

MESABI TRUST  
Form 10-Q  
September 08, 2006

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**  
WASHINGTON, D.C. 20549

**FORM 10-Q**

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934

For the quarterly period ended July 31, 2006

or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number: 1-4488

**MESABI TRUST**

(Exact name of registrant as specified in its charter)

**New York**

(State or other jurisdiction of  
incorporation or organization)

**13-6022277**

(I.R.S. Employer Identification No.)

**c/o Deutsche Bank Trust Company Americas  
Trust & Securities Services GDS  
60 Wall Street  
27th Floor**

**New York, New York**  
(Address of principal executive offices)

**10005**  
(Zip code)

**(615) 835-2749**

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

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Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act:

Large accelerated filer  Accelerated filer  Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

As of September 7, 2006, there were 13,120,010 Units of Beneficial Interest in Mesabi Trust outstanding.

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**PART I - FINANCIAL INFORMATION****Item 1. Financial Statements. (Note 1)****Mesabi Trust****Condensed Statements of Income****Three and Six Months Ended July 31, 2006 and 2005****(unaudited)**

	<b>Three Months Ended July 31, 2006</b>		<b>Six Months Ended July 31, 2006</b>	
		<b>2005</b>		<b>2005</b>
<b>A. Condensed Statements of Income</b>				
<b>Revenues</b>				
Royalty income	\$ 6,310,152	\$ 5,541,043	\$ 7,947,151	\$ 7,884,491
Interest income	16,962	12,410	24,934	23,047
	6,327,114	5,553,453	7,972,085	7,907,538
<b>Expenses</b>				
	137,759	145,972	308,876	364,895
Net income	\$ 6,189,355	\$ 5,407,481	\$ 7,663,209	\$ 7,542,643
Weighted average number of units outstanding	13,120,010	13,120,010	13,120,010	13,120,010
Net income per unit (Note 2)	\$ 0.47	\$ 0.41	\$ 0.58	\$ 0.57
Distributions declared per unit	\$ 0.40	\$ 0.37	\$ 0.70	\$ 0.70

See Notes to Condensed Financial Statements.

## Mesabi Trust

## Condensed Balance Sheets

July 31, 2006 (unaudited) and January 31, 2006

	July 31, 2006 (unaudited)	January 31, 2006
<b>B. Condensed Balance Sheets</b>		
<b>Assets</b>		
Cash	\$ 5,398,820	\$ 6,377,990
U.S. Government securities, at amortized cost (which approximates market)	668,387	648,193
Accrued income receivable	2,631,154	4,277,766
Prepaid expenses	61,904	25,007
Total current assets	8,760,265	11,328,956
Fixed property, including intangibles, at nominal values:		
Amended Assignment of Peters Lease	1	1
Assignment of Cloquet Lease	1	1
Certificate of beneficial interest for 13,120,010 units of land trust	1	1
	3	3
	\$ 8,760,268	\$ 11,328,959
<b>Liabilities, Unallocated Reserve and Trust Corpus</b>		
Liabilities		
Distribution payable	\$ 5,248,004	\$ 6,166,405
Accrued expenses	48,035	177,527
Total current liabilities	5,296,039	6,343,932
Unallocated Reserve (Note 3)	3,464,226	4,985,024
Trust Corpus	3	3
	\$ 8,760,268	\$ 11,328,959

See Notes to Condensed Financial Statements.

## Mesabi Trust

## Condensed Statements of Cash Flows

Six Months Ended July 31, 2006 and 2005 (unaudited)

	Six Months Ended July 31,	
	2006	2005
<b>C. Condensed Statements of Cash Flows</b>		
Cash flows from operating activities		
Royalties received	\$ 9,591,781	\$ 9,599,253
Interest received	26,915	26,655
Expenses paid	(475,264 )	(356,774 )
Net cash provided by operating activities	9,143,432	9,269,134
Cash flows from investing activities		
Maturities of U.S. Government Securities	10,810,385	8,452,420
Purchases of U.S. Government Securities	(10,830,579 )	(8,352,420 )
Net cash provided by (used for) investing activities	(20,194 )	100,000
Cash flow from financing activities		
Distributions to Unitholders	(10,102,408 )	(8,200,006 )
Net change in cash	(979,170 )	1,169,128
Cash, beginning of year	6,377,990	3,970,870
Cash, end of quarter	\$ 5,398,820	\$ 5,139,998
<b>Reconciliation of net income to net cash provided by operating activities</b>		
Net income	\$ 7,663,209	\$ 7,542,643
Decrease in accrued income receivable	1,646,612	1,718,370
Increase in prepaid expenses	(36,897 )	(4,762 )
(Decrease) increase in accrued expenses	(129,492 )	12,883
Net cash provided by operating activities	\$ 9,143,432	\$ 9,269,134

See Notes to Condensed Financial Statements.

