade.

Magnet Metal Supply – Diversifying away from China.

Currently about 85% of the world's REs comes from Chinese-sourced (sanctioned and illegal) supply. The graphic on page 4 indicates that Chinese supply of magnet metals is unlikely to increase in the next few years.

Potential end-users of NdPr oxide, particularly those in the western world, will no doubt place great importance on security of supply when establishing offtake agreements as the demand from EVs and wind turbine manufacture grows. They will be particularly keen to enter into supply agreements with non-Chinese suppliers with mining and processing operations in stable, low sovereign risk countries, which is likely to underwrite the financing and development of RE projects in these jurisdictions. In this regard ARU's Nolans Project is one of the standouts. Currently Lynas Corporation (ASX:LYC) with 5,500ktpa NdPr production is the only western world supplier of magnet metals.

Price Rises Igniting Investor Interest in Magnet Metals: In the past four months NdPr oxide prices have almost doubled (see chart page 3) to nearly US\$80/kg, but have taken a breather and eased to currently US\$67/kg. This is a sure sign of the tightening in the market and anticipation of the increased rate of demand to come.

These price rises have transformed the profitability of LYC which is now exhibiting strong cashflow that all of a sudden can comfortably cover its (current) ~A\$360M debt servicing requirements, dramatically reducing the company's perceived risk profile. As the charts on page 4 indicate, LYC's revenue has more than doubled from 3Q16 to 3Q17, and its share price has increased more than fourfold in 12 months. This is a sure sign of increased investor confidence in this sector, which is now starting to flow towards companies with magnet metals development projects such as ARU. ARU's share price has approximately doubled in the past twelve months, but our contention, based on the Nolans Project attributes and relative value compared to its development peers, is that it has much further to go.

Nolans Status and Development Timetable: The Nolans Environmental Impact Statement was lodged in May 2016. ARU is now focusing on pilot plant operation to confirm (to Definitive Feasibility Study level) key aspects of the processing flowsheet. The ore beneficiation, phosphoric acid production

and bulk pre-leach stages have been successfully piloted. Currently the acid bake process is being piloted, with the completion of pilot plant work on rare earth processing and rare earth separation expected to be completed by end of 2Q18. The final Feasibility Study should be completed in 4Q18, paving the way for detailed engineering and financing in mid CY19 and a possible first production in 4Q20 or 1H21. The Nolans Project has attained Major Project status with the Australian and NT governments which should help reduce approvals timelines.

Production and Earnings Forecasts: As shown on page 5, Nolans is forecast to produce 3,600tpa NdPr oxide out of a total output of 14,000tpa total TREO and 110,000tpa of phosphoric acid by-product. In terms of revenue, the NdPr magnet metals will dominate – forecast 75.1% of revenue, phosphoric acid 11.6% and other REOs just 6.5%. Our model forecasts FY23 (full nameplate capacity) revenue of A\$428M pa and EBITDA of A\$238M pa.

RCR Project Valuation: Our after-tax valuation (based on a 10% discount rate, 100% equity basis and 30-year mine life) A\$424M or A\$0.78 per share. The base case assumes a long-term NdPr price of US\$67/kg, which is similar to the current spot price. We consider this to be a conservative price forecast based on the demand outlook. Each US\$10/kg increase in the NdPr price increases the assessed after-tax NPV by ~A\$240M or ~A\$0.44 per share.

ASX-Listed Peer Group Comparison: We have compared forecast operational and cost metrics for ARU and four other ASX-listed magnet metal development companies, as well as benchmarking against the current producer LYC. ARU is a stand-out in this emerging producer group in relation to having the lowest projected operating costs (US\$ per kg NdPr oxide), long mine life, low sovereign-risk mining jurisdiction and low ratio of enterprise value to projected NdPr production.

