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Metals Exploration Plc

41.0p
Upgraded Resource 02/11/2007



Metals Ex (Metals Ex, AIM:MTL) has announced an improvement in its resource confidence and its total metals inventory on the results of the latest resource estimation.

More than 13,500m (over 91 holes) of drilling was carried out at 50m by 25m centres. The previous resource was 28.3Mt at 2.23 g/t gold and 0.06 % molybdenum (moly). The new resource estimate is 28Mt at 2.27g/t gold and 0.06% moly. Not exactly a startling change, but this hides some detail that should be seen well by investors.

Geologically the deposit has been shown to have a relatively continuous gold grade, though the thickness does vary. An area that was expected to return additional resources was cross-cut by a phonolite dyke, meaning that under the JORC reporting standard the far side needs more drilling in it to infer a resource. The previous drilling had returned mineralisation of a similar tenor on that far side. The more intense in-fill drilling has shown up some geological structures that should help the company better model the deposit and focus later phases of drilling. But that's all for the geological specialists amongst us.

The total contained gold has increased by 0.8% and the total contained molybdenum has increased by 14.8% despite an area of the resource being cut by that dyke. This has come about by an increase in grade rather than an increase in total resource. So far only 20% of the total area of the original inferred resource has been drilled out to a resolution sufficient to qualify for indicated status, but the grade increase in this area has bumped up the total metals inventory. The increase in grades, mainly the 50% increase in moly grade, leads to a gold equivalent increase of just under 200,000 oz (at \$25/lb for moly and \$650/oz for gold). Of the 2.05Moz of gold now estimated to be present in the resource 409koz are now slated as indicated, with over 10Mlb moly also indicated.

At 0.09% moly the Runruno deposit is approaching economic grades on moly alone. Of course over 2Moz of gold do not hurt the deposit's potential.

Share Price: 41.0p
12m High: 46.75p
12m Low: 22.5p
Market Cap: £37.0m
Shares in Issue: 91.6m undiluted
112.6m fully diluted
Gearing: nil
Cash at the Bank: £4m/ \$8m
EPIC Code: MTL
SEDOL No: B0394F6
Sector: Mining
Market: AIM
Broker and Nomad: Collins Stewart
PR: Pelham PR

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Previous Note: Free Gold ? 34p - 17/08/07

Analyst: Ian Falconer

Valuation

In the light of the most recent metals price predictions we are going to lower the moly price used in our forecast to \$25/lb from \$30/lb.

Data presented at the recent Mining Journal 20:20 Molybdenum Day including an expert speaker from the CRU Steel Business Unit predicted a rapidly growing supply gap from 2011. While much of that gap may be accounted for by mines that are currently in development it would still require at least one new moly-only mine the size of Thompson Creek to come online every year to satisfy the growing demand over and above those already known.

We have also slightly increased the operating costs associated with Runruno. Our valuation now uses \$2/t ore mined, \$1/t waste removed and \$7/t ore processed as basic OPEX metrics. Indophil/Xstrata's Tampakan development in the southern Philippines has forecast costs of less than \$7/t ore milled for a bulk mined underground operation. Runruno is likely to be an open pit. CGA's Masbate Mine has forecast operating costs of \$11.65/t of ore milled. We are comfortable that our cost estimate currently reflects realistic values, however the rapid rise in oil prices will inevitably impact costs unless alternative energy sources are used. At present, diesel powered generators would appear to be the only option unless geothermal energy could be proven viable on this ex-volcano.

EBITDA is currently shown at an average of £42.2m per year for the 10 year mine life. The revised valuation shows a post-tax NPV of £92.9m or 85.2p per share (fully diluted) at 30% discount using \$650/oz gold and \$25/lb moly.

Note; this does not include any value derived from the nickel assets in Indonesia. It does however assume that the CAPEX for Runruno will be self-funded from revenue generated by those Indonesian operations. In effect we are deferring the value assumed to be in the nickel across to Runruno where it can be reclaimed back against tax. If conventional financing alternatives were sought these would have the appropriate impact either on debt interest/repayments or additional equity distribution, or combination. Development of the Indonesian assets may also have those effects but they could reasonably be expected to have a less dilutive effect due to lower CAPEX requirements.

Metallurgy

Metallurgical tests are ongoing, with special focus on increasing the recovery of molybdenum. The recovery of 50% of contained moly to a concentrate would probably result in positive cash flow from this steel additive, but a real prize would be to prove that it is possible to recover the majority of contained moly to concentrate. If 98% of contained moly were

recovered (at \$650/oz of gold and \$25/lb moly) the mine would switch from being a gold mine with by-product moly to a moly mine with by-product gold. That may not be as attractive to investors in name, but it would offer a built-in hedge against quick price fluctuations in either metal as either metal would be capable of supporting the mine.