**MESABI TRUST**

**NOTES TO CONDENSED FINANCIAL STATEMENTS**

**July 31, 2006 (unaudited)**

Note 1. The financial statements included herein have been prepared without audit (except for the balance sheet at January 31, 2006) in accordance with the instructions to Form 10-Q pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations. In the opinion of the Trustees, all adjustments, consisting only of normal recurring adjustments, necessary for a fair statement of (a) the results of operations for the three months and six months ended July 31, 2006 and 2005, (b) the financial position at July 31, 2006 and January 31, 2006, and (c) the cash flows for the six months ended July 31, 2006 and 2005, have been made.

Note 2. Earnings per unit are based on weighted average number of units outstanding during the periods presented (13,120,010 units).

Note 3. The Trustees have determined that the Unallocated Reserve should be maintained at a prudent level, usually within the range of \$500,000 to \$1,000,000, to meet present or future liabilities of the Trust. Accordingly, although the actual amount of the Unallocated Reserve will fluctuate from time to time, and may increase or decrease from its current level, it is currently intended that future distributions will be highly dependent upon royalty income as it is received quarterly and the level of Trust expenses that the Trustees anticipate occurring in subsequent quarters. The Trustees determine the level of distributions on a quarterly basis after receiving notification from Northshore Mining Company as to the amount of royalty income that will be received and after determination of any known or anticipated expenses, liabilities and obligations of the Trust. At July 31, 2006, the Unallocated Reserve was represented by \$833,072 in unallocated cash and U.S. Government securities, and \$2,631,154 of accrued revenue primarily representing royalties not yet received by the Trust but anticipated to be received in October 2006 from Northshore Mining Company as part of the royalty due with respect to the second fiscal quarter, based upon reported lessee shipping activity for the month of July 2006.

## Item 2. Trustees Discussion and Analysis of Financial Condition and Results of Operations.

### Forward-Looking Statements

Certain statements contained in this document are considered forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. All such forward-looking statements, including those statements estimating calendar year 2006 production or shipments, are based on information from the lessee/operator (and its parent corporation) of the mine located on the lands owned and held in trust for the benefit of the holders of units of beneficial interest of Mesabi Trust. These statements may be identified by the use of forward-looking words, such as may, will, could, project, believe, anticipate, expect, estimate, continue, potential, plan, forecast and other similar words. Forward-looking statements are inherently subject to known and unknown risks and uncertainties. Actual results and future developments could differ materially from the results or developments expressed in or implied by these forward-looking statements. For a discussion of the factors, including but not limited to, those that could adversely affect the Trust's actual results and performance, see Risk Factors in Part I Item 1A of the Trust's Annual Report on Form 10-K for the year-ended January 31, 2006. Mesabi Trust undertakes no obligation, other than that imposed by law, to make any revisions to the forward-looking statements contained in this filing or to update them to reflect circumstances occurring after the date of this filing.

### Background

Mesabi Trust ( Mesabi Trust or the Trust ), formed pursuant to an Agreement of Trust dated July 18, 1961 (the Agreement of Trust ), is a trust organized under the laws of the State of New York. The Agreement of Trust specifically prohibits the Trustees from entering into or engaging in any business. This prohibition applies even to business activities the Trustees deem necessary or proper for the preservation and protection of the Trust Estate. Accordingly, the Trustees' activities in connection with the administration of Trust assets are limited to collecting income, paying expenses and liabilities, distributing net income to the holders of Certificates of Beneficial Interest in the Trust ( Unitholders ) after the payment of, or provision for, such expenses and liabilities, and protecting and conserving the assets held.

The Trustees do not intend to expand their responsibilities beyond those permitted or required by the Agreement of Trust, the Amendment to the Agreement of Trust dated October 25, 1982 (the Amendment ), and those required under applicable law. The Trust has no employees, but it engages independent consultants to assist the Trustees in, among other things, monitoring the amount and sales prices of iron ore products shipped from Silver Bay, Minnesota, based on information supplied to the Trustees by Northshore Mining Company ( Northshore ), the lessee/operator of the Mesabi Trust lands, and its parent company Cleveland-Cliffs Inc ( CCI ). References to Northshore in this quarterly report, unless the context requires otherwise, are applicable to CCI as well.

Leasehold royalty income constitutes the principal source of the Trust's revenue. Royalty rates are determined in accordance with the terms of Mesabi Trust's leases and assignments of leases.

Three types of royalties, as well as royalty bonuses, comprise the Trust's leasehold royalty income:

- Base overriding royalties, which historically constitute the majority of Mesabi Trust's royalty income, are determined by both the volume and selling price of iron ore products shipped. Northshore is obligated to pay Mesabi Trust base overriding royalties in varying

amounts, based on the volume of iron ore products shipped. Base overriding royalties are calculated as a percentage of the gross proceeds of iron ore products produced at Mesabi Trust lands (and to a limited extent other lands) and shipped from Silver Bay, Minnesota. The percentage ranges from 2-1/2% of the gross proceeds for the first one million tons of iron ore products so shipped annually to 6% of the gross proceeds for all iron ore products in excess of 4 million tons so shipped annually. Base overriding royalties are subject to price adjustments under the CCI Pellet Agreements and, as described elsewhere in this report, such adjustments may be positive or negative. (See the section entitled Royalty Comparisons below for more information.)