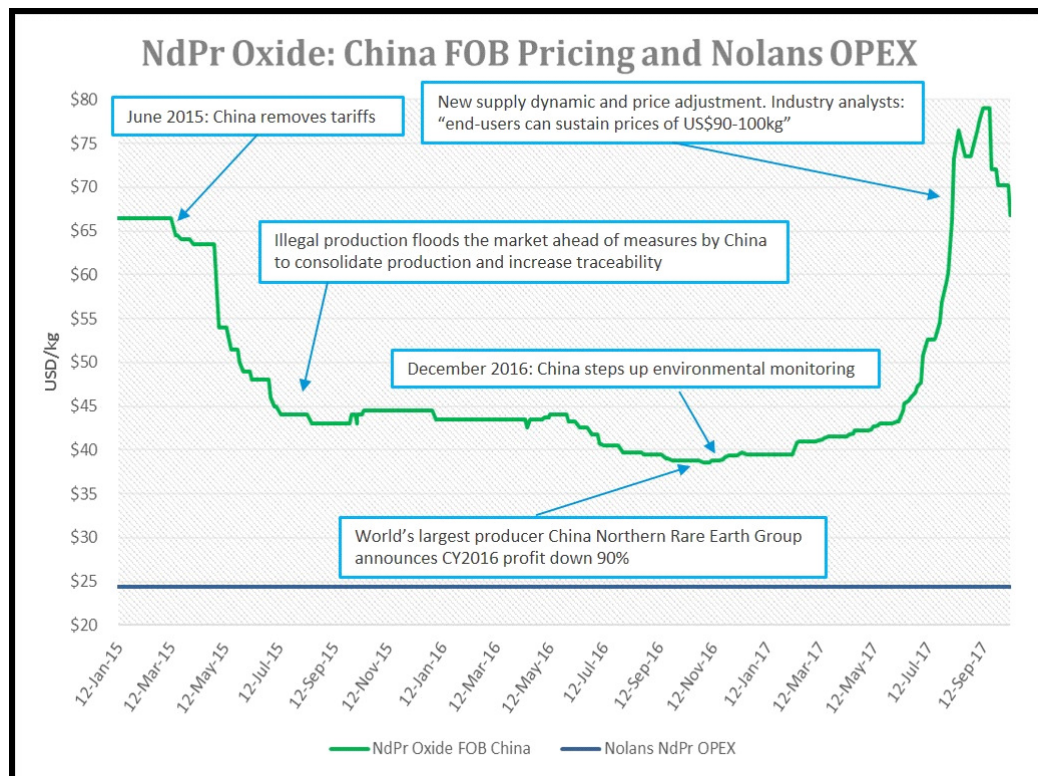
Gold Company Analogy: We have taken our steady state production and earnings forecasts for ARU and re-stated them in terms of the equivalent that a gold mining company would need to achieve. This analysis shows that ARU's forecast FY2023 revenue and profitability is equivalent to that of a gold company producing ~240kozpa with an all-in sustaining cost of just US\$632/ounce. At the same time we have identified a yawning gap between gold mine development company valuations and rare earths developers. We are not saying the gap will be eliminated, but it is starting to look way too big with recent NdPr price rises and the improved outlook for the sector.

Corporate: As at 26 September 2017 ARU's cash balance was A\$12.2M. The cash burn rate for project development, project evaluation and overheads has averaged just under A\$2M per quarter in FY2017. We don't see a pressing need for a further capital raising until 2H18, however the company has always sought to maintain a sizeable cash buffer.

Key 'Big Brother' Partnerships: ARU has entered into a MOU with South Korean chemical giant OCI to establish a Joint Venture Rare Earth Separation Plant in South Korea to toll process Nolans material. OCI also operates chemical plants in the USA, China and Europe. There are significant operational and financial benefits in co-locating the proposed JV RE Separation Plant near OCI's existing Gunsan chemical plant in South Korea. The MOU will assess the opportunity for joint funding and technical collaboration.

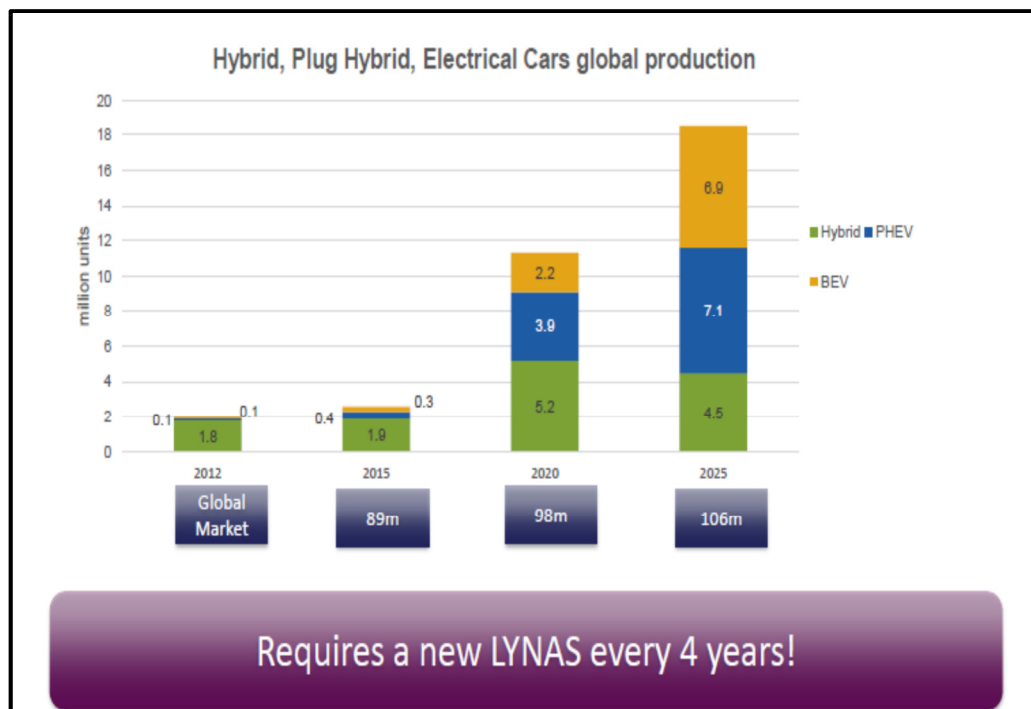
Investment Comment: We have previously commented that share market investors are starting to spot a "lithium look-alike" in the magnet feed NdPr sector. This appears to be coming to fruition with strong recent price rises for magnet metals and the share price of the western world's only producer Lynas Corporation (ASX:LYC) leading the way (showing you can make money out the much maligned rare earths) soaring by ~400% in the past year. Now there are signs that the share prices of the small cohort of ASX-listed magnet project development companies are starting to react with some strong gains in the past six months. We believe this is only the beginning, and for investors to go along for the ride, ARU is our favoured entry.

