

Australian Equity Research

8 January 2015

BUY

unchanged

PRICE TARGET A\$1.30↑

from A\$0.98

Price (9-Jan)	A\$0.69
Ticker	HFR-ASX

52-Week Range (A\$):	0.33 - 0.79
Avg Daily Vol (000s) :	250.6
Shares Out. (M) :	201
Market Cap (A\$M):	137
Enterprise Value (A\$M):	113
Major Shareholders:	EMR Capital 32%

FYE Jun	2016E	2017E	2018E
Potash Production (000t)	0	34	427
Total Cash Cost (Potash) (US\$/t)	0	156	149
EBITDA (A\$M)	(5)↓	3↓	102
previous	(0)	48	
EV/EBITDA (x)	(41.7)	126.2	3.5
Net Income (A\$M)	(13.8)	(16.4)	42.9
EPS (AUC)	(0.02)	(0.03)	0.08
P/E (x)	(27.8)	(23.3)	8.9



Source: FactSet

Highfield Resources Ltd (HFR) is a potash development company. HFR holds 100% interest in three projects located within the Ebro Basin in northern Spain. The company's primary asset is the 100% owned Muga-Vipasca Potash Project in Spain.

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Raising Target Price

What's in store for this potash pure play

Investment Perspective

Highfield Resources (HFR:ASX) is due to imminently release its much anticipated resource update for the Muga-Vipasca Potash Project in Spain. The resource update will lead into the finalisation of the Definitive Feasibility Study (DFS) which is due to be released in March. These two impending milestones have led us to review our estimates in the lead up to the DFS, resulting in a material lift to our Price Target. We maintain our BUY rating.

Investment Highlights

- HFR has announced an assay of 10m @ 14% K₂O (Hole J13-15) within a very broad 40m intersection averaging 9.5% K₂O. This is an exceptional result, well above the average thickness and grade of the existing resource which is 11.3% K₂O. This hole is in the northern extremities of the project area and highly likely to increase the total resource at Muga. Drilling is now finished and we anticipate a material (>15%) increase in the Measured and Indicated Resource to be announced before the end of January 2015.
- In mid-December HFR signed a MOU with the Port of Pasajés for a minimum 440ktpa of product, with the port confirming available capacity of >1Mtpa. The port is only 150kms by highway from Muga and provides direct access to the Atlantic as well as North-West Europe. Gaining access to a port is absolutely critical for a bulk commodity and this announcement was a positive move toward de-risking the logistics chain. HFR is also continuing to negotiate a similar MOU with the Port of Bilbao to provide additional optionality.
- Following the short delay submitting the Muga Mining Application (announced 11 December, 2014) and the revised construction timetable provided by HFR we have pushed back our commencement of construction and production respectively by 3 months with construction now commencing in DecQ15.
- We have undertaken a number of revisions to our DCF valuation of Muga including adjusting for the significant movement in exchange rates, including a second decline and increasing the forecast production rate to 1Mtpa of K60 product. The increase in throughput by 25% on our previous estimates has resulted in a material positive lift to our DCF which has been partially offset by a lift in our capital estimates and forecast project development equity raising. FID and financial close will likely fall around mid-2015, in conjunction with mining approval (expected June 2015). The next six months is set to materially de-risk the project and HFR.

BUY rating maintained and Target Price increased to A\$1.30 per share.

Our DCF-based (NPV_{12%}) valuation for Muga has been revised with key changes detailed on page 3. The changes have resulted in a material lift to the sum of the parts NAV and Target Price which is \$1.30 per share (previously \$0.98).

FINANCIAL SUMMARY

Highfield Resources

ASX:HFR

Date: 9/01/15
Year End: June

Market Information

Share Price	A\$	0.69
Market Capitalisation	A\$m	138.3
12 Month Hi-Lo	A\$	0.79 - 0.32
Issued Capital	m	200.50
Options & Performance	m	142.05
Fully Diluted	m	342.55

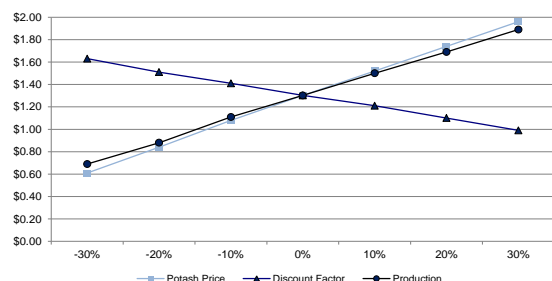
Valuation

		A\$m	A\$/share
Muga-Vipasca	NPV @ 12%	502.7	0.84
Pintano	NPV @ 12%	162.7	0.27
Sierra del Perdon		46.0	0.08
Cash		24.0	0.04
Options (InM)		6.3	0.01
Less: Debt		-	-
Future Equity Raised		136.1	0.23
Less: Corporate & O'heads		(100.2)	(0.17)
TOTAL NAV/Price Target		777.6	1.30
Price:NAV			0.53

Assumptions

	2016e	2017e	2018e
Potash Price (US\$/t CFR Brazil)	350	350	350
AUD:USD	0.79	0.78	0.78

