

COTTON & WESTERN MINING, INC.

(CWRN - OTC:PK)

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Exchange: US-OTC Pink Sheets  
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Recent Price: **\$1.390**  
Target Price: **\$2.300**

SPECULATIVE NEUTRAL RATING

Main Headquarters

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**Prospering on Chinese Steelmakers Thirst for Iron Ore**  
**Company Overview**

Cotton & Western Mining, Inc. (OTC PK: CWRN) is a US publicly traded company structured to produce and sell iron ore on a global scale. The company is focused on the growth and production of its iron ore in Mexico and other countries. The expansion project of its subsidiary based in Mexico should further establish Cotton & Western Mining as a valuable grade A crude iron ore producer.

- In 2005, iron ore prices rose 72% over 2004 as measured by a yardstick of prices set between the iron ore troika and key Japanese and Chinese steel mill customers.
- Global steel demand has soared** because of the huge economic growth in China and India, two of the world's biggest economies. China imports 200 million tons of iron ore a year. The vast majority of independent analysts expect industry conditions to remain buoyant due to the long time (typically 3-4 years) it takes to develop new iron ore projects and which are also very capital intensive, often several billion dollars in size.
- The troika (**Rio Tinto, BHP Billiton and CVRD**), which **controls about 70%** of the world supply is **pushing for a further 20% rise** in iron ore contract prices in 2006.
- For the FY2006, CWRN is scheduled to ship 600,000 dry metric tons (DMT) of crude iron ore to the Wah Seong China, Ltd. for projected revenues of \$23 million.
- Production at the **Pacific Pearl Iron Ore Mine** is expected to come on-stream towards the **end of Q3 FY2006, with an anticipated production rate of 100,000 dry metric tons per month**, shipping out of Harbor Center, Manila, the Philippines. Several steel mills and trading houses have shown a strong interest to sign a long term off-take agreement for the total production of the company's mines.
- Cotton & Western Mining, Inc. is engaged in several mining activities and provides the Asia Pacific Steel Manufacturing Sector with high grade A raw crude iron ore. In **July 2006** CWRN is scheduled to ship **75 or 100,000 dry metric tons of crude iron ore to Wah Seong China, Ltd. From the company's Mexico operations; at \$39.00 per DMT from the Pacific Ocean Port of Manzanillo, Mexico.**
- CWRN anticipates **strong revenue growth heading into 2007** from its current mining activity and near-term lease acquisitions.
- According to the CEO, the company is on schedule for its FY2006 strategic business plan. **A Form 10-SB filing with the SEC is anticipated by end of Y2006**, that will enable CWRN to obtain fully reporting status as a public company. This registration will allow for institutional investment in CWRN and provide a lower cost of capital to the company that can increase its global mining efforts.
- We believe the upside potential in the shares, outweighs the downside risks and shares seem attractive in light of our computed present value of proven reserves. Despite not having definite numbers for the total debt and cash position of CWRN, it appears that the shares are sitting at a deep discount relative to this PV of proven reserves and only assigning values of proven reserves to Los Pozos and Rio Fox mines. Our view is that shareholders should expect price gains to follow once CWRN reaches the FY2006/FY2007 production and shipment milestones we projected above. Our target price is set at 12.7 x forward PE of our FY 2007 EPS estimate of 18c or 0.65x our FY2007 revenue estimate of \$260 million. See INVESTMENT THESIS & RECOMMENDATION for more in-depth discussion (Page 7-9)**

Cotton & Western Mining, Inc.

Cotton & Western Mining Incorporated.		
(all figures in Millions)		
52 Week Hi/Lo Range	2.00/0.0825	
Fiscal Year End	31-Dec	
Shares Outstanding (05/01/2006)	66.5	
Float (approximately)	12.5	
Share price (05/05/2006)	1.39	
Market Capitalization	92.5	
Average Volume (3 months)	NA	
Insider Ownership	NA	
Institutional Ownership	NA	
Enterprise Value	NA	
Total Debt (09-30-05)	NA	
Total Cash (09-30-05)	NA	
	12/31/2006	12/31/2007
	FY2006 E	FY2007 E
Earnings Per Share (EPS)	0.06	0.18
Reserve Value/share*	9.96	
*(excluding liabilities and cash)		
	FY2006 E	FY2007 E
Total Revenue	91.83	260.00
Cost of Sales	59.69	169.00
Gross Profit/Loss	32.14	91.00
Operating expenditures	25.71	72.80
Net Pre-Tax Profit/Loss	6.43	18.20
Tax Expense	2.19	6.19
Net Income	4.24	12.01
NA = Not applicable/Not Available. A = Actual Reported figures E = Estimates		
Mining Reserves	Tons	
Total Proven Reserves	31.50	
Proven Reserves - Rio Fox	1.50	
Proven Reserves - Los Pozos	30.00	
Iron Ore Price (\$/ton)	35.0	
Reserve \$ Valuation	1102.5	
Present Value of reserves @ 15% over 6 yrs	662.28	
Capital Structure (as at 05-04-06)		
Authorized Common Stock	300 000 000	
Restricted Common Stock	54 018 000	

See Appendix A-1 for Analyst Certification and Important Disclosures.