DEVELOPMENTS IN MAGNET METALS MARKETS



Source: ARU

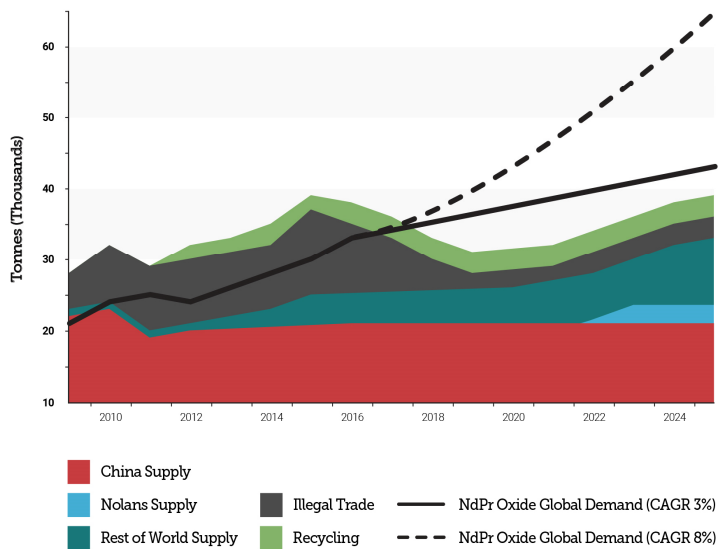
After a long period of depressed prices, we are finally seeing a strong resurgence in pricing for the key magnet metals rare earths neodymium (Nd) and praseodymium (Pr). Prices rose particularly strongly in August and September 2017 and have since eased slightly to around US\$67/kg, up by ~70% on prices at the start of CY2017.



Source: Lynas Corporation

To summarise the reason for the strength of magnet metals prices we have borrowed this chart from a recent Lynas Corporation (ASX:LYC) presentation. They assert the EV revolution will require a new Lynas (i.e. 5,500tpa of NdPr oxide) every four years. To put that in perspective, ARU's Nolans Project is forecast to produce 3,600 tpa of NdPr oxide.

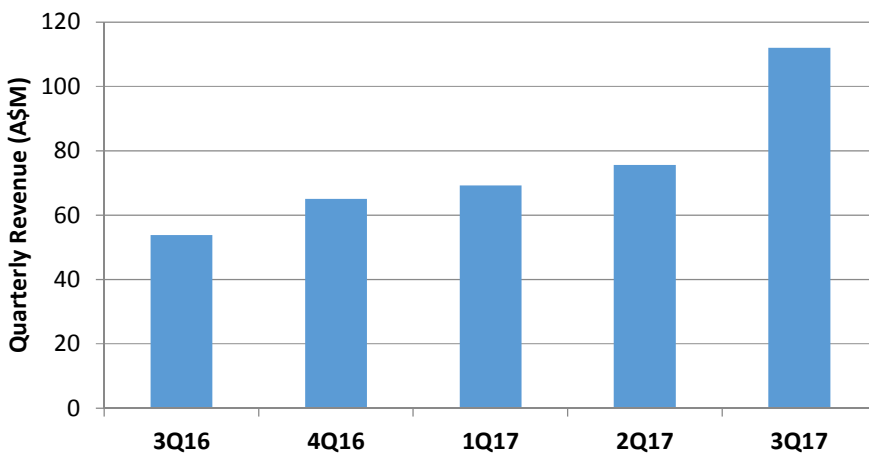
NdPr Oxide Supply & Demand



The looming NdPr magnet metals supply gap is also represented in the demand projections with a forecast increase in NdPr demand of up to 8% per annum (dotted line), which would require an extra ~30ktpa within a decade. Note the recent reduction in illegal trade from China and forecast lack of growth from this country. “Rest of World Supply” is currently Lynas Corporation – the only Western world producer at present.