Valuation Sensitivity



Production Metrics

	2016e	2017e	2018e
Muga-Vipasca			
Potash Production (kt)	0	34	427
Cash Operating Costs (US\$/t)	0	156	150

Reserves & Resources

	Mt	Grade (KCI)	Cont'd KCI
Muga-Vipasca			
Resources			
M&I	157	18.0%	28
Inferred	111	17.6%	20
Total	268	17.8%	47.85
Pintano			
M&I	-	-	-
Resources			
Inferred	187	17.8%	33.2Mt
Total	187	17.8%	33.2Mt

Directors & Management

Name	Position	Shares Held	%
Derek Carter	NE Chairman	5.5	2.7%
Anthony Hall	Managing Director	0.0	0.0%
Pedro Rodriguez	Executive Director	5.5	2.7%
Owen Hegarty	NE Director	0.0	0.0%
Richard Crookes	NE Director	0.0	0.0%

Substantial Shareholders

	Shares (m)	%
EMR Capital	65.0	32.4%

Source: HFR & Canaccord Genuity estimates

Company Description

Highfield Resources Limited (HFR:ASX) is an Australia potash exploration and development company focusing on its Spanish potash assets. Highfield acquired the Javier, Pintano and Sierra del Perdon Projects in October 2012 and is currently undergoing a drilling program in conjunction with a Feasibility Study to evaluate the future potential of the projects.

Profit & Loss (A\$m)	2014a	2015e	2016e	2017e	2018e
Revenue	0.0	0.0	0.0	14.9	191.2
Operating Costs	0.0	0.0	0.0	6.7	82.2
Royalties	0.0	0.0	0.0	0.0	0.0
Corporate & O'heads	3.6	17.5	4.1	4.7	6.4
Exploration (Expensed)	3.8	1.0	0.5	0.5	0.5
EBITDA	-7.2	-18.5	-4.6	3.0	102.1
Dep'n	0.0	0.0	0.0	1.3	17.2
EBIT	-7.2	-18.5	-4.6	1.7	84.9
Net Interest	0.2	0.0	-15.1	-25.1	-23.6
Tax	-2.4	-5.5	-5.9	-7.0	18.4
NPAT	-4.8	-12.9	-13.8	-16.4	42.9
Abnormals	-0.7	0.0	0.0	0.0	0.0
NPAT (reported)	-5.5	-12.9	-13.8	-16.4	42.9

Cash Flow (A\$m)	2014a	2015e	2016e	2017e	2018e
Cash Receipts	0.0	0.0	0.0	14.9	191.2
Cash paid to suppliers & employees	-2.9	-9.4	-4.1	-11.4	-88.5
Tax Paid	0.0	0.0	0.0	0.0	0.0
Net Interest	0.2	0.8	-7.4	-20.9	-22.8
Operating Cash Flow	-2.8	-8.6	-11.5	-17.4	79.8
Exploration and Evaluation	-5.8	-3.9	-2.0	-2.0	-2.0
Capex	0.0	-6.3	-187.2	-166.3	-54.5
Other	-0.0	-0.0	0.0	0.0	0.0
Investing Cash Flow	-5.8	-10.2	-189.2	-168.3	-56.5
Debt Drawdown (repayment)	0.0	0.0	250.0	10.0	-30.0
Share capital	14.6	162.2	0.0	0.0	0.0
Dividends	0.0	0.0	0.0	0.0	0.0
Financing Expenses	-0.7	-8.1	0.0	0.0	0.0
Financing Cash Flow	14.0	154.1	250.0	10.0	-30.0
Opening Cash	6.2	11.6	146.9	196.2	20.4
Increase / (Decrease) in cash	5.4	135.3	49.3	-175.8	-6.6
FX Impact	0.0	0.0	0.0	0.0	0.0
Closing Cash	11.6	146.9	196.2	20.4	13.8

Balance Sheet (A\$m)	2014a	2015e	2016e	2017e	2018e
Cash + S/Term Deposits	11.6	146.9	196.2	20.4	13.8
Other current assets	1.4	5.5	6.0	25.3	70.4
Current Assets	13.0	152.3	202.2	45.8	84.2
Property, Plant & Equip.	2.1	3.0	1.5	1.5	1.5
Exploration & Develop.	3.8	1.0	0.5	0.5	0.5
Other Non-current Assets	0.0	5.7	166.8	307.0	338.6
Payables	2.0	0.0	0.0	6.0	19.1
Short Term debt	0.0	0.0	0.0	30.0	85.0
Long Term Debt	0.0	0.0	250.0	230.0	145.0
Other Liabilities	0.0	1.2	5.5	12.3	13.6
Net Assets	50.9	200.2	186.4	173.8	266.4
Shareholders Funds	34.8	197.0	197.0	197.0	197.0
Reserves	25.5	25.5	25.5	29.2	79.0
Retained Earnings	-9.4	-22.3	-36.1	-52.5	-9.6
Total Equity	50.9	200.2	186.4	173.8	266.4