## THE COMPANY

Cotton & Western Mining Inc. (OTC PK: CWRN), is a US Corporation, founded by Robert L. Cotton and is incorporated in Nevada. The company is a producer of iron ore presently operating out of one mine, with plans to start another larger mine on June 15, 2006. Cotton & Western Mining, Inc. recently obtained a listing on Pink Sheets OTC Securities market on April 27, 2006. Under the terms of going public, the company instituted a 75 to 1 reverse split and reduced the shares outstanding.

Cotton & Western Mining, Inc. U.S.A. owns the rights to the **Rio Fox and Los Pozos Iron Mines located in Mexico** and has given exclusive management and operations rights to Cotton & Western Pacific Mining, S.A. de C.V.; a subsidiary of Cotton & Western Mining, Inc. U.S.A. Cotton & Western Mining, Inc. U.S.A. through Memorandum of Understanding has access to the **Pacific Pearl Iron Ore Mine, located in the Philippines** and will begin conformation drilling of a previous geological survey in the Q2 of 2006. To date, the initial chemical analysis show the ore at this location classified as grade A and represents a very substantial opportunity for the company in securing quality iron reserves for the future; estimated reserves are near 50 million metric tons. The Pacific Pearl will be the company's flagship mine. The government of the Philippines is promoting mining to foreign investment and has given the permits to begin exploration to the company. Diamond Core Drilling of the Pacific Pearl I, is now scheduled to begin before the end of May, 2006.

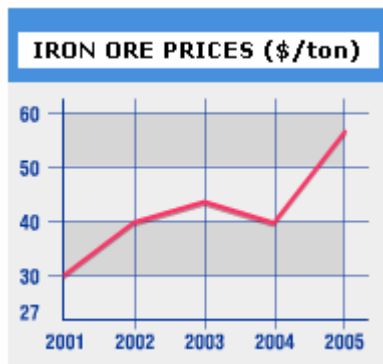
Cotton & Western Mining, Inc. U.S.A. will provide **the Asia Pacific Steel Manufacturing Sector with raw crude iron ore products**, for classifications of Fines (0-10mm size) for Mini Mills (those using electric blast furnaces) and Lump Ore (25-40mm size) for fully integrated steel mills. Cotton & Western Mining's objectives are to create fair profits for the corporation and increase value for its shareholders. This goal is to be reached by simple hard work and strict adherence to budgeted cost estimates, meeting operations schedules, and cost efficient mining techniques employed at each of CWRN mines.

Cotton & Western Mining's mission is to offer reliable, high-quality and cost effective raw materials to the steel manufacturing industry on a global scale.

## INDUSTRY

Iron ore is the source of primary iron for the world's iron and steel industries. It is therefore essential for the production of steel, which in turn is essential to maintain a strong industrial base. Iron ore is a mineral substance which, when heated in the presence of a reductant, will yield metallic iron (Fe). It almost always consists of iron oxides, the primary forms of which are **magnetite** ( $\text{Fe}_3\text{O}_4$ ) and **hematite** ( $\text{Fe}_2\text{O}_3$ ). Almost all (98%) **iron ore is used in steelmaking**. Iron ore is mined in about 50 countries. **The 7 largest of these producing countries account for about three-quarters of total world production.** Australia and Brazil together dominate the world's iron ore exports, each having about one-third of total exports.

The 3 dominant world iron ore miners (sometimes referred to as the troika) — **CVRD (Cia Vale do Rio Doce)** of Brazil, and the Anglo-Australian rivals **Rio Tinto** and **BHP Billiton**, together control the bulk of world iron ore supply. They are engaged in their annual round of price negotiations with key steel mill customers in China and Japan, and pushing for a 20% hike in prices which is presently being resisted. Last year the iron ore troika managed to force through an unprecedented 72 per cent rise in price. The rise shocked the steel mills, in particular those in China, which in the past had let their Japanese peers lead the negotiations. The protracted negotiations, which are taking longer than expected, will set the price under which the three miners, which control about 70% of world supply, will sell most of their iron ore over the next 12 months. The price becomes the yardstick for other iron ore miners. Analysts are forecasting prices rises of **between 10% and 20% in 2006**. CVRD has said it wants a 24% escalation over previous contract prices. Because iron ore isn't a pure commodity (it occurs in different sizes and chemical compositions) it isn't traded on metal exchanges. Instead, prices are set through a long-standing system under which the first company to strike a deal with a major client is followed by all others.