Source: ARU

ASX:LYC Sales Revenue



The real impact of NdPr price rises is now starting to show up in a dramatic rise in revenue and profitability for Lynas Corporation (ASX:LYC). Year-on-year revenue for the September 2017 quarter is up by 108% and the company is now accelerating debt repayments – inconceivable twelve months ago.

LYC – Lynas Corporation Ltd



Hence a quadrupling of the LYC share price in the past twelve months. We see LYC as a bell-weather stock which demonstrates the changing investor sentiment in the magnet metals sector – a sentiment that will continue to see increased confidence in the next generation of western world magnet metals producers (of which ARU is a lead contender) which are required to come on stream to fill the looming supply gap.

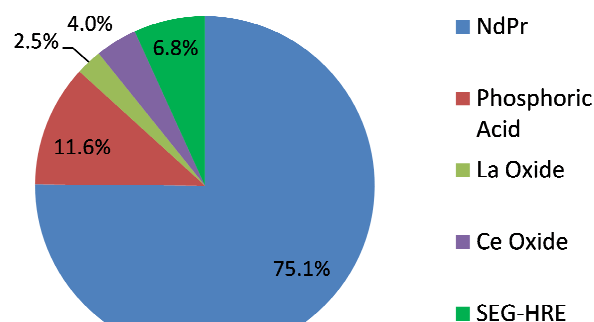
RCR FINANCIAL MODEL FOR THE NOLANS RARE EARTHS PROJECT

RCR Nolans Project Financial Model Base Case Key Assumptions

Long term exchange rate	A\$/US\$	0.75
Price escalation	per annum	0.0%
Cost/Capex escalation	per annum	0.0%
Tax Rate	per cent	30.0%
Royalty rate (est.)	per cent	3.5%
Product Prices		
NdPr Oxide	US\$/kg	67.00
La Oxide	US\$/kg	3.00
Ce Oxide	US\$/kg	1.80
SEG-HRE	US\$/kg	33.00
Phosphoric Acid	US\$/tonne	340.00
Production		
Mine Life	years	30
Initial Production	quarter	1Q21
Nameplate mining rate	kt/yr	525
Nameplate production	quarter	1Q23
Nameplate Product Output		
TREO	tonnes/yr	14000
NdPr Oxide	tonnes/yr	3600
La Oxide	tonnes/yr	2660
Ce Oxide	tonnes/yr	7080
SEG-HRE	tonnes/yr	660
Phosphoric Acid	tonnes/yr	110000
Operating Costs		
Corporate Overheads	A\$/kg NdPr	34.72
Operating Costs	A\$/kg NdPr	34.72
Corporate Overheads	A\$/M per annum	8.40
Capital Costs		
Pre-Production	US\$M	680
Sustaining	Per cent	2.0%
ARU Tax Losses	A\$/M	176

Forecast Revenue Distribution

(After nameplate production achieved in FY2023)



RCR Base Case Model Outputs Summary

Year: FY2023 (NAMEPLATE PRODUCTION ACHIEVED)

Revenue	A\$/M	428.1
Operating Costs	A\$/M	166.7
Admin & Overheads	A\$/M	8.4
Royalties	A\$/M	15.0
EBITDA	A\$/M	238.1
Depreciation	A\$/M	44.3
EBIT	A\$/M	193.8

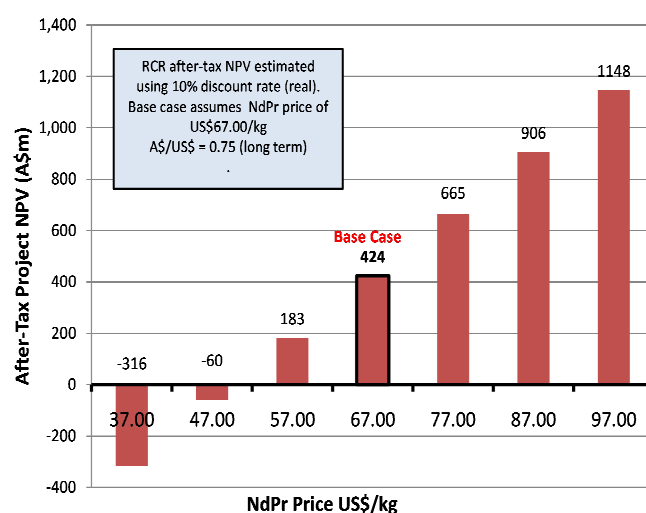
Note: Product prices escalated at 4%p.a. from 2017
Opex, capex, overheads esc. at 2.5% p.a. from 2017