- Royalty bonuses are earned when iron ore products shipped from Silver Bay are sold at prices above a threshold price. The royalty bonus is a percentage of the gross proceeds of product shipped from Silver Bay and sold at prices above a threshold price. The threshold price is adjusted (but not below \$30.00) on an annual basis for inflation and deflation (the Adjusted Threshold Price). The Adjusted Threshold Price is \$44.60 per ton for calendar year 2006. Comparatively, the Adjusted Threshold Price was \$42.89 for calendar year 2005. The royalty bonus percentage ranges from 1/2 of 1% of the gross proceeds (on all tonnage shipped for sale at prices between the Adjusted Threshold Price and \$2.00 above the Adjusted Threshold Price) to 3% of the gross proceeds (on all tonnage shipped for sale at prices \$10.00 or more above the Adjusted Threshold Price). Royalty bonuses are subject to price adjustments under the CCI Pellet Agreements and, as described elsewhere in this report, such adjustments may be positive or negative. (See the section entitled Royalty Comparisons below for more information.)
- Fee royalties, which historically constitute a smaller component of the Trust's royalty income, are payable to Mesabi Land Trust, a Minnesota land trust, which holds a 20% interest as fee owner in the Peters Lease. Mesabi Trust holds the entire beneficial interest in the Mesabi Land Trust for which U.S. Bank N.A. acts as trustee. Mesabi Trust is entitled to receive the net income of the Mesabi Land Trust, which is generated from royalties on the amount of crude ore mined after the payment of expenses. Currently, the fee royalty on crude ore is based on an agreed price per ton, subject to certain indexing. Crude ore is the source of iron oxides used to make iron ore pellets and other products.
- Minimum advance royalties: Generally, Northshore's obligation to pay base overriding royalties and royalty bonuses with respect to the sale of iron ore products accrues upon the shipment of those products from Silver Bay. However, regardless of whether any shipment has occurred, Northshore is obligated to pay to Mesabi Trust a minimum advance royalty. Each year, the amount of the minimum advance royalty is adjusted (but not below \$500,000 per annum) for inflation and deflation. The minimum advance royalty was \$714,988 for calendar year 2005 and is \$743,420 for calendar year 2006. Until overriding royalties (and royalty bonuses, if any) for a particular year equal or exceed the minimum advance royalty for the year, Northshore must make quarterly payments of up to 25% of the minimum advance royalty for the year. Because minimum advance royalties are essentially prepayments of base overriding royalties and royalty bonuses earned each year, any minimum advance royalties paid in a fiscal quarter are recouped by credits against base overriding royalties and royalty bonuses earned in later fiscal quarters during the year.

Northshore is obligated to make quarterly royalty payments in January, April, July and October of each year. In the case of base overriding royalties and royalty bonuses, these quarterly royalty payments



are to be made whether or not the related proceeds of sale have been received by Northshore by the time such payments become due.

Under the relevant agreements, Northshore may mine and ship iron ore products from lands other than Mesabi Trust lands. Northshore alone determines whether to mine off Trust and/or such other lands, based on its current mining and engineering plan. The Trustees do not exert any influence over mining operational decisions. To encourage the use of iron ore products from Mesabi Trust lands, Mesabi Trust receives royalties on stated percentages of iron ore shipped from Silver Bay, whether or not the iron ore products are from Mesabi Trust lands. Mesabi Trust receives royalties at the greater of (i) the aggregate quantity of iron ore products shipped that were mined from Mesabi Trust lands, and (ii) a portion of the aggregate quantity of all iron ore products shipped that were mined from any lands, such portion being 90% of the first four million tons shipped during such year, 85% of the next two million tons shipped during such year, and 25% of all tonnage shipped during such year in excess of six million tons.

As noted above, the information regarding amounts and sales prices of shipped iron ore products is used to compute the royalties payable to Mesabi Trust by Northshore. Deutsche Bank Trust Company Americas, the Corporate Trustee, also performs certain administrative functions for Mesabi Trust.

### Results of Operations

As shown in the table below, production of iron ore pellets at Northshore from Mesabi Trust lands during the fiscal quarter ended July 31, 2006 totaled approximately 1.25 million tons, and actual shipments over the same period totaled approximately 1.43 million tons. By comparison, actual pellet production during the same period in 2005 totaled approximately 1.04 million tons, and actual shipments approximated 1.35 million tons.

Three Months Ended	Pellets Produced from Trust Lands	Shipments from Trust Lands
July 31, 2006	1,246,138	1,427,269
July 31, 2005	1,035,952	1,351,033

During the six months ended July 31, 2006, production of iron ore pellets at Northshore from Mesabi Trust lands totaled approximately 2.46 million tons, and actual shipments over the same period totaled approximately 1.96 million tons. By comparison, actual pellet production during the same period in 2005 totaled approximately 2.19 million tons, and actual shipments approximated 1.89 million tons.