Two days ago the CEO of Rio Tinto described present demand for iron ore as "very, very strong" and said that current supply and demand conditions favored a further price rise for iron ore, but declined to indicate the extent of the hike that Rio Tinto is tabling. They said that the market keeps improving for miners and they are not in any hurry to settle for the start of the Japanese fiscal year on April 1. Iron ore is the key ingredient for steelmaking. Global steel demand has soared because of the huge economic growth in China and India, two of the world's biggest economies. **China imports 200 million tons of iron ore a year.**

The global iron ore industry finds itself in a boom phase that shows no sign of abating. The Chinese economy is one the world's fastest growing with industry and infrastructure development leading the expansion. Its intensifying demand drives up prices for its products, which are largely raw materials such as oil, zinc and copper. By 2010, it is estimated China will account for 30 percent of the world's consumption of iron ore, copper, nickel and aluminum.

This has also resulted in Chinese steelmakers having a greater need to build iron ore inventories to support this development. Economic reforms, rationalization of the many industries, significant investments in rail and port infrastructure and government subsidies are all paving the way for China to continue to exert demand pressures on iron ore producers that is supporting iron ore prices.

CWRN aims to take advantage of the conditions within the industry and the surging demand for many commodities including iron ore required for fueling Chinese economic growth. Expectations of higher iron ore prices are further supported by the fact that we have a **situation where spot prices have started to rise significantly above contract prices**, which has always been a strong indicator of future trends.



This heap of iron ore pellets will be used in steel production.

## IRON MINES

Cotton & Western Pacific Mining, S.A. de C.V. (an affiliate of CWRN) is currently farmed in to the Los Crestones Iron Ore Mine located 19 kilometers from the Port of Manzanillo, and is scheduled to make a one-off shipment of Iron Ore Fines in July, 2006. This affiliate also holds the exclusive rights (under contract with Cotton & Western Mining, Inc. U.S.A.) to manage and operate the Los Pozos Iron Ore Mine and the Rio Fox Iron Ore Mine, both located in the Republic of Mexico.

### Los Pozos / Mexico

The Los Pozos Iron Ore Mine is located in the State of Michoacan and it is classified as a high grade A Hematite  $\text{Fe}_2\text{O}_3$  and Magnetite  $\text{Fe}_3\text{O}_4$  iron ore mine with **proven reserves of near 30 million metric tons**. The minerals found at the Los Pozos Iron Ore Mine are Magnetite, Hematite, Gold, Pyrrhotite, Pyrite, Chalcopyrite, and the gangue minerals are Calcite, Quartzite, Actinolite, Tremolite, Limonite, Chert and Clay. There are 3 iron ore mines located on this mineral lease, each about the same size for an **estimated probable reserve of near 90 million metric tons**. Only Los Pozos I has been surveyed for geological formations, the other two mines are yet to named or surveyed.

The current status of the Los Pozos Iron Ore Mine is pre-operational, with Mining Plan, Environmental Impact Study, Environmental Permit, Blasting Permit and Heavy Haul Road Permit applications submitted to the appropriate Government Agencies. Infrastructure, consisting of approximately 70 kilometers (43.75 miles) of wide lane heavy haul road is to be constructed from the mine (elevation 1,000 meters ~ 3,250 feet) down to highway 200, which runs south along the Pacific Ocean. Mine stripping shall also begin at the same time, whilst scheduling for infrastructure was completed during the first quarter of 2006; the company has put on hold the opening of Los Pozos and has elected to open the Pacific Pearl first. The factors leading to the operational changes was based on cost of infrastructure at Los Pozos compared to the lower cost of the Pacific Pearl and together with the shipping cost from the Philippines being substantially less than that of Mexico.

**When opened, the estimated life of Los Pozos is four years at the rate of 4.8 million metric tons a year of Iron Ore Fines, above 65% total Fe.**

### Rio Fox / Mexico

The Rio Fox Iron Ore Mine started production of Hematite  $Fe_2O_3$  and Magnetite  $Fe_3O_4$ ; in November 2005. The mine is located in the State of Colima, the Republic of Mexico. There are a total of four known mines on the mineral lease; they are Rio Fox, Rio Fox II, Rio Fox III and Miss Lucky. **The Rio Fox Iron Ore Mine has proven reserves of 1.4 million metric tons and probable iron ore reserves of 2.8 million metric tons with the combined probable reserves of all four mines approximately 8.0 million metric tons.** The Iron deposits of Rio Fox although small are of high grade A crude iron ore and will not require any concentration to market as a finished product. Operations at Rio Fox were suspended in December 2005 and moved to Los Crestones Farm in due to transportation cost as the mine is 105 kilometers from the Port of Manzanillo.