Corporate Valuation

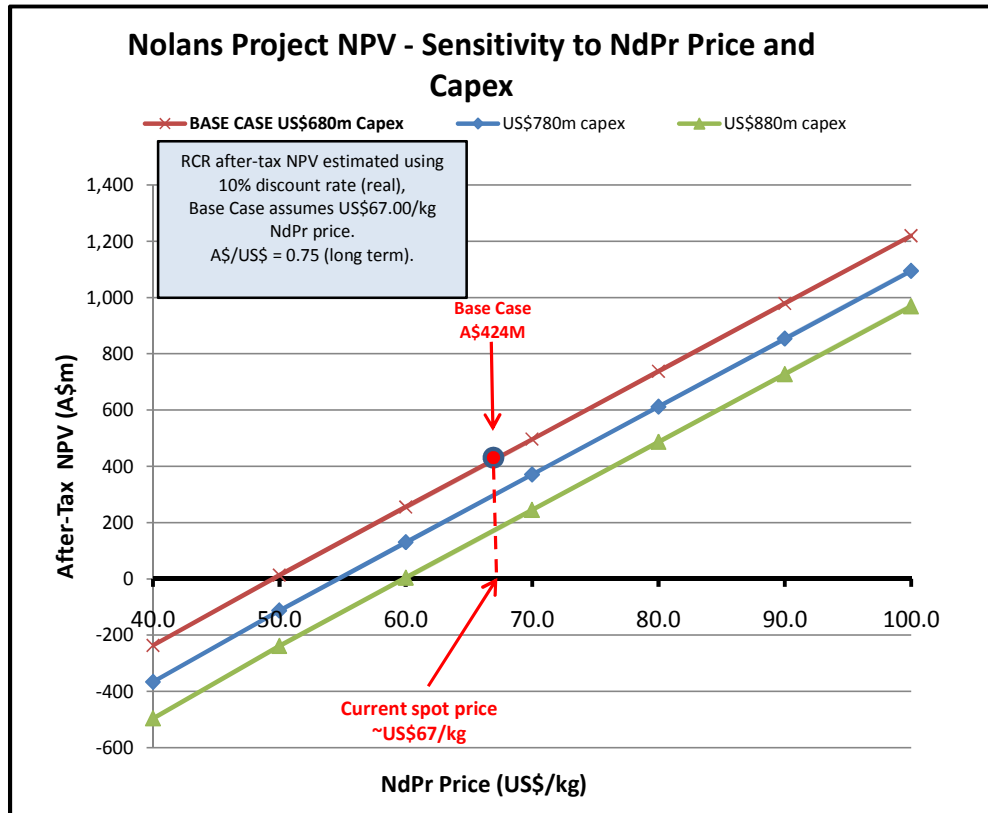
NPV @ 10% discount rate	A\$/M	423.9
NPV per ARU share	A\$/share	0.78

NPV is calculated after tax, allowing for ARU current tax losses (est. ~A\$176M).
Assumes 100% equity funding.

Nolans Project NPV - Sensitivity to NdPr Price



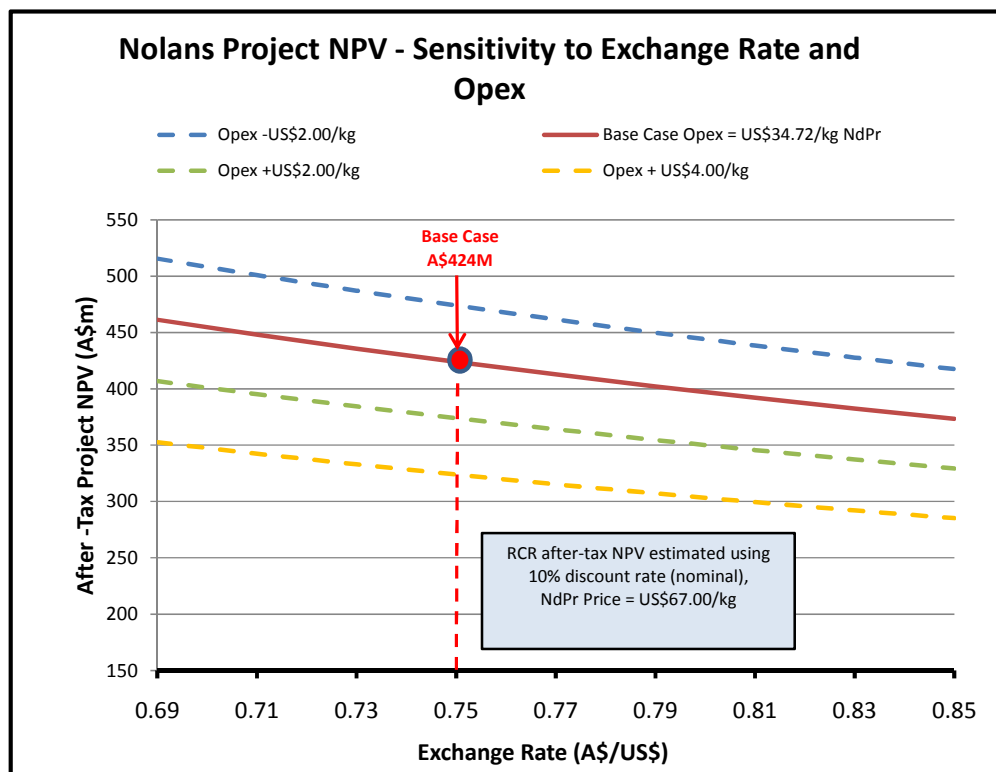
CORPORATE VALUATION – SENSITIVITY ANALYSIS



Our analysis suggests that the project needs sustained NdPr prices above US\$55-US\$60/kg to attract project financing.

