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## Highfield Resources Ltd (HFR)

### December 2014 quarterly report

**Recommendation**

**Buy** (unchanged)

**Price**

**\$0.79**

**Valuation**

**\$1.15** (previously \$0.90)

**Risk**

**Speculative**

**Expected Return**

Capital growth	46%
Dividend yield	0%
Total expected return	46%

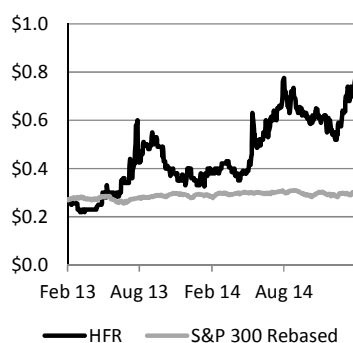
**Company Data & Ratios**

Enterprise value	\$212m
Market cap	\$237m
Issued capital	301m
Free float	51%
Avg. daily val. (52wk)	\$132k
12 month price range	\$0.35-\$0.80
GICS sector	Materials

**Price Performance**

	(1m)	(3m)	(12m)
Price (A\$)	0.63	0.65	0.40
Absolute (%)	22.22	19.38	92.50
Rel market (%)	20.15	17.11	86.26

**Absolute Price**



SOURCE: IRESS

### Muga project progresses with DFS due this quarter

HFR further progressed its Muga potash project during the December 2014 quarter, including: lodging a Mining Concession application; signing Memoranda of Understanding (MOU) with two Atlantic ports; and completing final drilling and assays as inputs for the definitive feasibility study (DFS). An updated JORC resource estimate and a DFS are scheduled for completion in the current quarter.

The parameters of the Mining Concession application suggest a larger project than estimated by the Javier prefeasibility study (PFS, May 2014). With the likelihood of a larger project and ongoing project de-risking we have upgraded our HFR valuation to \$1.15/sh (previously \$0.90/sh).

### DFS to build upon the successful Javier PFS

HFR's Javier PFS (later renamed Muga-Vipasca) supported a conventional room and pillar mine and flotation processing flow sheet. Production was estimated at 860ktpa potash (K60) at C1 costs of US\$145/t for a capital cost of US\$308m. A resource upgrade is scheduled for February 2015 and the DFS for completion in March 2015. The DFS is expected to outline a dual-decline access mine and processing capacity to support over 1Mtpa of potash production. On completion of the DFS, HFR will arrange financing to commence development at Muga from mid-2015.

### Investment thesis – Buy (Speculative) Valuation \$1.15/sh

HFR provides unique leverage to an agricultural linked commodity with a solid demand outlook. The company's key project is expected to use conventional mining and processing technologies. Permitting and a DFS are underway for development to commence from mid-2015. HFR is fully funded to the completion of the Muga-Vipasca DFS. HFR is a Speculative investment as it carries exploration, permitting, development and offtake risks.

**Earnings Forecast**

Year ending June	2015e	2016e	2017e	2018e
Sales (A\$m)	-	-	126	168
EBITDA (A\$m)	(7)	(12)	66	88
NPAT (reported) (A\$m)	(5)	(7)	33	68
NPAT (adjusted) (A\$m)	(5)	(7)	33	68
EPS (adjusted) (cps)	(2)	(2)	7	14
EPS growth (%)	na	na	na	106%
PER (x)	(46.1)	(41.5)	11.6	5.6
FCF Yield (%)	-5%	-74%	-26%	17%
EV/EBITDA (x)	(29.1)	(18.3)	3.2	2.4
Dividend (cps)	-	-	-	-
Yield (%)	0%	0%	0%	0%
Franking (%)	0%	0%	0%	0%
ROE (%)	-8%	-6%	18%	29%

SOURCE: BELL POTTER SECURITIES ESTIMATES

# December 2014 quarterly report

## Key achievements during the quarter

- A Mining Concession application was lodged with the relevant jurisdictions for the Muga potash mine in December 2014. The Mining Concession application covers the development of a dual decline underground mine. Mine capacity will commence at 400t per hour of ore and expand to 800t per hour after around 19 months. Full production is expected to be over 1Mtpa K60 potash product and the initial mine life is 19 years. The Mining Concession application included an Environmental Impact Assessment and a Mineral Extraction Plan.
- HFR has now signed two MOUs with sea ports on the Atlantic coast. In mid-December 2014, a non-binding MOU was signed with the Port Authority of Pasajes (150km north of Muga) for port capacity sufficient to handle all expected exports from the Muga project. In late-January 2015, HFR signed a MOU with the Port Authority of Bilbao (220km by road from Muga) under similar terms. Together, the two MOUs cover capacity sufficient to export all potash production from the Muga project.
- Final drill holes from the 2014 exploration campaign at Muga were completed. Assays from this drilling will support a resource upgrade due in February 2015 and ultimately the Muga DFS due in March 2015.