Cat 966G loads Primary crusher at Rio Fox

### Pacific Pearl / Philippines

The Pacific Pearl Iron Ore Mine is located in the Province of Bulacan, on the island of Luzon, the Republic of the Philippines. The Pacific Pearl is non-operational and is now scheduled to open in July, 2006, starting at 100,000 Dry Metric Tons per month. The mineral lease is 8,000 hectares, (20,000 acres) and is known to hold large deposits of Hematite and Magnetite. Geological Surveys of the lease are **scheduled for Q2 2006, which could provide upside to current proven reserves and lengthen the consolidated life of mine profile of CWRN's mining portfolio.**

### Los Crestones (Farm-in)

In late December 2005 Cotton & Western Pacific Mining, S.A. de C.V. moved from Rio Fox onto the Los Crestones mine, citing a need to reduce transportation cost for its initial shipments. This Iron Ore Mine is located 19 kilometers from the Port of Manzanillo. The company is contracted to excavate, crush & screen 60,000 DMT of Magnetite from the mine on a one time basis, with options for up to 100,000 DMT. The extraction of iron ore is completed and stock piled awaiting transportation.

## OUTLOOK AND OFF-TAKE CONTRACTS

Turbo charged economies such as China are searching worldwide to pour billions of dollars into mineral mines such as iron ore. The CEO of Cotton & Western Mining, Inc, Bob Cotton Jr. said CWRN will continue to strengthen its relations with China based companies and anticipate record revenue growth from current purchase orders in the coming year.

CWRN primary client is Wah Seong China, Ltd. Hong Kong, S.A. the People's Republic of China. For the year ending December 2006, **CWRN is scheduled to ship 600,000 dry metric tons of crude iron ore** to Wah Seong China, Ltd. valued in revenues at \$23 million. The **primary source of material shall be mined and shipped from both the Mexico and Philippine Iron Mines**. The revenues generated from 2006 sales shall be used to increase production at the company's mines for year 2007.

## RIO FOX / MEXICO

- Contracted for **1.2 million dry metric tons of 0~11mm Rio Fox Fines**, non-concentrated crude Hematite and Magnetite iron ore: Contract signed with Iron Trading Limited, London, pass through for **Guangxi Wanxin Iron and Steel Co. Ltd.** Signed July 2005, for shipments in year 2006 is currently on hold citing high transportation cost. The company intends to reopen the Rio Fox when it is financially able to acquire forty tractor trucks and trailers, thus reducing transportation cost by more than \$5 dollars per metric ton.
- Contract for **800,000 dry metric tons of 0~11mm Rio Fox Fines**, non-concentrated crude Hematite and Magnetite iron ore: Contract with **Guangxi Wanxin Iron and Steel Co., Ltd.** verbal agreement, Cotton & Western Mining, Inc. has deferred signing the contract until the mine has reopened and made its first shipment.
- 2.1 million Dry Metric Tons of 15~20mm Rio Fox Lump, non-concentrated crude Hematite and Magnetite iron ore: Contract with **Shandong Hongda Metallurgic Co., Ltd.** Cotton & Western Mining, Inc. has deferred signing the contract until such time as the company has increased its production capacity. It is not yet determined if the products will be sold from Mexico or the Philippines.

## Mine life & production rate

### LOS POZOS / MEXICO

The Los Pozos Iron Ore Mine is not yet scheduled to open; but, once on-stream it is expected that **Los Pozos will be producing 400,000 metric tons per month**, shipping out of the Pacific Ocean Port of Lazaro Cardenas, Mexico. Several steel mills and trading houses have shown a strong interest to sign a long term off-take agreement for all 30,000,000 metric tons. Cotton & Western Mining, Inc. is negotiating with potential buyers and will sign one or more off-take agreements prior to opening the mine. High infrastructure cost consisting of a 70 kilometer heavy haul road together with the need to build suitable loading facilities at the Port of Lazaro Cardenas is cited as the reasons for delaying operations at Los Pozos Mine.

### PACIFIC PEARL / PHILIPPINES

Cotton & Western Mining, Inc. has scheduled the Pacific Pearl Iron Ore Mine for opening ahead of Los Pozos Iron Mine, citing lower infrastructure cost and lower shipping cost to China as the primary reasons. As of May, 2006, preparations are being made to begin diamond core drilling at Pacific Pearl I, to confirm geological surveys made in 1958. Estimated reserves at the Pacific Pearl mines are 50 million metric tons of magnetite, making the Pacific Pearl the company's largest reserve. Initial production is scheduled for 70,000 dry metric tons per month, shipping out of Harbor Center, Manila Bay; increased production will be shipped out of Subic Bay accommodating large Cape sized vessels. Both ports are less than 100 kilometers from the mine. Negotiations for long term off-take agreements are under way and it is anticipated that an agreement will be reached with Wah Seong China, Ltd. for near term production of Pacific Pearl I.