The NPV reduces to zero with a US\$17/kg reduction in NdPr price to around US\$50/kg.

A blow-out in capex of ~A\$100M is equivalent to a reduction in NdPr price of approximately US\$4/kg.



A variation in the long term A\$/US\$ exchange rate to 0.85 (up from 0.75 assumed in the base case) reduces the after-tax NPV by approximately A\$50M, to A\$373M.

Every US\$2/kg change in operating costs from US\$34.72/kg NdPr oxide assumed in the base case affects the after-tax NPV by ~A\$50M.

COMPARING MAGNET METALS TO GOLD DEVELOPMENT COMPANIES

RE-MODELLING ARU'S FORECAST FY 2023 REVENUE AND COSTS AS A GOLD COMPANY EQUIVALENT

Gold Price	US\$/oz	1300
Long Term Exchange Rate	A\$/US\$	0.75
ARU Tonnes Mined	ktpa	525.0
ARU Revenue	A\$M	428.1
Gold Production Equivalent	oz pa	247,003
Grade Equivalent (95% recovery)	g/t	15.40
ARU Opex C1 Cash Costs	A\$M	166.7
Opex Equivalent C1 Cash	A\$/oz	674.7
	US\$/oz	506.0
ARU Admin	A\$M	8.4
ARU Royalties	A\$M	15.0
ARU Sustaining Capex	A\$M	18.1
AISC	A\$M	208.2
AISC Equivalent	A\$/oz	842.8
	US\$/oz	632.1

Blue shaded boxes = forecast for ARU in FY2023

Red numbers = Gold-equivalent production, grade and costs

If ARU was a gold company...

...achieving forecast annual revenue of A\$428.1M from mining 525ktpa would imply a head grade of 15.4g/t and would require annual production of about 247kozpa...

...and ARU's forecast annual cash cost of A\$166.7M would be equivalent to US\$506/oz...

...and the AISC would be equivalent to US\$632/ounce...

Commentary: Gold versus Magnet Metals

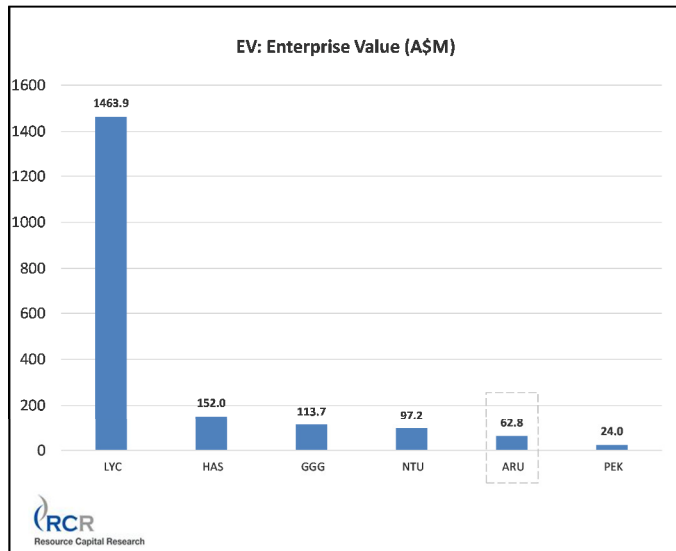
Based on our forecasts, ARU's revenue and costs for FY2023 are equivalent to those that would be generated by a gold mining company producing ~247kozpa of gold at an All-In Sustaining Cost (AISC) of ~US\$632/oz. A gold development company with those credentials would surely attract huge investor interest.

ARU's current Enterprise Value (EV) is ~A\$70M. Compare this with Dacian Gold (ASX:DCN) with a current EV ~A\$400M developing the Mt Morgans Gold Project (forecast 186kozpa @ AISC ~US\$810/oz; ~A\$220m capex) or Gold Fields Limited's purchase of 50% of the 270kozpa Gruyere Gold Project for A\$350m (purchasing 50% of ~270kozpa @ AISC US\$740/oz; ~A\$500M capex, plus exploration upside. ARU's Nolans Project forecast capex is ~A\$870M at current exchange rates.

Why the massive gulf in valuations between gold projects and potentially out-performing rare earths companies?