Recoveries of 95% contained gold have already been demonstrated with a combination of gravity, floatation and pressure oxidation.

We know that the company is already exerting considerable effort to enhance the moly recovery and expect it to continue to explore all avenues in its hunt for better recovery.

Molybdenum can present some unusual problems in processing and sampling when compared with other more "normal" metals. One of its more specialized uses is in lubricants and it is the properties that make it useful in this role that can make it tricky to extract in the first place. Its principle ore, molybdenite (MoS₂), has a crystalline structure much like graphite where large sheets of metallic ions are loosely bound to each other. Pressure parallel to these sheets can and does cause the bonds to shear and the sheets to slide across one another with very low resistance. As a result it is relatively easy to smear molybdenite off samples or break it down into microscopic fragments that are difficult to recover economically (known as slimes in the discipline of hydrometallurgy).

There are ways to mitigate this process and recover a high proportion of the total moly content but the balancing act is whether these methods are economic when the molybdenite is intermingled with gold.

Indonesian Nickel

The second front of progress for Metals Ex is in the current boom industry of direct-ship nickel laterites. Historic drilling on the Waigeo Island laterite resource (in which Metals Ex has a 90% interest) shows a non-JORC compliant resource approaching 36Mt at 1.5% nickel and 0.14% cobalt with a matrix containing around 35% iron. The low phosphorus of the iron content could make this resource attractive to steel makers. The resource is at surface and according to the company may extend up to 50m in depth. Below it is a saprolite layer, seen in outcrop, which is potentially richer in nickel than the known shallower resource this overlies the ophiolitic bedrock (a serpentinised harzburgite). The saprolite has not yet been drilled so its extent, thickness and grade is not known. The laterite at surface is thought to extend over much of the 12,000 hectares of the property.

The area that Metals Ex is concentrating on at present is known as the Sarenbon deposit. It holds around 15.7Mt at 1.53% nickel, 0.14% cobalt and 34% iron. This estimate is, again, historic and non-compliant against any reporting standards, but is being drilled

right now so we expect that some assay results will be available in due course. The minimal infrastructure required to bring this type of deposit into production may be possible to fund through forward sales to the nickel-hungry Far East Market.

Press Reports of Anti-Mining Concerns

Metals Ex appears to have got caught up in regional concern over the practices of international miners operating in the Nueva Vizcaya region of Luzon. The Secretary for the Department of the Environment and Natural Resources (DENR), Lito Atienza visited the region on October 24th to meet with individuals and groups who were able to voice any concerns directly to him.

Secretary Atienza was reported by the Philippines press (Inquirer.net) to strongly support the case for legal mining development in line with central government policy but accepted that some tribal leaders had raised valid issues regarding consultation and land ownership. These tribal leaders do not represent the population of the area encompassing Metals Ex's Runruno project which is not located in a tribal area.

There is no suggestion in these reports of lack of support from the population at or around Runruno or from the government agencies that issue exploration and mining permits for that area. Indeed the Mayor of Quezon, the nearest town to Runruno, believes that his area's positive views on the activities of Metals Ex and the company funded Runruno Foundation are being ignored by regional government (The Manila Bulletin Online). Metals Ex is confident that he represents the views of its neighbours.

This has all the hallmarks of an on-going battle between the pro and anti-mining fraternities. What matters is that the local government and populous support the ongoing work by Metals Ex. At present that support appears strong and press reports from both sides of the argument seem to confirm this.

Discussion

This season's drilling has returned an upgraded resource as expected. The vagaries of geology meant that it wasn't an increase in volume. Instead it was an increase in grade, but intersecting the dyke did increase the company's knowledge of the deposit even if it didn't increase the deposit's size. The increase in moly grade was the surprise (a pleasant one) with a 50% grade increase in the area drilled to indicated confidence under JORC. This adds over

5Mlbs to the total contained molybdenum. At \$25/lb this is \$150m worth of metal in-situ.

One of the company's geologists was in London last month full of enthusiasm for the nickel deposits on Waigeo Island. We look forward to seeing some hard geological data on what looks like a great acquisition (see Hardman & Co note "Free Gold?" 17/08/07). The company has apparently generated some interest both in the Far East and closer to the home markets with this nickel property. This is not surprising given its potential size.

We know that the company is watching with great interest the European Nickel/Rusina JV which is testing ENickel's heap leach technique on Filipino nickel laterite. The Waigeo deposit, as currently estimated, would be a similar size to both Rusina's Acoje laterite and ENickel's Caldag Mine. The heap leach process produces a mixed nickel-cobalt hydroxide concentrate that is much more saleable in the long term than direct shipping unprocessed laterite.