## FINANCIALS

**The company has not submitted SEC filings containing financial data, nor has it made meaningful disclosure of financial affairs to shareholders via press releases or other sources.** The company has a December 31<sup>st</sup> year-end date. The absence of financial data plays a vital role in setting and selection of our investment rating. Due to our ratings and selection criteria, companies that have not provided financial information are unable to be classified in a category higher than SPECULATIVE NEUTRAL RATING, irrespective of other possible overriding bullish factors that may influence or justify a higher rating.

Current and prospective shareholders should note that CWRN announced on April 21, 2006 that they will be filing the Form 10-SB Registration, in an effort to obtain full reporting status with the Securities Exchange Commission (SEC). Such filing is to be

made with the SEC by the end of August 2006. Upon the effective date of the Form 10-SB filing, Cotton & Western Mining, Inc. will attain **Section 12 (g) reporting status** with the SEC, under the Exchange Act of 1934, which will allow for broader market participation in CWRN shares by institutional investors.

*See Appendix A-I for Analyst Certification and Important Disclosures.*

It is anticipated that **reporting status will be achieved no later than October 2006**, with the company then becoming electronically traded in a regulated market for small reporting companies, such as the OTC Bulletin Board or NASDAQ Small-Cap market. Even though the current listing is on the Pink Sheets Exchange, management stated that the company will make available results of full GAAP audits for our last two calendar years, allowing for a seamless transition to reporting status.

**Readers should note that despite our risk factor caveats and our SPECULATIVE NEUTRAL RATING we are optimistic about the prospects of mining operations and production rates and DMT shipments of iron ore of CWRN.** If production targets are met at Pacific Pearl, current purchase orders scheduled for delivery indicate that CWRN has already secured shipments of at least 600,000 metric tons of iron ore in FY2006 and using a price of \$39 per metric ton we arrive at a revenue projection of \$23 million for FY 2006. Looking ahead into FY 2007 we expect the Pacific Pearl to be fully operational at a monthly production rate of 400 000 tons of iron ore, which together with Rio Fox production implies annual production of just under 5 million tons. At an iron or tonnage price of \$40, which we believe is realistic unless there are major disruptions to steel supply/demand dynamics, we arrive at a FY2007 revenue estimate for CWRN of \$160 million.

**Noteworthy financial and per share statistics are listed in the table found on page 1 of this report. WE STRESS TO READERS that our income statement estimates (costs, revenues, EPS, taxes etc.) for FY2006 and FY2007 found there are derived from benchmark gross, net and operating margins for large peers and other steel related stocks and not from current or past financials from the company itself. These figures are intended to be PRO FORMA of what actual numbers could be published, but these estimated numbers should not be relied upon due to the lack of company specific financial data to our disposal to arrive at these estimates.**

### **Liquidity and Capital Resources**

No information was readily available to enable us to review the cash and cash equivalent position of the company at the time of writing of this report. It is uncertain if the **company has sufficient resources and is covered to conduct its operational and/or expansion plans and finance further geological studies for the coming year. However we believe** management will manage the existing resources in a prudent fashion, to maximize its search and detection processes and recovery efforts in the best possible way to manage shareholder capital.

### **RISK FACTORS /CONCERNS**

The business model, and longer term consistency of revenue and income potential, remain uncertain and is not fully proven. CWRN is **substantially dependent on the expertise of its management team and directors**, the loss of which could materially adversely affect future anticipated results. The company is still considered to be a **development stage company** and has generated limited revenues. The company may not be able to generate or obtain sufficient funds to operate its business which, could harm results and force the company to curtail or cease plans for expanding operations. There can be **no assurance the company will be successful in its effort to secure additional financing** to support operations that will necessitate achievement of near and medium term goals.

The **mining operations are inherently subject to changing conditions** that can affect levels of production and production costs for varying lengths of time and can result in decreases in profitability. There is a direct risk due **to exposure to commodity prices related to input prices** such as the purchase of diesel fuel, explosives and freight costs. In addition, weather conditions, equipment replacement or repair costs, fires, variations in thickness of the layer, or seam of ore deposits, amounts of overburden, rock and other natural materials and other geological conditions can be expected in the future to have, a significant impact on operating results. Prolonged disruption of production at any mine would result in a decrease in revenues and profitability, which could be material, especially when considered that CWRN currently has only one operational mine.

Other factors affecting the production and sale of iron ore that could result in decreases in profitability of CWRN include continued high pricing environment for raw materials used in mining activities, including, among other things, diesel fuel, explosives and steel; changes in laws or regulations, including permitting requirements; litigation; work stoppages or other labor difficulties; labor shortages; changes in the Chinese steel market and local and global iron ore market and general economic conditions. Mining operation will be conducted on leased property and the risk exists that the company may not be able to successfully negotiate new leases or mining contracts for properties containing additional reserves or maintain its leasehold interests in properties on which mining operations are not commenced during the term of the lease.