## Muga project now looking bigger than Javier PFS parameters

In July 2014, HFR announced that the Javier potash project would be divided into two separate projects, Muga and Vipasca. A PFS for a mine at Javier focussing on high grade mineralisation was completed in May 2014.

HFR's Mining Concession application parameters suggest that the Muga project will be larger than examined in the Javier PFS:

- Ore extraction rates to 800t per hour will deliver an annualised mining rate (7Mtpa) far in excess of the 4.7Mtpa in the Javier PFS.
- The Javier PFS examined a single decline access underground mine compared with the Mining Concession application examining a dual-decline operation.
- The Javier PFS estimated average potash production (K60) of 860ktpa compared with the Mining Concession application estimating over 1Mtpa.

The key parameters and estimated economic returns (HFR estimates) from the Javier potash project PFS are outlined in the following table.

**Table 1 - Javier PFS (May 2014) summary of parameters & economic returns (HFR estimates)**

Definitive feasibility study due	2014
Construction Phase 1	2015-16
Production Phase 1, Construction Phase 2	2016-17
Full production	From 2018
Ore mined & processed (peak)	4.7Mtpa
Average potash production (K60)	860ktpa
Mine life (initial)	20 years
Pre-production capital cost	US\$250m
Total capital cost	US\$308m
All-in cash cost (Port of Bilbao)	US\$145/t
Total C3 cost	US\$162/t
<b>NPV (10%)</b>	<b>US\$1.06b</b>
<b>IRR</b>	<b>48.4%</b>

SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

## Capital position and near-term capital requirements

- At 31 December 2014, HFR had cash of \$25m and no debt. We see this as sufficient to take the Muga project to financing stage (mid-2015).
- The Javier PFS (May 2014) contemplated a US\$308m capital project (including 20% contingency on all costs). HFR is now considering a larger project than estimated by this PFS (dual decline and higher production rates). However, we expect much of the additional expense for the larger project will be absorbed by the contingency and more competitive markets for mining inputs.
- Assuming a US\$308m capital cost and a funding mix of 70% debt (project finance) and 30% equity, HFR will require an additional \$110m equity in mid-2015.

## Valuation upgrade: TP\$1.15/sh (previously \$0.90/sh)

We have upgraded our HFR valuation. HFR are progressively de-risking the Muga project and it now appears the project will be larger than suggested by the Javier PFS. Our HFR valuation is based off the Javier PFS (see Table 1 for parameters) and assumes:

- A flat potash price of US\$300/t to long-term (FOB Vancouver, spot US\$306/t).
- A 20% risk discount (previously 40%) to account for permitting and development risks. We will reduce this discount as permitting and development milestones are met.
- A \$110m equity raising at \$0.60/sh in mid-2015 (current share price \$0.79/sh) to take into account dilution from a likely equity raising to assist with project funding.

Our HFR valuation conservatively excludes earlier stage projects which could add significant future value. Such projects include the Sierra del Perdón project, which is currently the subject of a scoping study.

**Table 2 - Bell Potter HFR valuation**

Ordinary shares m	201	
Performance shares m	100	
Options in the money m	39	
<b>Diluted m</b>	<b>340</b>	
	<b>\$m</b>	<b>\$/sh</b>
Project (unrisked NPV10)	627	1.85
Project (risk discount 40%, NPV10)	502	1.48
Corporate overheads	-67	-0.20
Total	435	1.28
Cash & options	45	0.13
Total	480	1.41

**Project capital raising assumption**

Project capital requirement US\$m	308
Project capital requirement A\$m	362
Equity / (Debt + Equity) %	30%
Debt requirement \$m	254
Equity requirement \$m	109
Share issue price \$/sh	0.60
New shares issued m	181
Diluted shares on issue m	521