Six Months Ended	Pellets Produced from Trust Lands	Shipments from Trust Lands
July 31, 2006	2,464,724	1,964,328
July 31, 2005	2,191,887	1,888,975

The higher production and shipment figures through July 31, 2006, are the result of increased mining activity at Northshore combined with an increase in the volume of shipments from Silver Bay.

**Comparison of Three Months Ended July 31, 2006 and July 31, 2005**

Net income for the quarter ended July 31, 2006 was \$6,189,355 an increase of approximately 14% compared to the fiscal quarter ended July 31, 2005. This increase was due to increases in the base overriding royalties paid to the Trust, resulting from an increase in the volume of shipments, and higher royalty bonuses during the quarter due to increases in pellet prices. In addition, expenses decreased nearly 6% from the comparable prior period due to a reduction in the general and administrative expenses, primarily legal and accounting fees, incurred by the Trust. The following table provides a summary of results for the three months ended July 31, 2006 and July 31, 2005, respectively.

	<b>Three Months Ended July 31,</b>	
	<b>2006</b>	<b>2005</b>
Total royalty income	\$ 6,310,152	\$ 5,541,043
Interest income	16,962	12,410
Gross income	6,327,114	5,553,453
Expenses	137,759	145,972
Net income	\$ 6,189,355	\$ 5,407,481

**Comparison of Six Months Ended July 31, 2006 and July 31, 2005**

Net income for the six months ended July 31, 2006 was \$7,663,209, an increase of approximately 2% over the six months ended July 31, 2005. This increase was due to a slight increase in the bonus royalties figure for the first half of fiscal 2007. Trust expenses also decreased 15% from the comparable prior period due to a reduction in the general and administrative expenses, primarily legal and accounting fees, incurred by the Trust. Following is a summary of results for the six months ended July 31, 2006 and July 31, 2005, respectively.

	<b>Six Months Ended July 31,</b>	
	<b>2006</b>	<b>2005</b>
Total royalty income	\$ 7,947,151	\$ 7,884,491
Interest income	24,934	23,047
Gross income	7,972,085	7,907,538
Expenses	308,876	364,895
Net income	\$ 7,663,209	\$ 7,542,643

**Unallocated Reserve**

Unallocated Reserve as of July 31, 2006 was \$3,464,226, an increase of approximately 29% compared to the Unallocated Reserve as of July 31, 2005. The increase is primarily due to an increase in the royalty revenue that was accrued on the Trust's balance sheet at the end of the fiscal quarter ended July 31, 2006, but not yet paid to the Trust. At July 31, 2006, approximately 76% of the Unallocated Reserve, or \$2,631,154, was accrued revenue primarily representing royalties not yet received by the Trust but anticipated to be received in October 2006 from Northshore as part of the royalty due with respect to the Trust's second fiscal quarter. The increased royalty revenue accrual, which is based upon reported lessee shipping activity for the month of July 2006, is reflected as Accrued Income Receivable on the balance sheet at July 31, 2006, which the Trustees anticipate will be distributed, after providing for expenses and reserves, during the quarter in which it is received.

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The Trustees have determined that a portion of the Unallocated Reserve, usually within the range of \$500,000 to \$1,000,000 or such other amount as the Trustees may deem prudent, should be maintained as a reserve for unexpected loss contingencies. At July 31, 2006, approximately 24% of the Unallocated Reserve, or \$833,072, was represented by unallocated cash and U.S. Government securities.

The Trustees will continue to monitor the economic circumstances of the Trust to strike a responsible balance between distributions to Unitholders and the need to maintain adequate reserves at a prudent level, given the unpredictable nature of the iron ore industry, the Trust's dependence on the actions of the lessee/operator, and the fact that the Trust essentially has no other liquid assets. Following is a comparison of Unallocated Reserve over the past year.

	As of July 31,	
	2006	2005
Unallocated Reserve	\$ 3,464,226	\$ 2,682,399

Although the actual amount of the Unallocated Reserve will fluctuate from time to time, and may increase or decrease from its current level, it is currently intended that future distributions will be highly dependent upon royalty income as it is received and the level of Trust expenses. The amount of future royalty income available for distribution will be subject to the volume of iron ore product shipments and the dollar level of sales by Northshore. Shipping activity is greatly reduced during the winter months and economic conditions, particularly those affecting the steel industry, may adversely affect the amount and timing of such future shipments and sales.