Trading in the shares will continue to be subject to major fluctuations for the foreseeable future. The stock is thinly traded at prices around \$1.00 and selling of small positions could have a negative impact on the share price in absence of sufficient liquidity. The reverse is true if one or more large investors decide to acquire a block of CWRN shares that would result in demand outstripping supply and result in an upward squeeze in the price given the scant liquidity and daily trading volume.

**We caution that historical volume activity on CWRN has been noticeably light and we are unable to determine if trading volumes to will improve in the coming months with any degree of certainty.** Major dilution of common stock can occur if company issues large blocks of common stock or convertible debt are converted/warrants exercised into common stock, that can negatively impact on the value of the shares either theoretically, or if sold outright in the open market. NASD and SEC Regulations covering rules on Penny Stocks apply for CWRN, subjecting NASD broker-dealers to additional sales practice and disclosure requirements.

*See Appendix A-I for Analyst Certification and Important Disclosures.*

Cotton & Western Mining's **current conduct and operations are in compliance with Mexican guidelines** but, there can be no assurance that Mexico's central or local governments will not impose new, stricter regulations or interpretations of existing regulations that would require additional expenditures or a delay in permitting. The possibility exist that new legislation or regulations may be adopted or that the enforcement of existing laws could become more stringent, either of which may have a significant impact on mining operations or for similar reasons customers' ability to use iron ore and may require customers to significantly change operations or to incur substantial costs that can detract from iron ore spending. Demand for iron ore is closely linked to steel demand and consumption patterns of the steel mill industry in China and Japan.

These iron ore consumption patterns are influenced by factors beyond the company's control, including the steel and steel-related industries (such as infrastructure development and construction activity which is dependent on the strength of the economy and interest rate volatility); government regulation; technological developments and the location, availability, quality and price of competing sources of iron ore. **Any reduction in the demand for iron ore by Chinese steel manufacturing customers may cause a decline in profitability.** In addition, past experience show the steel industry and hence steel prices are both cyclical and volatile and current sustainability of the boom cycle of iron ore demand and pricing (used to manufacture steel) hinges on the strength and durability of the expansion of the Chinese economy.

**Replacement reserves may not be available when required** or, if available, may not be capable of being mined at costs comparable to those characteristic of the depleting mines. For new iron ore acquisitions the company may not be able to accurately assess the geological characteristics of any new mining reserves, which may adversely affect its profitability and financial condition. Exhaustion of reserves at the Pacific Pearl, Los Pozos, Rio Fox mines and at mines that are to be acquired and/or developed in the future, can also have an adverse effect on operating results. Los Pozos is estimated to exhaust its proven reserves in approximately 6 years at current projected production levels unless current or new probable reserves are identified to supplement proven reserves. The Reserve information on geological data assembled is analyzed by staff, which includes various engineers and geologists, and is periodically reviewed by outside firms. The reserve estimates are annually updated to reflect production of iron ore from the reserves and new drilling or other data received. **There are numerous uncertainties inherent in estimating quantities of recoverable reserves, including many factors beyond CWRN control.**

**Estimates of economically recoverable iron ore reserves** and net cash flows necessarily **depend upon a number of variable factors and assumptions, such as geological and mining conditions** which may not be fully identified by available exploration data or may differ from experience in current operations, historical production from the area compared with production from other producing areas, the **assumed effects of regulation by governmental agencies, and assumptions concerning iron ore prices, operating costs, taxes, development costs, and reclamation costs**, all of which may cause estimates to vary considerably from actual results. For these reasons, estimates of the economically recoverable quantities attributable to any particular group of properties, classifications of such reserves are based on risk of recovery and estimates of net cash flows expected are prepared by different engineers or by the same engineers are conducted at different times and may vary substantially. Actual iron ore tonnage recovered from identified reserve areas or properties, and revenues and expenditures with respect to reserves may vary from estimates, and such variances may be material. Therefore there is a risk that estimated proven reserves may not be a true reflection of actual recoverable reserves.

There are no current pending legal actions against the company or outstanding settlements that we are aware of. Further details and a more elaborate discussion of risk factors will be contained in future SEC filings once the company attains **Section 12 (g) reporting status** with the SEC, under the Exchange Act of 1934.

## **MANAGEMENT**

The key management of Cotton & Western Mining, Inc. U.S.A. together with its Operating Subsidiary Cotton & Western Pacific Mining, S.A. de C.V. work as a team, the company is fortunate to have experienced Iron Mineral Mining Engineers with combined knowledge gained in over 50 years of iron ore mining in Mexico. The team is dedicated to achieve and sustain commercial success.