Cash & options	154	0.30
<b>Total</b>	<b>589</b>	<b>1.13</b>

SOURCE: BELL POTTER SECURITIES ESTIMATES

**Table 3 - Bell Potter valuation sensitivity**

Potash price FOB Vancouver US\$/t	Risk discount				
	40%	30%	20%	10%	Unrisked
US\$200/t	0.32	0.35	0.37	0.40	0.42
US\$250/t	0.61	0.68	0.75	0.82	0.90
US\$300/t	0.89	1.01	<b>1.13</b>	1.25	1.37
US\$350/t	1.17	1.34	1.51	1.68	1.85
US\$400/t	1.46	1.67	1.89	2.10	2.32

SOURCE: BELL POTTER SECURITIES ESTIMATES

## Forthcoming news flow and value catalysts

- February 2015 – Muga project JORC resource update;
- March 2015 – Completion of Muga project DFS;
- March 2015 – Sierra del Perdon JORC mineral resource estimate;
- Mid-2015 – Receipt of government approvals and permits;
- Mid-2015 – Completion of financing for development of the Muga project;
- Mid-2015 – Strategic/offtake partner secured; and
- Mid-2015 – Commencement of Muga project construction.

### Muga-Vipasca JORC mineral resource estimate (May 2014)

HFR's Javier PFS was based on the development of a high-grade component (154Mt at 12.9% K<sub>2</sub>O) of its total resource of 268Mt at 11.2% K<sub>2</sub>O. However, the Muga project is now focussed on the relatively shallow and high-grade PAB sylvinitic beds within the Muga-Vipasca (Javier) project area. The PAB potash beds commence at depths of around 250m.

HFR expect to delineate an updated resource for Muga in February 2015.

**Table 4 - Muga-Vipasca JORC mineral resource estimate**

<b>Total resource</b>	<b>Mt</b>	<b>K<sub>2</sub>O %</b>	<b>KCl %</b>
Measured	17.4	11.3	17.9
Indicated	139.9	11.3	18.0
<b>Measured &amp; Indicated</b>	<b>157.3</b>	<b>11.3</b>	<b>18.0</b>
Inferred	111.3	11.1	17.6
<b>Total</b>	<b>268.6</b>	<b>11.2</b>	<b>17.8</b>
<b>High-grade resource</b>	<b>Mt</b>	<b>K<sub>2</sub>O %</b>	<b>KCl %</b>
Measured	9.2	13.0	20.7
Indicated	74.2	13.4	21.2
<b>Measured &amp; Indicated</b>	<b>83.4</b>	<b>13.4</b>	<b>21.1</b>
Inferred	70.7	12.4	19.8
<b>Total</b>	<b>154.1</b>	<b>12.9</b>	<b>20.5</b>
<b>High-grade PAB potash beds resource</b>	<b>Mt</b>	<b>K<sub>2</sub>O %</b>	<b>KCl %</b>
Measured	5.2	13.0	20.7
Indicated	46.4	13.2	20.9
<b>Measured &amp; Indicated</b>	<b>51.6</b>	<b>13.2</b>	<b>20.9</b>
Inferred	39.1	12.5	19.8
<b>Total</b>	<b>90.7</b>	<b>12.9</b>	<b>20.4</b>

SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

### Recent quarterly cash flows

Since listing, HFR has spent around \$17m on exploration, evaluation and development. Administration costs have averaged around \$0.6m per quarter.

**Table 5 - Quarterly cash flow**

	<b>Jun-13(a)</b>	<b>Sep-13(a)</b>	<b>Dec-13(a)</b>	<b>Mar-14(a)</b>	<b>Jun-14(a)</b>	<b>Sep-14(a)</b>	<b>Dec-14(a)</b>	<b>Mar-15(e)</b>
Exploration & evaluation \$k	-404	-922	-1,570	-2,242	-1,100	-1,943	-3,242	-4,500
Administration \$k	-392	-551	-621	-878	-887	-1,826	-1,048	-700
Earn-in receipts \$k	0	0	0	0	0	0	0	0
Capital raised \$k	5,100	4,861	0	0	9,102	21,693	-13	0
Other \$k	-11	12	59	59	29	37	37	0
Total quarterly cash flow \$k	4,293	3,400	-2,132	-3,061	7,144	17,961	-4,266	-5,200
<b>Quarter end cash \$k</b>	<b>6,189</b>	<b>9,589</b>	<b>7,457</b>	<b>4,396</b>	<b>11,565</b>	<b>29,508</b>	<b>25,084</b>	<b>19,884</b>