### Royalty Comparisons

Royalties received in July 2006 included a royalty bonus payment, reflecting prices of pellets shipped that exceeded the current Adjusted Threshold Price of \$44.60 per ton. Total royalty income for the three months ended July 31, 2006 increased approximately 14%, as compared to the prior comparable period due to an increase in the volume of shipments and generally higher pellet prices. The following table summarizes Mesabi Trust's royalty income for the three months ended July 31, 2006 and July 31, 2005, respectively:

	Three Months Ended July 31,	
	2006	2005
Base overriding royalties	\$ 3,373,097	\$ 3,011,663
Bonus royalties	2,823,672	2,445,365
Minimum advance royalty paid (recouped)		
Fee royalties	113,383	84,015
<b>Total royalty income</b>	<b>\$ 6,310,152</b>	<b>\$ 5,541,043</b>

Total royalty income for the six months ended July 31, 2006 increased less than 1%, as compared to the prior comparable period. The slightly higher total royalty income figure is the result of a small increase in bonus royalties and fee royalty figures due to higher pellet prices and increased production at Northshore. The following table summarizes Mesabi Trust's royalty income for the six months ended July 31, 2006 and July 31, 2005, respectively:

	Six Months Ended July 31,	
	2006	2005
Base overriding royalties	\$ 3,912,795	\$ 3,936,680
Bonus royalties	3,809,214	3,768,634
Minimum advance royalty paid (recouped)		
Fee royalties	225,142	179,177
<b>Total royalty income</b>	<b>\$ 7,947,151</b>	<b>\$ 7,884,491</b>

## Recent Developments

**Production and Shipments.** CCI reported in its Form 10-Q filed July 27, 2006 that production for the first six months of 2006 for Northshore was approximately 2.5 million tons of iron ore pellets, representing an increase of approximately 100,000 tons from the first six months of 2005. CCI's forecast for production at Northshore is currently set at 5.0 million tons of iron ore pellets (using iron ore mined both from Mesabi Trust lands and from other than Mesabi Trust lands) for calendar year 2006, which represents an increase of 100,000 tons from total actual production for calendar year 2005. Northshore has not provided the Trustees with an estimate of its calendar year 2006 shipments of iron ore pellets.

During calendar years 2005, 2004, 2003, 2002 and 2001, the percentage of shipments of iron ore products from Mesabi Trust lands was approximately 90.1%, 92.0%, 95.5%, 97.5% and 99.2%, respectively, of total shipments. Northshore has not advised the Trustees as to the percentage of iron ore products from Mesabi Trust lands it anticipates shipping in calendar year 2006. See the description of the uncertainty of market conditions in the iron ore and steel industry under **Important Factors Affecting Mesabi Trust** below and the information under the heading **Risk Factors** in Part I Item 1A of the Trust's Annual Report on Form 10-K for the year-ended January 31, 2006.

**Capacity Expansions.** In a Form 8-K filed August 10, 2006, CCI stated that it is reevaluating its plans to restart an idled pellet furnace at the Northshore Mine's pellet facility. As previously reported, CCI decided to defer plans to repair and restart an idle furnace at Northshore until market conditions improved. CCI estimates that its annual production would increase by approximately 800,000 tons if it were to restart the idle furnace at Northshore. Northshore has not provided the Trustees with an estimate of its future production plans or anticipated shipments of iron ore pellets. Accordingly, the Trustees are unable to make any projections as to the extent to which CCI's potential capacity expansions, if any, may impact future royalties payable to the Trust.

**Iron Ore Pricing and Contract Adjustments.** During the course of its fiscal year some portion of the royalties paid to Mesabi Trust will be based on estimated prices for iron ore products sold under certain term contracts between Northshore, CCI and certain of their customers (the **CCI Pellet Agreements**). Mesabi Trust is not a party to the CCI Pellet Agreements. These prices are subject to interim and final pricing adjustments, which can be positive or negative, and which adjustments are dependent in part on multiple price and inflation index factors that are not known until after the end of a contract year. This can result in significant and frequent variations in royalties received by Mesabi Trust (and in turn the resulting amount available for distribution to Unitholders by the Trust) from quarter to quarter and on a comparative historical basis, and these variations, which can be positive or negative, cannot be predicted by Mesabi Trust.

CCI reported in its Form 10-Q filed July 27, 2006 that it experienced a decrease in sales margins for the second quarter and first half of 2006 versus the same period in 2005. The decrease was primarily due to lower sales volume and higher production costs, partially offset by higher sales price realizations. According to CCI, the increase in sales prices of approximately 13 percent in its second quarter and 14 percent in the first half of 2006 reflected contractual base price increases, higher term sales contract escalation factors including higher steel pricing, higher Producers Price Index, and lag year adjustments, partially offset by lower international benchmark steel prices. CCI reported a 15 percent increase in operating expenses in its second quarter with a 12 percent increase through June 30, 2006, due to higher energy and supply pricing, higher labor costs, increased maintenance activity and lower production. The Trustees are unable to predict whether base contract iron ore prices will continue to increase or whether such increases have any potential impact on future royalties payable to the Trust.

Because the shipments of iron ore products using iron ore mined from Mesabi Trust lands represent only a fraction of CCI's overall sales and because Mesabi Trust is not party to the CCI Pellet Agreements, while this news indicates that the trend of prices realized by CCI appears higher, the actual impact on royalties (and ultimately distributions by Mesabi Trust) cannot be estimated.