**Robert L. Cotton Jr. - President and CEO** [Cotton & Western Mining, Inc. U.S.A.]  
North East Louisiana State University 1975

**Jose Ramirez Casas - Executive Vice President & Chief Mining Engineer** [Cotton & Western Mining, Inc. U.S.A.]  
University of Autonoma de Zacatecas, Mexico 1973  
Mining and Metallurgical Engineering

**John M. King - Secretary** [Cotton & Western Mining, Inc. U.S.A.]

**Robert L. Cotton III - Manager Product Quality Control** [Cotton & Western Mining, Inc. U.S.A.]  
Kingwood Community College

**Jose Ramirez Casas - President & Chief Mining Engineer** [Cotton & Western Pacific Mining, S.A. de C.V.]  
University of Autonoma de Zacatecas, Mexico 1973  
Mining and Metallurgical Engineering

**Ruben de Jesus Leyva de Alba - Chief Geologist** [Cotton & Western Pacific Mining, S.A. de C.V.]

**Robert L. Cotton III - Manager Product Quality Control** [Cotton & Western Pacific Mining, S.A. de C.V.]  
Kingwood Community College

## **INVESTMENT THESIS AND RECOMMENDATION**

Our analysis suggests that **Cotton & Western Mining, Inc.** is an interesting speculative play among micro-cap companies offering **exposure to the investor on the commodity related boom spurred by Chinese economic growth together with the firming demand and firming pricing conditions for iron ore as a result of expansion in its industrial sector and the ever dominant and pervasive role of iron ore to Chinese and Japanese steel producers.** For stone-cold U.S. investors, the obvious play here is to simply tag along by taking positions in foreign and domestic companies supplying the Chinese juggernaut.

Both operating and financial risk involved in investing in a young mining company are typically high and should be considered by investors. In this case the operational risks associated with mining include unintended explosions, risks associated with weather conditions, strikes, technical breakdowns and many others. There is no assurance that the mining results and production achieved in the past will be sustained with the same quality and grades in future to satisfy orders. **Most input costs are relatively fixed and cannot be influenced or determined by management,** which can have an adverse effect on profitability. Readers should understand that there can be **no assurance that the company will be able to fast-track its intended path towards raising production above the 400,000 ton level per month at the Pacific Pearl and also develop other mining interests,** that will flow through directly to the top and or bottom line to build a consistent longer term profitable track record to enrich shareholder value. The future spot **price of iron ore is one of the biggest unknowns** and does and will play a material role in the financial performance of CWRN in the short, medium and long term.

We therefore only recommend investors that have a **high tolerance for risk** that are able and willing to forfeit either most or all of their capital in search for extraordinary returns, to consider investing in the shares. Also, in our view investors willing to commit capital to CWRN should do so with **absolute minimum 2 year investment horizon,** but preferably longer, to allow ample opportunity for growth to emerge until broader price discovery can materialize within the investment community that will **allow the value behind long term iron ore supply relationships with Chinese clients be unlocked and mine operating margins and efficiency improves at Los Pozos and Rio Fox and Pacific Pearl deposits are mined commercially.** Short term we expect CWRN stock to continue to build a base around \$1.40, before resuming its uptrend. In the medium term a major risk factor may involve that **additional capital raising or stock offering may be needed to continue acquisition-based growth, which we cannot determine due to lack of financial disclosure.**

One of the core reasons which is pivotal to our bullish argument for upside in CWRN, follows from our interpretation of the financial data and analysis of the consolidated **proven reserve position** (31.5 million tons) of the two mines that have been studied geologically. **Our assessment is that the large discount between the present value (PV) of reserves valuation (at \$662 million) and the market capitalization of CWRN (\$92 million)** presents the investor with an undeniable **value opportunity,** assuming that iron ore prices can average at or above \$35 per ton and that the company does not have a substantial amount of debt that would negate our discount argument. The value was calculated assuming \$175 million annual sales from these mining reserves, discounted back into present value terms over a 6 year period, at a rate of 15%. The \$175 million figure was calculated assuming annual production of 5 million tons of iron ore at an average price per ton of \$35. **The greater the benefit of The Pacific Pearl and future Los Pozos opportunity that can be realized, the greater the scope for the \$662 million PV of reserves valuation to be ratcheted upward, which will render the discount even more compelling.** Ideally we would here make an adjustment to the PV of reserves calculation by subtracting the value of outstanding debt and adding the value of cash and cash equivalents and then examining this adjusted figure expressed on a per share basis. The pre-adjusted figure we obtain is \$9.92 per share compared with a share price of \$1.40 which suggests a unusually wide discount.

**Based on recent results and management's guidance, we expect financial performance to gain pace and production levels to rise during the latter half of the coming financial year (FY2006).** Under the assumption that **capital raising activity is well-managed and expecting revenue in 2006, positive cash flow from operations to be generated in FY 2006** as more progress is made to deliver shipment of orders to its customer base and continued expansion

of the Chinese demand for iron ore prevails, we are of the opinion that CWRN stock has major upside potential. Given managements and our own independent forecasts, we are of the opinion that revenue potential of \$23 million is achievable for FY 2006.