The company's intention to use proceeds from the sale of nickel laterite into the direct-ship market in order to fund short-mid term future development will, if successful, make it the master of its own destiny to a large extent. In our previous note we showed rough calculations that suggest that the operations on Waigeo Island could spin off significant profit. Possibly enough profit to be able to develop the Runruno complex far enough to know its full potential.

However, it depends on how long that development takes and what the full potential of the Runruno complex is as to whether enough profit would be generated to develop the gold-moly resource through to production. At present we feel that the nickel revenues will probably be enough to develop the known 2Moz deposit.

If a valued-added nickel product were shipped from Indonesia a completely different shape of company would emerge, but of course costs would be higher and time-spans would lengthen.

Our valuation of Runruno alone has become more conservative but not because of any deficiency in the deposit or the quality of the operation to develop it. We feel that this is justified given the increasing exchange rate risk, increasing oil prices and the increasing number of moly-only mines under development.

Metals Exploration PLC

Summary NPV30 Calculation for Runruno

02/11/2007

All figures reported in £ Sterling unless stated

Year Ending December	Gross Mining Revenue (Note 1)	Variable Costs (Note 2)	Net Cashflow	Cumulative Capital Spend (Note 3)	Depreciation Amount (Note 4)	Taxable Income	Tax Rate (Note 5)	Taxation Amount	Discounted Cash Flow (Note 6)	Net Present Value after Tax & Depreciation
1	21,235,438	14,780,700	6,454,738	0	0	0	0%	0	6,454,738	92,930,302
2	80,113,628	27,351,225	52,762,403	0	0	0	0%	0	31,220,357	86,475,563
3	80,113,628	27,351,225	52,762,403	200,000	0	52,663,403	50%	5,940,272	21,266,787	55,255,207
4	80,113,628	27,351,225	52,762,403	400,000	80,000	52,623,803	50%	26,311,902	9,212,528	33,988,420
5	80,113,628	27,351,225	52,762,403	600,000	120,000	52,604,003	50%	26,302,002	7,083,894	24,775,891
6	80,113,628	27,351,225	52,762,403	800,000	160,000	52,584,203	50%	26,292,102	5,447,098	17,691,998
7	80,113,628	27,351,225	52,762,403	1,000,000	200,000	52,564,403	50%	26,282,202	4,188,498	12,244,900
8	80,113,628	27,351,225	52,762,403	1,000,000	200,000	52,663,403	50%	26,331,702	3,227,989	8,056,402
9	80,113,628	27,351,225	52,762,403	1,000,000	200,000	52,663,403	50%	26,331,702	2,483,069	4,828,413
10	80,113,628	27,351,225	52,762,403	1,000,000	40,000	52,742,603	50%	26,371,302	1,912,925	2,345,344
11*	22,889,608	7,390,350	15,499,258	1,000,000	0	15,499,258	50%	7,749,629	432,418	432,418
12*	0	0	0	0	0	0	0%	0	0	0

Peak NPV30 £ 92,930,302 \$ 184,931,300 € 137,211,590

Discounted AVPS (Note 7) 94.4 p undiluted
85.2 p fully diluted

Payback Period End Year 3 Dependant on when tax payments are due (see Note 5)

Note 1 Assumes 100% ownership. Year 1 operations assume a six months construction period and a six months production ramp-up.

Note 2 Total variable costs include extraction of ore and waste, processing and refining, marketing and near-mine exploration costs

Note 3 We have allowed sufficient CAPEX for the equivalent of replacing one small FEL every year until Year 7, in addition to the upfront mine and processing plant commissioning. Under Philippines mining law covering large projects (greater than \$50m CAPEX) the company may elect to pay no tax until initial start-up CAPEX is recovered through profitable operation or may elect to take a 5 year tax holiday. Upon either condition being completed the company will be subject to 50% corporation tax. The scenario shown is CAPEX recovery. This will require government confirmation and approval on inception.

Note 4 Depreciation has been assumed to be straight line at 20% of capital items purchased outside the initial recoverable CAPEX

Note 5 Taxation has been assumed to be 50% for LOM once CAPEX has been recovered. During that period no corporation tax is payable under the terms of an FTAA.

Note 6 Discount rate of 30% to reflect a country with relatively high risks.

* Production ramp-down and remediation period. Costs unknown

Metals Prices Assumes a flat \$650/oz for gold and flat \$25/lb for molybdenum

Exchange rate Assumes a flat \$ to £ ER of 0.50 and € to £ of 1.5

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