**Mittal Steel USA Agreements.** Even though Mesabi Trust is not a party to any iron ore supply contract with any customer of Northshore/CCI, the royalties it receives under the Amended Assignment Agreements are dependent on the volume and price of iron ore products that are shipped from Silver Bay. A substantial portion of shipments of iron ore from Mesabi Trust lands are sold under one of the CCI Pellet Agreements, the Pellet Sale and Purchase Agreement dated April 10, 2002 between CCI (together with Northshore and other affiliates) and International Steel Group, Inc. (together with its affiliates, ISG) (the ISG Agreement). According to the terms of the ISG Agreement, CCI is ISG's sole supplier of iron ore through 2016 for its Cleveland and Indiana Harbor Works. The term of the ISG Agreement is through December 31, 2016, unless either party gives the other written notice to terminate by December 31, 2014 (two years prior to the end of the term). If no notice of termination is given, the agreement will continue on an annual basis, subject to termination with 2-years' prior written notice. The ISG Agreement also provides for upward or downward adjustments of iron ore prices, which adjustments are dependent in part on multiple price and inflation index factors that are not known until after the end of a contract year. Many portions of the ISG Agreement such as prices, price adjustments and price adjustment formulas have received confidential treatment in accordance with the rules of the Securities and Exchange Commission and the Trustees have not been permitted to review the entire agreement. The Trustees are not able to quantify the effect of the amendment to the ISG Agreement on future royalties payable to the Trust.

Additional shipments of iron ore from Mesabi Trust lands are sold under the Amended and Restated Pellet Sale and Purchase Agreement dated May 17, 2004 between certain affiliates of CCI (including Northshore), ISG and ISG Weirton Inc. (the Weirton Agreement). According to the terms of the Weirton Agreement, CCI is one of two suppliers of iron ore pellets through 2018 to Weirton (now Mittal Steel-Weirton).

In its Form 10-Q filed July 27, 2006, CCI reported that on April 13, 2006, it entered into a letter agreement with Mittal Steel USA that resolved a dispute between the companies over the terms of the iron ore supply agreement between CCI and Mittal Steel USA's Weirton facility. Under the terms of the letter agreement, the three separate iron ore supply agreements between CCI and Mittal Steel USA's Cleveland and Indiana Harbor West, Indiana Harbor East and Weirton facilities were modified to aggregate Mittal Steel USA's purchases under the agreements during the years 2006 through and including 2010. During this period, Mittal Steel USA is obligated to purchase specified minimum tonnages of iron ore pellets on an aggregate basis as specified in the letter agreement. The terms of the letter agreement permit Mittal Steel USA to manage its ore inventory levels through buy down provisions, which permit Mittal Steel USA to reduce its tonnage purchase obligation each year at a specified price per ton, and with deferral provisions, which permit Mittal Steel USA to defer a portion of

its annual tonnage purchase obligation beginning in 2007. The letter agreement also permits Mittal Steel USA to use the committed volume at any of its facilities. As part of the settlement, CCI canceled an invoice for approximately 325,000 tons of iron ore pellets that were not purchased by Mittal Steel USA's Weirton facility in January 2006. In addition, Mittal Steel USA waived all Special Steel Payment claims as described in CCI's Form 8-K filed on February 10, 2006.

The terms of the letter agreement resulted in a definitive agreement that amended the terms of the three separate iron ore supply agreements between the Company and Mittal Steel USA's Cleveland and Indiana Harbor West, Indiana Harbor East and Weirton facilities.

The Trust is not a party to the ISG Agreement or the Weirton Agreement and the Trustees are unable at this time to determine what, if any, impact CCI's settlement with Mittal may have on royalties already paid or payable in the future to the Trust.

**Mesabi Nugget Project.** Since 2002, CCI has been participating in the Mesabi Nugget Project with Kobe Steel, Ltd. (Kobe Steel), Steel Dynamics, Inc., Ferrometrix, Inc. and the State of Minnesota. The project's objective is to develop and apply a new iron making technology (Kobe Steel's Itmk3 process) for converting iron ore into nearly pure iron nugget form. CCI has indicated that if the Mesabi Nugget Project successfully achieves commercialization, iron nuggets from this new process would be used as an alternative to steel scrap as a raw material for electric steel furnaces and blast furnaces or basic oxygen furnaces of integrated steel producers.

In its Form 10-Q filed July 27, 2006, CCI affirmed its continued involvement in the Mesabi Nugget Project. CCI's board of directors has authorized \$50 million in capital expenditures for the Mesabi Nugget Project, subject to the project obtaining non-recourse financing for its capital requirements in excess of equity investments made by the project participants and the project participants reaching mutually agreed upon terms. The authorized capital expenditures by CCI include \$21 million for construction and operation of the commercial nugget plant, \$25 million to expand the Northshore concentrator to provide the iron ore concentrate, and \$4.4 million for railroad improvements to transport the concentrate. CCI stated further that its equity interest in the venture is expected to be approximately 25 percent.