*See Appendix A-I for Analyst Certification and Important Disclosures.*

Using our own gross margin and operating cost assumptions that are a function of a range of values of peer companies, we estimate a FY 2006 EPS of 6c (assuming 66.5 million weighted number of shares outstanding). We have made allowance for tax applying an effective tax rate of 34%. Some peer companies used to extract the necessary statistics are CVRD (RIO), BHP Billiton (BHP), Rio Tinto (RTP), Gerdau S.A (GGB), Mittal Steel (MT) and Tenaris SA (TS) even though none of these are pure play iron ore public companies that enables direct comparison.

Using our FY 2006 EPS forecasts we deduce that the shares are presently trading at a forward PE multiple of 23.3x which is slightly demanding. Using like margin assumptions and other revenue estimates for FY2007 we obtain an EPS forecast of 18c for FY2007. Given these calculations and our bottom up analysis which is more qualitative in nature, we set a 12 month target price for the security of \$2.30.

This number was arrived at by applying a 18 month forward PE ratio of 15x (a slight premium to the industry mean trailing 12 month PE ration of 13x due to the higher expected average growth rate of CWRN) to our FY 2007 EPS estimate of 18c, which yields \$2.71 per share. This forward share price is then discounted at a rate of 10.5% (k) (SEE TABLE BELOW) to arrive at a present value of the share price of \$2.27 per share, where k is a function of the beta coefficient, the risk-free rate, and expected return of the market.

		Forward PE multiple	EPS Growth	PEG Multiple	Forward Price	Discount Rate (k)	Present Value
FY 2006 EPS	0.06	15.0	NA	NA	0.96	11%	0.89
FY 2007 EPS	0.18	15.0	183%	0.19	2.71	11%	2.27
Average							
Price to Book	NA			Assumptions	Beta	0.69	
Price to Sales	1.01				R <sub>f</sub>	4.8%	
Current PE	NA				R <sub>m</sub>	13.0%	
Forward PE	21.8				k	10.5%	
(FY 2006 EPS)							
EV	NA				$k=R_f+(R_m-R_f)*Beta$		

All factors considered, we anticipate a stake in CWRN still has compelling upside potential in the coming 18 months in light of the fact that negligible value is assigned to possible added value and incremental production benefit that will be realized when the Pacific Pearl mine starts commercial production. Our assessment is that the current share price rating (as measured by reserve value per share, Price to Sales, Forward PE and Relative PE) and valuation is poor (using all 4 metrics) associated with the operational risk and mining timing delays of planned commercialization of Pacific Pearl that is scheduled to start in the next 3 months.

We HIGHLIGHT to the reader that this forecast is made under the assumption that the Pacific Pearl mining schedule and permitting progresses smoothly and production targets are attained. It is also made assuming CWRN can attain our FY2006 revenue expectation of \$23 million and a minimum of \$4.24 million after tax income. Moreover, we believe that the present market for CWRN shares is far from efficient, does not fully reflect the leverage possible from new potential acquisitions and developments that can result in higher reserves and production that can enhance productivity if new mining assets are added in a strategic manner, which can be done in synergistic fashion. We regard the present market capitalization as extremely modest in light of the fact that current production will rise sharply from under 1 million tons in 2006 to close to 5 million tons in 2007, and will then still be well below present supply arrangements that are available from customers seeking iron ore shipments from CWRN to meet demand.

Under these assumptions we initiate coverage on CWRN with a SPECULATIVE positive rating. Risk to our recommendation include amongst other: failure of new mines and projects to come on-stream, due to production difficulties in the near term, a slowdown in production or unexpected decline in iron ore prices that will lead to a contraction in forward PE multiple assumptions and dampen the reserve valuation, a steep rise in mining and production costs or unanticipated replacement cost of mining equipment, fees and/or any adverse regulatory changes in the markets it serves. New competition in its regional market by other larger iron ore producers, tax expense accounting changes, any inability to obtain necessary financing from capital markets when needed, to continue its business projects and/or major share dilution that can occur, if large quantities of shares are issued to extinguish debt or paid for services, are some additional factors that will counteract price appreciation potential or cause shares to decline in value.

See Appendix A-1 for Analyst Certification and Important Disclosures.



## ANALYST CERTIFICATIONS

## APPENDIX-A1

The research analyst, who upon request wrote this report, certifies that the views expressed in this research report, accurately reflects his personal view about the subject company. The analyst also certifies that he does not own or have any beneficial interest in shares of the covered company, also that no part of his compensation was, is or will be directly or indirectly related to the specific recommendation or view expressed in this report. Based on the facts that were provided, the industry trends present and sources of information used to produce this report, it is my best opinion and reflection of what the company's rating and share appreciation potential could be once research coverage is widely adopted. Investors are urged to consider this report as only a single factor in making their investment decision. Information, opinions or recommendations contained in this report or research note are submitted solely for advisory and information purposes and we also do not accept any obligation to provide updates to this report in future.

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