RBS Morgans

11 July 2011

Produced by: RBS Morgans Limited

Industrial Minerals Corp.

Quality and market timing

Commercial production of the primary product, a chromite foundry sand, has begun at the Oregon Heavy Mineral Project, building to 70,000tpy, primarily for the American market, with by-product magnetite, zircon and garnet.

Buy

Important: The above recommendation has been made on a 12 month view and may not suit your investment needs or timeframe. The basis it is prepared on is summarised on the last page of this report. **PLEASE CONTACT YOUR ADVISER TO DISCUSS THIS GENERAL RECOMMENDATION BEFORE ACTING ON IT.**

Mod-High Volatility

Target price
A$0.36

Price
A$0.25

Short term (0-60 days)
n/a

IDM110711

Market capitalisation
A$137.7m

Average (12M) monthly turnover
A$1.48m

Sector: Materials
RIC: IDM.AX, IDM AU
Priced A$0.25 at close 30 June 2011.
Source: Bloomberg

Key forecasts

	FY11	FY12F	FY13F	FY14F	FY15F
Sales Revenue (US$m)	N/A	59.6	62.1	65.8	82.0
Chromite (kt)	N/A	66.3	66.3	66.3	74.3
Hi Fe (kt)	N/A	23.2	23.2	23.2	74.3
Zircon (kt)	N/A	2.8	2.8	2.8	3.1
Garnet (kt)	N/A	9.9	9.9	9.9	11.1
Project Cashflow (US$m)	N/A	31.9	34.3	37.9	50.3

Source: Company data, RBS Morgans forecasts year to June

SpheriChrome™ – for the domestic market

The North American market for chromite foundry sand, estimated at 100,000tpy, is currently entirely supplied from South Africa. Compared with the SA product, chromite grains from IDM's 100%-owned Oregon project are finer and more spherical, with a polished surface. As a foundry sand, these characteristics reduce the requirement for binder and resins, and improve heat transfer leading to higher tensile strength and enhanced finish for the castings. SpheriChrome™ can also be used as a substitute for or blended with more highly priced zircon sand. Exclusive marketing agreements are in place for North America and Europe with two leading suppliers to the foundry, refractory and metallurgical industries.

Oregon Heavy Mineral Sands Project

In southwest Oregon, the project has Proven Reserves (meeting JORC Code standards) of 8.68Mt at 7.5% chromite, 1.6% garnet and 0.4% zircon in 7 deposits. There are additional resources of a further 20Mt at 9.0% chromite in a number of other deposits. The process plant at Coos Bay is now in commercial production. The plant has been designed to handle a range of feedstocks, with annual throughput ranging from 500ktpy to 1.5Mtpy, with a nameplate capacity of 70,000tpy of the primary chromite sand product. The level of garnet and zircon by-product will be variable - around 10,000tpy of garnet and 3,000tpy of zircon.

The Balance Sheet

At 31 December 2010 the mine properties and development were valued at A$20.8m and Property, Plant and Equipment – primarily the processing plant – at A$45.7m, with a further A$11.4m spent in the March '11 Q to complete the build. Our estimate is that the project – mine properties and plant – are valued at A$80m. As at 31 March IDM had drawn down its US$35m loan facility. Subsequent to the end of the March Q, IDM raised A$13m with a non-renounceable rights issue at A$0.20/share, with an attached A$0.35 option expiring June 2013.

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Company overview

Through 100%-owned Oregon Resource Corporation (ORC), Industrial Minerals Corp. (IDM.ASX) is developing the Oregon Heavy Minerals project, located near Coos Bay in the Cape Arago district of SW Oregon, USA. Total ore reserves held under lease are 8.68Mt @ 21.5% Heavy Minerals (HM), including 7.5% chromite, 1.6% garnet and 0.4% zircon. Plant site development commenced in early 2010, with wet commissioning achieved in the June 2011Quarter. Product from the commissioning phase has been trialled by North American foundries, supplied under an exclusive North American sales agreement with HA International. Commercial sales commenced mid June 2011, with a projected annual rate of 70,000tpy of chromite sand, and associated garnet.