Shares on issue (diluted) m 219 236 236 236 256 301 301 301

SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

# Potash market: Oligopoly controlled

Potash is the generic term for potassium salts used as fertilisers. It is known to improve the yield, nutrient value and disease resistance of food crops. The market for potash is typically quoted as that of potassium chloride (KCl or MOP, "muriate of potash"), the most common fertiliser product. The market for potassium oxide (K<sub>2</sub>O) also often quoted, with 1t KCl equivalent to 0.637t K<sub>2</sub>O. A potash product of K60 is 60% K<sub>2</sub>O.

Total global production of KCl is 56-60Mtpa, of which the international traded market is around 45Mtpa. China and Russia's domestic potash production-consumption balance accounts for the smaller traded market.

## Supply: Top three marketers account for around 80% of trade

Canada and Eastern Europe dominate the global supply of potash:

- Canadian potash supply from PotashCorp (NYSE:POT), Mosaic (NYSE:MOS) and Agrium (NYSE:AGU) is marketed through joint venture company Canpotex, and accounts for around 40% (15-17Mtpa) of global trade.
- Uralkali (Ukraine, LI:URKA) (10Mtpa) and Belaruskali (Belarus) (8Mtpa) account for around 40% of global potash trade. Until July 2013, Uralkali and Belaruskali operated under the BPC cartel.

### New supply: Excess low-cost capacity is a barrier to entry

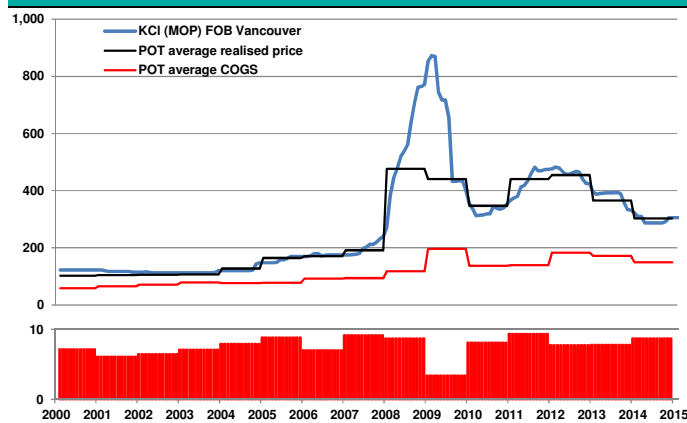
In 2012-13, the Canpotex producers operated at 60-70% capacity and Uralkali at 70-80% capacity. Excess capacity from the majors is 11-13Mtpa, around 25% of the global traded market. Low cost excess capacity is a barrier to entry for new large-scale projects.

## Demand: Brazil and China are key import markets

Over 2002-12, global KCl demand has grown at an annualised rate of 1.7%, and the traded market by around 0.9% (<http://www.fertilizer.org/>). Global potash trade is most leveraged to the markets of Brazil, the United States and China.

- Brazil (8Mtpa) import essentially all of their potash requirements;

**Figure 1 – Potash prices (FOB Vancouver) & POT realised prices and costs US\$/t and volumes Mt**



SOURCE: BLOOMBERG (WWW.WORLDBANK.ORG) & COMPANY DATA

- The US (7Mtpa) source the majority of its potash requirements from the Canadian producers; and
- China (10Mtpa) imports 50-60% of its potash requirements.

## Prices and industry costs

In recent years, Potash prices (FOB Vancouver) have ranged US\$280-480/t.

Differences in the reporting of revenues and costs across companies makes it difficult to make direct comparisons. However, we calculate that the major producers:

- Average realised prices have correlated relatively well with the FOB Vancouver price (WBPCMHP Index); and
- Unit costs have averaged around US\$200/t.

## Potash market: Top producers & users by country

Brazil, the US and China stand out as large users of potash. Brazil and the US import the majority of its potash requirements. China imports around half of its potash needs.