We believe the main issue driving this differential has been the clear lack of profitability in the sector due to depressed rare earths prices in recent years (as demonstrated by the only two Western world producers of rare earths Lynas in Australia (ASX:LYC) and the now bankrupt Molycorp in the USA). Compounding this is the increased capital raising risk associated with high capital intensity rare earth plants (relative to gold processing plants) and increased technical risk of rare earths production and refining. However, with magnet metal prices now showing signs of a long-awaited up-trend, and Lynas Corporation starting to demonstrate strong positive cashflow and an ability to service debt, the gulf between the gold company valuations and development rare earth company valuations is likely to continue to narrow as the perceived risk in the rare earth sector reduces and investor appetite for rare earth companies continues to grow.

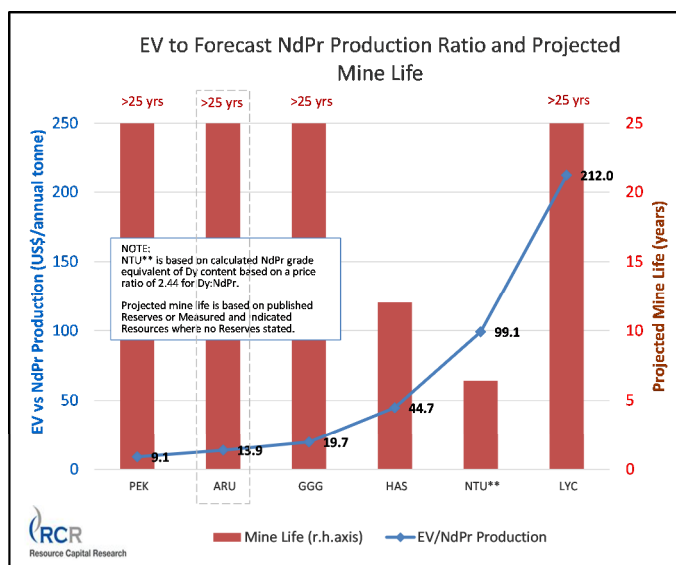
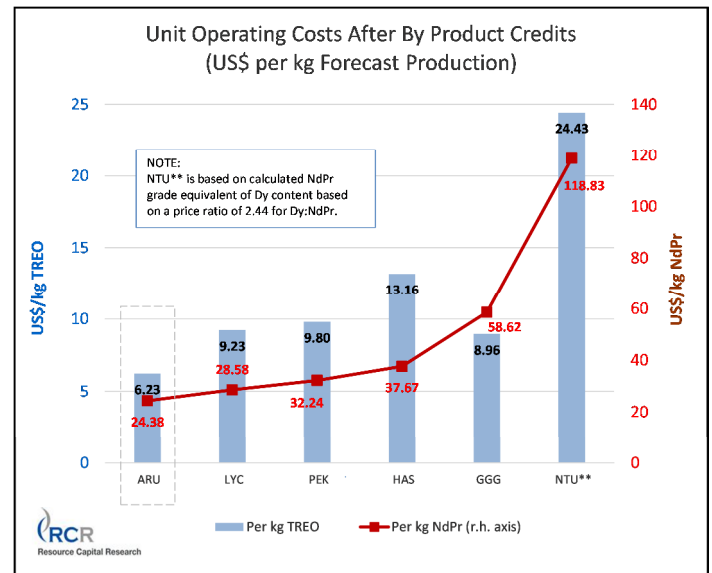
BENCHMARKING ARU AGAINST ASX-LISTED PEERS



The chasm in enterprise value (EV) between the existing producer (ASX:LYC) and the five ASX-listed magnet metals development companies reflects the potential upside if these projects can be financed and brought into production.

ARU's market valuation in terms of EV looks relatively low relative to three of its peers, but is significantly higher than the EV of Peak Resources (ASX:PEK) which has suffered a crisis in investor confidence recently due to sovereign risk issues – its 75%-owned Ngualla Project is in Tanzania where recent Government law changes have caused investor flight.

By contrast, ARU's projected unit operating costs (after by-product credits) are leading the pack and come in marginally under those reported by ASX:LYC in its September 2017 quarterly report. Of particular importance are the unit operating costs per kg of NdPr (red data points).



The ratio of EV to forecast NdPr production shows ARU in a relatively undervalued position relative to its peers, except for ASX:PEK with its Tanzanian exposure. The implied undervaluation is further reinforced by the long projected mine life for ARU (based on Measured & Indicated Resources).