Figure 1 : Oregon Heavy Mineral Project - Location

Source: Industrial Minerals Corporation – 2010 Annual Report

Background – Project and Market

Coos Bay Heavy Minerals

During the 1930s and 40s the U.S. Geological Survey reported the discovery of heavy mineral deposits in Coos County, southwestern Oregon containing the valuable heavy minerals chromite, garnet, zircon, ilmenite, kyanite and magnetite in a relatively unconsolidated form, and that crushing would not be required to produce products of a commercial grain size.

The area has a number of palaeo-beach terraces, ranging in elevation from 10m to 450m above seal level. In 1989 the Bureau of Mines estimated that the terraces, within an area covering 240 square km, held 8.1 million metric tons of heavy minerals, with chromite sand approximately 12% of this tonnage.

In 1991, Oregon Resource Corporation drilled 550 exploration and evaluation holes, and assayed 2,603 of the samples collected, primarily for chromite and zircon. In 1993 an 8.2 tonne sample was processed in Australia, and the chromite sand product returned to local steel foundries for evaluation. Reports from 2 of the foundries which responded were positive, in one case in comparison with a premium zircon foundry sand.

In 20064 bulk samples were submitted to Outokumpu Corporation (now Outotec) to further evaluate mineral separation processing plant options. This work confirmed and improved on previous testwork, and provided further samples for testing by foundries.

Foundry Sand

Foundry sands are typically high-silica sands. To produce higher quality castings with lower tolerances, and where silica sand has proven ineffective, higher value chromite, olivine, zircon and ceramic sands have been used for the molds, or as facing for molds.

The physical characteristics of the Oregon Resources chromite sand differs from the South African chromite sand which now supplies the US market. The ORC chromite is much finer, 80-85 American Foundry Society (AFS) Grain Fineness Number (GFN), compared with the current South African chromite's 50-55 AFS GFN. Another unique characteristic is the well-rounded grain structure with highly polished surfaces, reducing the grain's surface area. Tests to date indicate that these characteristics will enable foundries to reduce the amount of chemical binder required to provide similar core tensile strengths, while providing an improved casting finish.

Source: *A new chromite sand that offers unique characteristics to the Metal Casting Industry. Daryl F. Hoyt, Foundry Sand Technology, Marseilles, Illinois, USA. (Feb 2006).*

The Foundry Sand Market

With many industrial minerals, the value of the industrial mineral is a minor part of the production cost of a making a product. In many cases, manufacturers are reluctant to change from traditional practice and traditional suppliers to achieve what may prove to be a minimal saving in terms of production cost, and risk a potential disruption to the production process. New entrants in the industrial minerals industry must demonstrate significant operational benefits, and commonly, at least initially, pricing benefits as well.

The world wide market for chromite foundry sand is estimated at 750,000t. The current market in the North America is 100,000tpy, supplied in its entirety from South Africa (Source: *Hoyt*). Based on its test performance, the Oregon chromite sand – SpheriChrome™ - is expected to prove attractive to the US foundry industry at a time when confidence in supply from South Africa may be adversely affected by the level of industrial unrest, inflation and uncertainty over the level of black empowerment in the Republic. With zircon sand prices at US$850/t in 2008, reported chromite sands prices were in the range US$500-600/t for 5,000tonnes (IDM Annual Report 2008).