Although Mesabi Trust is not a party to the Mesabi Nugget project and its involvement in this project has not been solicited, iron ore from Mesabi Trust lands may be used to supply concentrate to the commercial modules. At this time, however, the Trustees are unable to make projections as to whether, and to what extent, any possible future royalties might be payable to the Trust with respect to any commercial nugget plants.

**USWA Written Notification.** In its Form 10-Q filed April 27, 2006, CCI stated that it received a Written Notification from the United Steel Workers Association indicating that, effective April 1, 2006, the USWA initiated an organizing campaign at Northshore. CCI stated that, pursuant to its collective bargaining agreements with the USWA, it was required to remain neutral during the organizing campaign. In its Form 10-Q filed July 27, 2006, CCI reported that based upon subsequent conversations with USWA representatives, the organizing campaign has been postponed pending resolution of issues relating to the neutrality commitment in the collective bargaining agreement. CCI also reported that although previous efforts to organize Northshore employees have been unsuccessful, it cannot predict the timing of when a campaign may begin or the outcome of a campaign when it begins. The Trustees cannot determine the impact such a campaign may have, if any, on the future royalties of the Trust.

**EPA Notice of Violation.** In a Form 8-K filed on February 15, 2006, CCI reported that Northshore received a Notice of Violation (the Notice) from the U.S. Environmental Protection Agency

( EPA ) alleging: (1) that Northshore violated the Prevention of Significant Deterioration ( PSD ) requirements of the Clean Air Act in the 1990 restart of Furnaces 11 and 12; (2) that Northshore violated the PSD Regulations in the 1995 restart of Furnace 6; (3) Title V operating permit violations for not including in the Title V permit all applicable requirements (including a compliance schedule for PSD and Best Available Control Technology requirements associated with the furnace restarts); and (4) Northshore s failure to comply with calibration of monitoring equipment as required under Northshore s Title V permit. CCI reported in its Form 10-Q filed July 27, 2006 that the alleged violations took place before it acquired Northshore (formerly Cyprus Northshore Mining Company) in a stock purchase in 1994. CCI has investigated the allegations in the Notice and has communicated its position to the EPA. The Trust has not been named in the Notice and the Trustees have not received any information regarding the Notice, other than that which has been publicly reported by CCI. The Trustees cannot determine the impact, if any, of any proven violations on the future royalties of the Trust.

**Securities Regulation.** The Trust is a publicly-traded trust listed on the New York Stock Exchange ( NYSE ) and is therefore subject to extensive regulation under, among others, the Securities Act of 1933, the Securities Exchange Act of 1934, the Sarbanes-Oxley Act of 2002 ( Sarbanes-Oxley ) and the rules and regulations of the NYSE. Issuers failing to comply with such authorities risk serious consequences, including criminal as well as civil and administrative penalties. In most instances, these laws, rules and regulations do not specifically address their applicability to publicly-traded trusts such as Mesabi Trust. In particular, Sarbanes-Oxley mandated the adoption by the Securities and Exchange Commission (the SEC ) and NYSE of certain rules and regulations that are impossible for the Trust to literally satisfy because of its nature as a pass-through trust. Pursuant to NYSE rules the Trust is exempt from many of the corporate governance requirements that apply to publicly traded corporations. The Trust does not have, nor does the Agreement of Trust provide for, a board of directors, an audit committee, a corporate governance committee or a compensation committee. The Trustees intend to closely monitor the SEC s and NYSE s rulemaking activity and will comply with such rules and regulations to the extent applicable.

#### **Important Factors Affecting Mesabi Trust**

The Agreement of Trust specifically prohibits the Trustees from entering into or engaging in any business. This prohibition seemingly applies even to business activities the Trustees deem necessary or proper for the preservation and protection of the Trust Estate (as such term is defined below). Accordingly, the Trustees activities in connection with the administration of Trust assets are limited to collecting income, paying expenses and liabilities, distributing net income to the Trust s Unitholders after the payment of, or provision for, such expenses and liabilities, and protecting and conserving the assets held. Consequently, the income of the Trust is highly dependent upon the activities and operations of Northshore, and the terms and conditions of the leases and assignments of leases between the Trust and Northshore.

Neither the Trust nor the Trustees have any control over the operations and activities of Northshore, except within the framework of the leases and assignments of leases between the Trust and Northshore. CCI alone controls (i) historical operating data, including iron ore production volumes, marketing of iron ore products, operating and capital expenditures as they relate to Northshore, environmental and other liabilities and the effects of regulatory changes; (ii) plans for Northshore s future operating and capital expenditures; (iii) geological data relating to reserves (iv) projected production of iron ore products; and (v) the decision to mine off Trust and/or state lands (which is based on its current mining and engineering plan). The Trustees do not exert any influence over mining operational decisions, nor do the Trustees provide any input regarding the ore reserve estimate reported by CCI. While the Trustees request material information for use in periodic reports as part of their evaluation of the Trust s disclosure controls and procedures, the Trustees do not control this information and they rely on the

information in CCI's periodic and current filings with the SEC to provide accurate and timely information in the Trust's reports filed with the SEC.