ASX-Listed Magnet Metals Companies

Company	ASX Code	Project	Project Equity	Location	Stage	First REO production*	Share Price (A\$)**	12 Month High	12 Month Low	12 Month Gain
Arafura Resources Ltd	ARU	Nolans	100%	NT	BFS well advanced	2020	0.135	0.155	0.050	92.9%
Greenland Minerals & Energy Ltd	GGG	Kvanefeld	100%	Greenland	FS Completed	2020	0.100	0.195	0.055	44.9%
Hastings Rare Metals Ltd	HAS	Yangibana	70-100%	WA	Sc. Study, PFS Underway	2020	0.260	0.265	0.071	173.7%
Lynas Corporation Ltd	LYC	Mt Weld	100%	WA/Malaysia	In Production	2013	0.220	0.230	0.052	307.4%
Northern Minerals Ltd	NTU	Browns Range	100%	WA	DFS complete	2022	0.117	0.175	0.091	-19.3%
Peak Resources Limited	PEK	Ngualla	75%	Tanzania	PFS, Commenced BFS	2019	0.040	0.130	0.034	-42.9%

* First production based on current projections in company releases, apart from HAS which estimates 2018 but RCR estimates 2019, and LYC which is already in production. NTU is projected to start pilot plant production in 1H18, but not full production until 2022.

Production for development projects is contingent on successful project financing and offtake agreements.

** Share prices are closing prices as at 17 October 2017

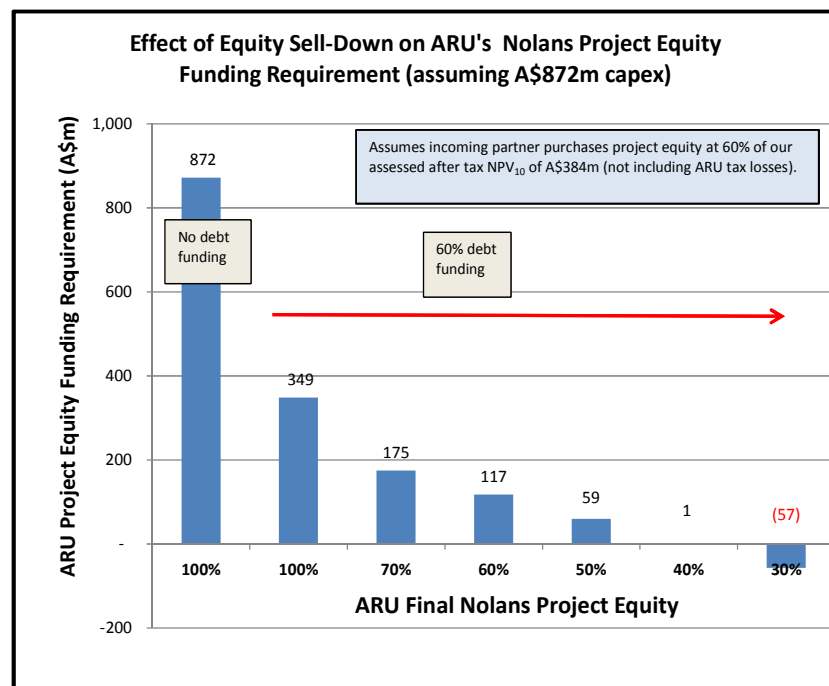
SELECTION CRITERIA

The ASX-listed project developers in the Table all have a major component of magnet-feed NdPr in their projected product mix, or in the case of NTU, Dy, which is also predominantly a magnet feed.

Notes and assumptions utilised in the preparation of the ASX-listed peer comparison

- Exchange rate of AUD1 = USD 0.79.
- Forecast operating data for development projects based on published company reports and project updates. ARU forecast operating expense includes provision for staff and administration costs.
- Enterprise values based on closing share price on 17 October 2017.
- Contained NdPr (kt) and annual NdPr production is presented on a project basis. NdPr production has not been adjusted to reflect the relevant underlying project interest for PEK (75%) and HAS (91%).
- LYC NdPr annual production is based on "ready for sale production volumes" and operating costs based on total operating and staff (but not administration) cashflows reported in the last four quarters, up to and including the September 2017 quarter.

ADDRESSING THE PROJECT FINANCING RISK



We consider that perceived capital raising risk is one of the major factors that results in valuations of magnet metals development companies such as ARU being around one order of magnitude less than that of the current ASX-listed producer – LYC. The question is asked, "How can a company such as ARU capitalised at around A\$70M raise the estimated US\$680M (A\$872M) capital expenditure to get into production?"

In our view, the answer is in proceeding with a project equity sell-down, which will facilitate the path to project financing – particularly if it involves an end-user who is more interested in offtake contracts than making a killing on the investment (i.e. likely to pay more than an arms-length investor).

To illustrate this, the graph on the left shows, (based on our valuation assumptions), that if 60% debt financing is secured for the Nolans Project, bringing in a partner to take up 40% project equity would leave ARU with A\$117M equity funding to raise. A 50% partner would require ARU to raise just A\$59M equity.

CONTACT

Resource Capital Research
ACN 111 622 489

Level 21, 68 Pitt Street
Sydney NSW 2000

T +612 9439 1919
E info@rcresearch.com.au

www.rcresearch.com.au

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