Ratios & Multiples	2014a	2015e	2016e	2017e	2018e
EBITDA Margin	nm	nm	nm	20%	53%
EV/EBITDA	nm	nm	nm	209.2x	5.9x
Op. Cashflow/Share	-\$0.02	-\$0.02	-\$0.02	-\$0.03	\$0.14
P/CF	nm	nm	nm	nm	nm
EPS	-\$0.04	-\$0.04	-\$0.02	-\$0.03	\$0.08
EPS Growth	nm	nm	nm	nm	-362%
PER	-17.7x	-16.9x	-28.0x	-23.5x	9.0x
Dividend Per Share	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
Dividend Yield	0%	0%	0%	0%	0%
ROE	-11%	-6%	-7%	-9%	16%
ROIC	-27%	-12%	-2%	-1%	30%
Debt/Equity	0%	0%	134%	132%	54%
Net Interest Cover	nm	nm	-0.3x	0.1x	3.6x
Book Value/share	\$0.33	\$0.36	\$0.33	\$0.31	\$0.48
Price/Book Value	2.1x	1.9x	2.1x	2.2x	1.4x

CHANGES TO VALUATION

We have undertaken a revision of our DCF valuation for Muga including adjusting for the significant movement in exchange rates, the move by HFR to introduce a second decline and the 3 month delay to construction.

HFR released the PFS for Muga-Vipasca in May 2014, since then the Euro has depreciated against the US\$ by more than 14%. The PFS was completed based on an exchange rate of 0.75 EUR:USD with current exchange rate at 0.85. We note that almost all capital items will be sourced within Europe and transacted in Euros. The movement has been favourable for HFR as it completes its DFS and commences placing orders for long lead items. We have considered the move in exchange rates and revised capital cost estimates using a 0.80 exchange rate.

HFR has also stated the DFS will now consider twin declines and an increased steady state production of 1mtpa of K60 product. We have increased our overall capital estimate (net of the exchange rate differential) by US\$20m to US\$320m to allow for the additional decline with the cost partially offset by favourable move in exchange rate. However the increase in throughput by 25% on our previous estimates has resulted in a material positive lift to our DCF.

We forecast the equity component of Muga project capital to be completed in the JunQ 2015 for a total amount of A\$140m (previously A\$125m). We have increased this due to our forecast lower A\$ exchange rates in 2015 of \$0.80 (previously \$0.88). We have not changed the forecast equity raising price of \$0.55 per share, but continue to consider this be a conservative estimate due to the anticipated positive newsflow in the intervening period.

Following the short delay submitting the Muga Mining Application and the revised construction timetable provided by HFR in mid-December we have pushed back our commencement of construction and production respectively by 3 months with construction now commencing in DecQ15.

The net impact of these changes sees our target price increase to A\$1.30 per share (previously A\$0.98). Our target is derived from our estimated project NPV12% for Muga-Vipasca in combination with a sum of the parts Net Asset Valuation for HFR.

Sierra del Perdon

HFR owns 100% of the Sierra del Perdon ("SdP") project which covers 149km² of prospective potash ground, located 40km from Muga-Vipasca. It is HFR's second project which is a brownfields asset, previously mined via conventional underground mining from 1963 - 1996 and produced over 10Mt of K60 potash. Both historic construction and operating approvals for production are in place for 500ktpa of Potash. The mine was closed in 1997 when potash prices reached US\$110/t and new mine infrastructure was required, in the latter years it was producing approximately 200ktpa.

The company previously deferred a resource estimate due to the priority placed on Muga-Vipasca and no exploration target has been set. The asset is likely to become a renewed priority for the company in 2015/16 and the scoping study is now progressing. We have reviewed the project and believe the asset has clear latent value.

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Highfield Resources Limited - HFR:

The Target Price for HFR is set using a DCF (NPV) methodology for the two principal assets in combination with a sum of the parts NAV.

Risks to achieving Target Price / Valuation:

Highfield Resources Limited - HFR:

- **Geological risk** – the actual characteristics of an ore deposit may differ significantly from initial interpretations and expectations.
- **Financing risk** – the ability for HFR to fund further exploration and resource drilling and the development of its projects should also be considered a key investment risk. Credit markets may prove to be not conducive to raising the required funds to commence construction of the project.
- **Permitting** – many of the licenses held for all three projects are pending for approval for Investigation Permits. Once an Investigation Permit is allocated, HFR would then need to apply and receive a Mining Concession before commencement of construction and mining. There are always unforeseen risks associated with permitting.
- **Capital expenditure & operating risk** – the risk that capital and/or operating costs exceed budget and/or exhaust available funding before project completion, and reduce the profitability and free cash generation of the project.
- **Commodity price & exchange rate risk** – as with all mining and mineral exploration companies, commodity price and exchange rate risks should also be considered.

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Rating	Coverage Universe		IB Clients
	#	%	%
Buy	654	60.72%	32.87%
Hold	328	30.45%	12.20%
Sell	43	3.99%	0%
Speculative Buy	52	4.83%	59.62%
	1077*	100.0%	

*Total includes stocks that are Under Review

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