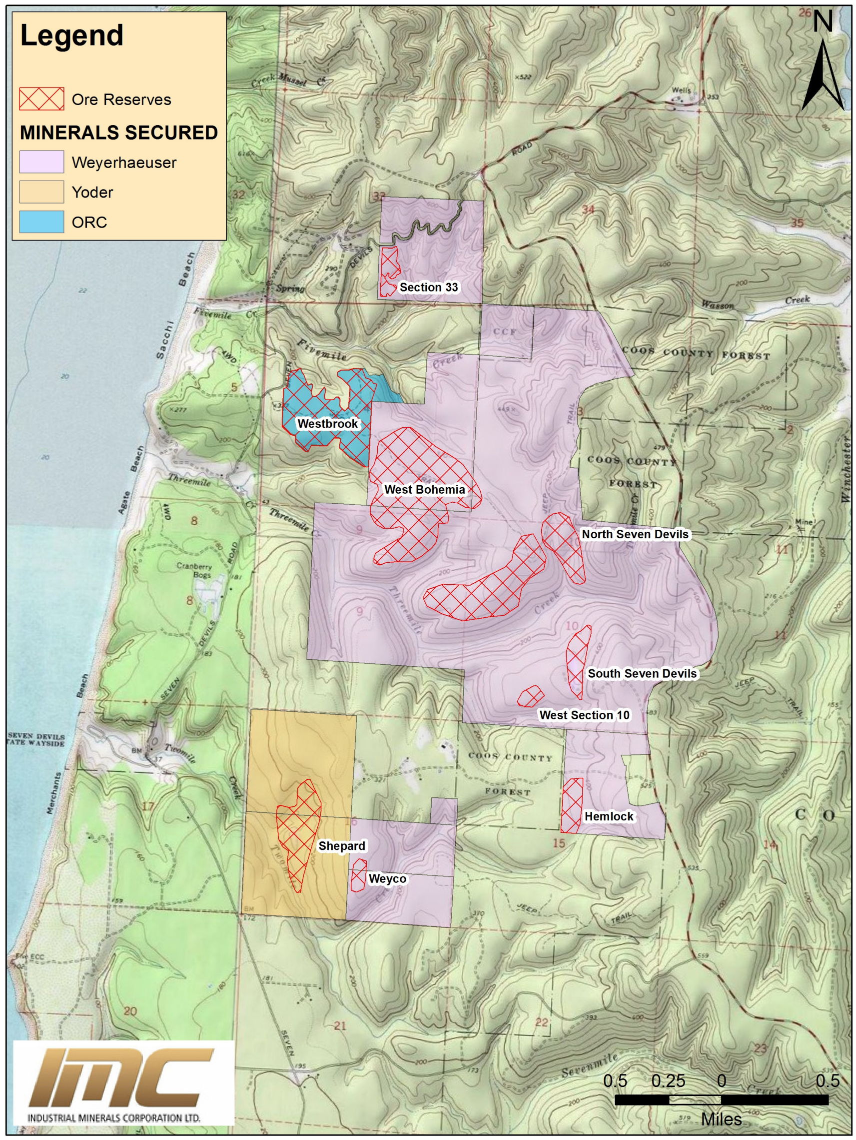
In its 2010 Annual Report, IDM reports that world wide consumption of zircon sand in the foundry industry was 125,000t, including resin coatings. Zircon sand for this application typically sells at a premium to the SA chromite sand of 50-90%. Given the current supply/demand balance for zircon it is expected that it will be in short supply for this application. The testwork in 2006 by one foundry indicates that the Oregon chromite sand has the potential to replace the premium zircon sand in some applications.

Oregon Heavy Minerals Project

Resources, reserves and title conditions

The deposits to be exploited are located in three marine palaeo-terraces between 30m and 120m above sea level, and are centred approximately 35km by road from Coos Bay, the site of the processing plant. The area largely consists of undeveloped timberlands and can be rehabilitated to forest lands or for alternate use after mining. The deposits are within one-half mile of all-weather paved roads and are accessible by all-weather gravel roads. The mined material will be trucked to the processing plant at Coos Bay, where water, electricity, and natural gas are available. Tailings will be de-watered at the process site, and returned to backfill the pits prior to rehabilitation. This will minimise the area of land disturbance.

Figure 2 : Oregon HMP – Ore Reserves



Source: Industrial Minerals Corporation July 2011

Industrial Minerals corp. intends to initially develop the reserves within the Seven Devils and Pioneer terraces. The Seven Devils terrace is a nearshore to inner shelf transgressive depositional sedimentary sequence, now approximately 80 metres above sea level. The mineral-bearing sequence extends from surface to 30m, with an average thickness of 15m in the reserves. Coarse sands overlie a basal conglomerate, which in turn unconformably overlies a Tertiary mudstone. At the base of the coarse sand sequence, in the high energy environment immediately above the conglomerate, the heavy mineral concentrations can be up to 95%. In the upper part of the sequence the heavy mineral component is commonly below 10% in sands deposited in a lower energy regime.