In accordance with the Agreement of Trust and the Amendment, the Trustees are entitled to, and in fact do rely, upon certain experts in good faith, including (i) the independent consultants with respect to monthly production and shipment reports, which include figures on crude ore production and iron ore pellet shipments, and discussions concerning the condition and accuracy of the scales and plans regarding the development of the Trust's mining property; and (ii) the accounting firm they have contracted with for non-audit services, including reviews of financial data related to shipping and sales reports provided by Northshore and a review of the schedule of leasehold royalties payable to the Trust.

For a discussion of additional factors, including but not limited to those that could adversely affect the Trust's actual results and performance, see "Risk Factors" in Part I, Item 1A of the Trust's Annual Report on Form 10-K for the year-ended January 31, 2006.

### **Critical Accounting Policies**

This Trustees' Discussion and Analysis of Financial Condition and Results of Operations is based upon the Trust's financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires the Trustees to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. These estimates form the basis for making judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. The Trustees base their estimates and judgments on historical experience and on various other assumptions that the Trustees believe are reasonable under the circumstances. However, future events are subject to change and the best estimates and judgments may require adjustment.

Critical accounting policies are those that have meaningful impact on the reporting of the Trust's financial condition and results, and that require significant management judgment and estimates. The Trustees have determined that there are no critical accounting policies.

### **Item 3. Quantitative and Qualitative Disclosures About Market Risk.**

Not applicable.

### **Item 4. Controls and Procedures.**

*Evaluation of Disclosure Controls and Procedures.* The Trustees maintain disclosure controls and procedures designed to ensure that information required to be disclosed by the Trust in the reports that it files or submits under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time periods specified in the rules and regulations of the Securities and Exchange Commission. Disclosure controls and procedures include controls and procedures designed to ensure that information required to be disclosed by the Trust is accumulated and communicated by Northshore, and consultants to the Trustees as appropriate, to allow timely decisions regarding required disclosure.

As part of their evaluation of the Trust's disclosure controls and procedures, the Trustees rely on quarterly shipment and royalty calculations provided by Northshore. Because Northshore has declined to support this information with a written certification attesting to whether Northshore has established disclosure controls and procedures and internal controls sufficient to enable it to verify that the



information furnished to the Trustees is accurate and complete, the Trustees must rely on (a) a general certification from Northshore and Northshore's parent, CCI, certifying as to the accuracy of the royalty calculations, and (b) CCI's conclusions that its overall disclosure controls and procedures are effective. In addition, the Trust's consultants review the schedule of leasehold royalties payable and shipping and sales reports provided by Northshore against production and shipment reports prepared by the Eveleth Fee Office, Inc., an independent consultant to the Trust (Eveleth Fee Office). Eveleth Fee Office gathers production and shipping information from Northshore and prepares monthly production and shipment reports for the Trustees. Furthermore, as part of its engagement by the Trust, Eveleth Fee Office also attends Northshore's calibration and testing of its crude ore scales and boat loader scales which are conducted on a periodic basis.

As of the end of the period covered by this report, the Trustees carried out an evaluation of the Trust's disclosure controls and procedures. The Trustees have concluded that such disclosure controls and procedures are effective.

***Changes in Internal Control Over Financial Reporting.*** To the knowledge of the Trustees, there has been no change in the Trust's internal control over financial reporting that occurred during the Trust's last fiscal quarter that has materially affected, or is likely to materially affect, the Trust's internal control over financial reporting. The Trustees note for purposes of clarification that they have no authority over, and make no statement concerning, the internal controls of Northshore.

**PART II - OTHER INFORMATION**

**Item 1. Legal Proceedings.**

None.

**Item 1A. Risk Factors**

There have been no material changes in the Trust's risk factors as described in Part I Item 1A, Risk Factors in the Trust's Annual Report on Form 10-K for the year ended January 31, 2006.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.**

None.

**Item 3. Defaults Upon Senior Securities.**

None.

**Item 4. Submission of Matters to a Vote of Security Holders.**

None.

**Item 5. Other Information.**

None.

**Item 6. Exhibits.**

31 Certification of Corporate Trustee of Mesabi Trust pursuant to Rule 13a-14 of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

32 Certification of Corporate Trustee of Mesabi Trust pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

99.1 Report of Gordon, Hughes & Banks, LLP, dated September 5, 2006 regarding its review of the unaudited interim financial statements of Mesabi Trust for its quarter ended July 31, 2006.

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**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

**MESABI TRUST**  
(Registrant)

By: DEUTSCHE BANK TRUST COMPANY  
AMERICAS  
Corporate Trustee

By: DEUTSCHE BANK NATIONAL TRUST  
COMPANY

Date: September 8, 2006

By: /s/ Rodney Gaughan  
Name: Rodney Gaughan  
Title: Assistant Vice President

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\* There are no principal executive officers or principal financial officers of the registrant.