



Golden State Resources Ltd

Golden State Resources: Building long term value from monetising assets

By Proactive Investors

Better known as an oil and gas explorer, recent value-adding exercises by Golden State Resources (ASX: GDN) have generated net cash inflows as well as potential annuity-style income for the company in the medium term, not largely recognised by investors.

In September 2010, GDN disposed of 35 million shares in White Canyon Uranium (ASX: WCU), for A\$3.5 million, reaping an additional A\$1.5 million from when the deal was first announced in July. The sale agreement was A\$2.0 million on signing and A\$1.5 million after approval by WCU shareholders at their November meeting.

This represents a significant financial return for GDN on historical acquisition costs of A\$100,000 for the tenements in 2005.

GDN retains a holding of 10.7 million shares in WCU, or 5.2% of the company. This asset holding could also be monetised by GDN at an appropriate time for additional net revenues.

Johnson Range Iron Ore Project

GDN held an initial 100% interest in the Johnson Range Iron Ore Project, which is located in the Yilgarn region of Western Australia and adjoin the Cliffs Natural Resources Inc. (NYSE: CLF) Windarling iron ore operation.

Johnson Range Project covers 12 tenements spanning 201 km² in the Central Yilgarn area. GDN was engaged in a JV with Polaris Minerals in relation to the Johnson Range Project.

Mapping at Johnson Range had indicated potential for "Carina style and size mineralisation" outcrop over one kilometre strike in Zone 1 (see Figure 1); with three discontinuous exposures over three kilometres strike in Zone 2.

Assays up to 68.4% iron (Fe) average were returned from exploration, including 62.1% Fe in Zone 1 and an average of 58.5% Fe in Zone 2. Notably, the rock chip samples were low in phosphorous and silica.

Zone 1 was along strike from an area drilled by Cliffs Natural Resources near its Koolyanobbing iron ore producing mine.

GDN was approached by a number of parties interested in acquiring its stake in the Johnson Range Project. However, given Cliffs is an existing iron ore producer in the region with its nearby Koolyanobbing iron ore operations, in the heart of the WA Goldfields, GDN negotiated an agreement with Cliffs for an upfront payment and retain a royalty on future iron ore sales.

GDN was informed that there was an exploration target potential of 40+ million tonnes for Zone 1 in the Johnson Range Project tenements. In Zone 2, there is significant ore banding and mineralisation over three exposures in the three kilometres of strike. In total it would not be unreasonable to assume a total of 50+ million tonnes for the combined Zone 1 and Zone 2 of GDN tenements of potential high grade hematite up to 68% Fe.

Date: October 2010

Price: A\$0.035

Market Cap: A\$19.8M

1 Year Share Price Graph



Share Information

Code: GDN

Listing: ASX

52 week	High	Low
	A\$0.075	A\$0.023

Sector: Materials

Website: www.goldenstate.com.au

Company Synopsis:

Golden State Resources (ASX: GDN) is headquarters in Perth, Western Australia. Floated in 1996, the Company is primarily focused on oil and natural gas exploration in the USA and mineral projects in the Eastern Goldfields region of Western Australia.

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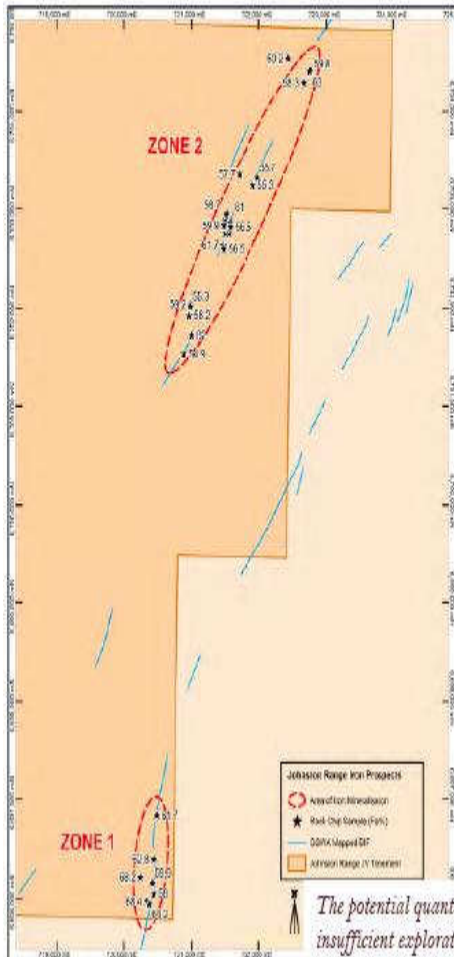
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Johnston Range JV



The potential quantity and grade of iron deposits reported is conceptual in nature and there has been insufficient exploration to define a Mineral Resource and it is uncertain if further exploration will result in the determination of a Mineral Resource.

- Third significant Yilgarn Project
- Mapping indicates potential for "Carina style and size mineralisation"
 - Outcrop over 1km strike in Zone 1
 - 3 discontinuous exposures over 3km strike in Zone 2
- Assays to 68.4% Fe
 - Average 62.1%Fe in Zone 1
 - Average 58.5%Fe in Zone 2
- Extensive drilling by Cliffs along strike from Zone 1
- Target exploration potential 20-40 Mt in Zone 1
- Drilling planned 2010
- Polaris initially earning 70%

[Polaris Metals NL, ANNUAL REPORT, 30 NOV 2009, PAGE 11]

GDN sold its stake in the Johnson Range Project to Cliffs Natural Resources for an A\$3 million up-front payment, by way of a non-refundable prepayment on future royalty payments.