Table 1 : Oregon HMP – Reserves

Proven Reserves	Tonnes	HM Grade	Chromite	Garnet	Zircon
	kt	%	%	%	%
Seven Devils Terrace					
South Seven Devils	793.5	28.7	12.5	2.8	0.8
North Seven Devils	948.5	33.7	11.8	2.6	0.6
Westbrook	824.3	21.9	8.5	1.0	0.4
Section 33	205.7	19.5	8.5	1.4	0.3
West Bohemia	5,124.9	15.0	5.3	0.7	0.2
W Bbohemia Section 10	30.0	18.0	6.0	1.0	0.3
Pioneer Terrace					
Shepard	755.9	42.9	10.1	5.4	0.6
Total	**8,682.7**	**21.5**	**7.5**	**1.6**	**0.4**

Source: Industrial Minerals Corporation – 2010 Annual Report

The largest deposit – West Bohemia – is located approximately 2.5km east of the current strand. West Bohemia, Westbrook and Section 33 are at or near surface averaging 6 m in thickness. The North and South Seven Devils deposits, I km east of West Bohemia, are both 15m thick, with a maximum depth of 30m. The North and South Seven Devils deposits are both narrowly bounded by north-south trending faulting. To the west the reserves on the Seven Devils terrace are broad and laterally continuous, representative of beach deposition and transgression.

The younger Pioneer terrace, 30m above sea level, also consists of a sand sequence above a conglomerate, unconformably overlying the Tertiary mudstone. A basal conglomerate of well-rounded rocks and agates exists above an unconformable layer with the same Tertiary mudstone encountered on the Seven Devils terrace deposits. It hosts the Shepard deposit 2km south of West Bohemia. The Pioneer terrace contains a greater percentage of garnet, averaging 12.6% compared with 4.6% to 9.8% in the Seven Devils terrace, which contain higher concentrations of chromite and zircon. However sphericity, rounding, the surface polish and overall sizing are consistent. *Source: Developing a new process design based on the unique geological characteristics of an industrial mineral bearing placer system in south-western Oregon, USA. J. Drew & T. Lessard, 2009.*

With the exception of the Shepard deposit, which is on the Pioneer Terrace, the deposits shown in Figure 2 are on the Seven Devils Terrace. The Westbrook deposit is on privately owned land, with a royalty regime of 5% of the value of industrial minerals produced and 10% on precious metals. The other Seven Devils Terrace deposits shown in figure 2 are on land leased from Weyerhauser, with a 3.5% gross revenue royalty for industrial minerals and 5% for precious metals. The Shepard deposit is also on leased land, with the royalty US$0.875/t mined and 10% of the Net Smelter Return from precious metals.

Table 2 : Oregon HMP - Resources

Indicated Resources	Tonnes	Chromite
Additional to reserves	**kt**	**%**
South Slough	2,539.0	7.4
Pioneer Eagle	800.0	13.8
Section 36	121.4	7.3
Buller	121.4	15.7
Rose	38.9	14.4
Sub-Total	**3,620.7**	**9.2**
Inferred Resources		
Weyerhauser	9,200.0	7.8
Kimberley Clark	7,300.0	7.8
Sub-Total	**16,500.0**	**7.8**
Total Resource	**20,120.7**	**8.0**

Source: Industrial Minerals Corporation – 2010 Annual Report

There are further resources in the South Seven Devils, Pioneer and South Slough Terraces which are located adjacent to the proven reserve areas.

Mining and transport – ore and waste

With the heavy mineral grade increasing from surface to the base of the terrace, grade control will be critical to maintain a constant grade to achieve optimal plant performance. Bulldozers will be used to take slices of material from top to bottom of the full vertical plane of the terrace. The sand will then be trucked 35km the processing plant.

Waste material will be returned to the minesite. To produce tailings suitable to truck back to the mine site the tailings are de-watered. This has the advantage of reducing water consumoption with the recovered water re-used in the plant. At 70-90ppm TDS it is relatively pure, compared with 130ppm TDS commonly used in processing plants. De-watering thickens the tailings to 65% solids, but this would fluidize with trucking back to the minesite. Coarse waste from the dry plant is added and this is then vacuum filtered to produce material with 82% solids and no free water, which is suitable for trucking.

The addition of oversize material from the dry plant creates a cake that can be stacked, transported to backfill the minesite and immediately contoured for rehabilitation.

Processing plant

The process plant at Coos Bay consists of a wet concentrating plant to produce a heavy mineral concentrate containing the valuable minerals, followed by processing through a dry mill to separate the mineral product streams.

The wet plant is a conventional heavy mineral gravity circuit using spirals to produce a concentrate containing the valuable heavy minerals (VHM). In the spirals the different minerals sort into bands on the basis of density. A consistent HM feed grade keeps the width of the bands of different minerals as uniform as possible, maximising recovery.