Cliffs will also pay GDN a gross royalty of 2% based on the average/tonne FOB sales of gross extraction volumes (without any deduction to the rights of any other party) of all iron ore transported from the ex-GDN Johnson Range project tenements.

In addition, a 2% gross royalty on the sale of all other minerals from Johnson Range was also struck with Cliffs. The tenements may also be prospective for gold given the tenements are in the heart of the WA goldfields. The 2% gross is also on other minerals.

Cliff is the largest producer of iron ore pellets in North America, a major supplier of direct shipping lump and fines from Australia with a market capitalisation of over US\$9 billion and ranks in the NYSE S&P 500 largest companies.

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Given this, and Cliff's extensive iron ore operations near Johnson Range Project and in Western Australia, GDN's probability of generating significant revenues from the timely development of the Johnson Range Project would be accelerated.

Potential of the Johnson Range Project for Cliffs

Cliffs' Portman operations near Koolyanobbing adjoining the ex-GDN tenements (Zone 1) had reserves lasting through to 2018, however this mine life could now be significantly shortened to about mid-decade due to the planned 30 per cent increase in output and the release of existing equipment on the completion of mining activity at Cliff's Cockatoo Island operations in 2012. These produce 1.5 million tonnes per annum but have a mine life only to 2012.

Given Cliffs has already conducted extensive drilling along strike from Zone 1 near its Koolyanobbing operations and the rapidly depleting current ore bodies at Cockatoo Island, it is a reasonable assumption that Cliffs will extend mining operations into Zone 1 at Johnson Range Project concurrently before the current resource is exhausted.

This was given a higher probability in September 2010, when following a feasibility study, Cliffs announced a A\$320 million expansion of its Koolyanobbing operations in a move designed to lift production by about 30 per cent within two years. This will also include an upgrade to rail infrastructure to Esperance port.

Notably, Cliffs' senior vice president and managing director of Asia Pacific Iron Ore, Duncan Price said that Cliffs will drill its recently acquired "satellite tenements to increase the resource base at Koolyanobbing and extend its mine life".

In addition, Cliffs stated, "that recently acquired mineral tenements located near its existing Asia Pacific Iron Ore deposits will enable the Company to continue potentially increasing the current resource base."

The expansion of Cliffs' Koolyanobbing operations, 50km north of Southern Cross, is aimed at lifting its iron ore production from about 8.5 million tonnes a year to 11 million tonnes per annum in 2012.

Cliffs indicated that capital for this project will be spent over the next two years, with the bulk of the spending occurring in 2011. The improvements are expected to consist of enhancements to the existing rail infrastructure, an increase in rolling stock, and upgrades to various other existing operational constraints. Cliffs anticipates these improvements to be fully implemented in the second half of 2012.

Infrastructure

In terms of infrastructure, the existing operating infrastructure and port facilities at Esperance are well ahead of other emerging iron ore producing areas. The Trans Australian Railway, which is at the doorstep of Koolyanobbing, (near to the Johnson Range Project) intersects the Esperance Railway enabling ore to be railed direct to Esperance Port.

Cliffs currently transports 8.5 million tonnes per annum via the existing rail line to Esperance Port, which is significant for GDN. With new capital investment by Cliffs, to enhance rail infrastructure and rolling stock, capacity will increase to 11 million tonnes per annum in 2012.

Timing of Royalty flows to GDN

Based on the foregoing analysis and the need for Cliffs to expand output from its WA operations, it is becoming more probable that production from the ex-GDN Johnston Range project tenements could commence in 2011/12. Especially, as hematite from the tenements would appear to be consistent with the production profile of Cliff's direct shipping lump and fines products from its WA operations.

In terms of risk assessment, timing would appear to be the only risk although this is mitigated given the mine life depletion at Cliff's Cockatoo Island operation in 2012.

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Effect of Iron ore Royalty on GDN

The potential future royalties from Johnson Range Project have significant positive implications for the valuation of GDN in the medium to longer term. Based on similar resource and mining studies and mining operations, it is possible to model several scenarios to extrapolate potential revenues for GDN from the royalties and the positive effects on medium term cash flow and valuation for GDN. (Assume US\$/A\$ parity).

Scenario 1

Fines price	US\$100/t	US\$100/t
Production	2mtpa	3mtpa
2% Royalty to GDN	A\$4.0m pa	A\$6.0m pa

Scenario 2

Fines price	US\$130/t	US\$130/t
Production	2mtpa	3mtpa
2% Royalty to GDN	A\$5.2m pa	A\$7.8m pa

On these scenarios, the monetisation of the Johnson Range Project by GDN represents a potentially large inflow of revenue and income to accrue to GDN, without taking any financial or project risk - enabling the company to focus on Exploration & Discovery of Gas & Oil from its Golden Eagle field in Utah.

Once Cliffs produces and commences iron ore sales from the Johnson Range Project, the royalties accruable to GDN each year will be significant and provide GDN with an annuity income, based on the gross revenue amount of iron ore sales from the Johnson Range Project by Cliffs.

At the upper end the future annual royalty revenue from the Johnson Range project represents an important component of building longer term value for GDN. In the event that the upper case scenario is achieved, 2% of 30 million tonnes at today's ore prices will equate to A\$80 million of revenue for GDN over the life of the Johnson Range project.

When compared with the current market capitalisation for GDN at approximately A\$20 million, this income and value is potentially highly significant to the company and investors in the medium term.

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