While vertical slot mining is expected to result in a consistent feed to the wet plant from each deposit, the mineral composition varies between deposits. Testwork was undertaken to determine the spirals configuration and the optimal feed rate and percentage of solids for a number of the individual deposits. For example, in terms of garnet content, the Shepard deposit contains over 7 times the grade of garnet contained in the West Bohemia deposit. The wet plant has been designed to process at rates from 70tph to 140tph. The recoveries achieved during pilot plant testwork are shown in Table 3.

Table 3 : Oregon HMP – Wet Plant Recoveries

Deposit	Recovery	
	Chromite %	Zircon %
Shepard	74.2	67.3
West Bohemia	79.8	80.6
North Seven Devils	88.1	71.5
South Seven Devils	83.5	74.0

Source: Industrial Minerals Corporation – 2010 Annual Report

The dry plant is designed to process 20tph to 40tph to cater for the different mineral compositions depending on the deposit mined.

Industrial Minerals is also evaluating the option of installing a rougher spiral wet plant located adjacent to the active mining areas. A rough split of the heavy mineral concentrate (HMC) in the field would reduce haulage costs to the Coos Bay processing site and enhance the profitability of mining lower grades.

Product - SpheriChrome™

While the product focus is on producing chromite sand for the foundry markets, the fully developed production suite is expected to consist of:
Chromite sand (55% by value);
Hi-Iron Ilmenite (30%)
Two Garnet products (differentiated by size) (11%); and Zircon sand (3%).

Work will also continue to evaluate production of a higher value Ultra Low Carbon product.

ORC signed a memorandum of understanding with HA International LLC in 2009 to collaborate on blended product formulation, trademarks and intellectual property co-ownership. HA International is North America's largest supplier of products for core/mold production and supplies a comprehensive range of products to the foundry industry in three market segments: Resins Systems for bonding sand; Resin Coated Sand (RCS) for the shell process; and Refractory Coatings. HA International has exclusive marketing and distribution rights for ORC's chromite sand in North America, marketed as SpheriChrome™.

In its marketing literature HA International states that the sand structure of SpheriChrome™ offers high compatibility with zircon sands, and can be used as a zircon substitute or can be blended with zircon sand. It states that "the unique roundness offers foundries the ability to reduce emissions and save by significantly reducing the need for binder or resin. In addition when formed in a casting the spherical nature of the grains inherently provides a superior bridge with the adjoining grains and enhances heat transfer, which results in superior tensile strength of the casting and clean break out from the mould."

The European marketing rights are held by Possehl-Erzkonto Gmbh, a leading trader of mineral raw materials and leading supplier of raw materials to the refractory and metallurgical industries. Possehl group companies supply the metallurgical, casting, cement, and construction materials industries, as well as the chemical and plastics processing industries.

Valuation and risks

Our valuation is based on a DCF calculation for the reserves of the Oregon Heavy Mineral Project, with a heavily risked value (50%) assigned to the resources. A more rapid ramp-up of production than we have modelled, the construction of the rougher spirals plant and market penetration delivering the price premium which could be anticipated would lead to an increase in our valuation and target price above A$0.36/share. Risks are associated with the plant ramp-up and market acceptance, as well as movement in the prices of the products, and in terms of Australian investors, the A$/US$ exchange rate.

Valuation & Assumptions	
Fair-Value	$0.36
Price Target	$0.36
Upside/Downside	40.1%
**Methodology*	DCF
Assumptions	
WACC	13.46%
Beta	2.83
Equity risk premium	4.5%
Risk-free rate	5.25%

Asset	**A$m**	**A$/share**
Oregon HM Project - Reserves	147.0	0.23
Oregon HM Project - Upside	86.4	0.13
Net Cash	10.0	0.02
Corporate & Other	-15.0	-0.02
Total valuation	**228.4**	**0.36**

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REGULATORY DISCLOSURES

RBS Morgans Corporate Limited was the Underwriter to the Industrial Minerals Corporation Limited rights issue in May 2011 and received fees in this regard.

RECOMMENDATION STRUCTURE

For a full explanation of the recommendation structure, refer to our website at https://www.rbsmorgans.com/research_disclaimer

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