**Table 6 - Top potash producers, consumers, importers & exporters kt KCI**

Top 10 producers kt	2008	2009	2010	2011	2012	Top 10 consumers kt	2008	2009	2010	2011	2012
Canada	17,554	7,357	17,149	16,532	16,462	China	7,808	7,167	8,667	9,500	10,000
Russian Federation	9,892	6,152	10,213	10,877	9,006	Brazil	6,148	5,248	6,490	7,385	8,073
Belarus	8,279	4,142	8,704	8,887	8,051	United States	4,672	6,741	6,942	6,997	7,191
China	3,580	4,334	5,168	5,650	5,670	India	5,521	6,054	5,857	4,293	3,436
Germany	5,474	2,981	4,936	5,177	5,094	Indonesia	1,588	1,335	2,083	2,335	2,483
Israel	3,557	2,755	3,241	3,348	4,167	Malaysia	1,172	1,167	1,917	2,083	2,117
Chile	945	1,103	1,417	1,607	2,073	Belarus	1,037	1,105	1,100	1,312	1,200
Jordan	2,005	1,120	1,943	2,259	1,824	France	651	694	997	802	850
United States	1,817	1,258	1,569	1,695	1,553	Viet Nam	631	500	667	733	750
Spain	740	579	522	1,048	1,190	Poland	683	690	758	697	747
<b>Top 10</b>	<b>53,842</b>	<b>31,781</b>	<b>54,862</b>	<b>57,079</b>	<b>55,090</b>	<b>Top 10</b>	<b>29,911</b>	<b>30,700</b>	<b>35,478</b>	<b>36,137</b>	<b>36,848</b>
<b>Global</b>	<b>55,111</b>	<b>32,946</b>	<b>56,177</b>	<b>58,472</b>	<b>56,410</b>	<b>Global</b>	<b>38,587</b>	<b>39,335</b>	<b>45,808</b>	<b>46,954</b>	<b>47,914</b>
<b>Top 10 % of Global</b>	<b>98%</b>	<b>96%</b>	<b>98%</b>	<b>98%</b>	<b>98%</b>	<b>Top 10 % of Global</b>	<b>78%</b>	<b>78%</b>	<b>77%</b>	<b>77%</b>	<b>77%</b>
Top 10 importers kt	2008	2009	2010	2011	2012	Top 10 exporters kt	2008	2009	2010	2011	2012
Brazil	6,649	3,502	6,266	7,534	7,559	Canada	16,526	6,065	16,157	16,777	14,117
United States	7,872	3,050	8,519	7,850	6,910	Russian Federation	9,241	5,356	9,428	10,384	8,154
China	5,600	1,567	5,640	7,580	5,650	Belarus	6,580	3,043	6,928	7,836	6,522
India	5,695	5,317	6,494	4,263	2,623	Germany	4,289	2,733	4,166	4,257	4,529
Indonesia	2,051	977	2,327	3,307	2,515	Israel	3,288	2,498	4,929	4,798	3,855
Malaysia	1,888	784	2,044	2,287	1,692	Chile	548	963	1,309	1,361	1,756
France	1,332	574	1,178	1,022	981	Jordan	1,808	1,039	1,981	2,103	1,563
Viet Nam	765	402	835	1,031	883	Spain	457	67	33	768	854
Poland	898	307	889	822	820	United States	369	492	426	424	524
Thailand	705	287	808	1,141	786	Norway	358	383	392	450	467
<b>Top 10</b>	<b>33,455</b>	<b>16,766</b>	<b>35,000</b>	<b>36,838</b>	<b>30,418</b>	<b>Top 10</b>	<b>43,465</b>	<b>22,639</b>	<b>45,749</b>	<b>49,157</b>	<b>42,339</b>
<b>Global</b>	<b>45,381</b>	<b>23,541</b>	<b>46,783</b>	<b>48,684</b>	<b>42,169</b>	<b>Global</b>	<b>45,440</b>	<b>24,229</b>	<b>47,584</b>	<b>50,920</b>	<b>43,974</b>
<b>Top 10 % of Global</b>	<b>74%</b>	<b>71%</b>	<b>75%</b>	<b>76%</b>	<b>72%</b>	<b>Top 10 % of Global</b>	<b>96%</b>	<b>93%</b>	<b>96%</b>	<b>97%</b>	<b>96%</b>

SOURCE: INTERNATIONAL FERTILIZER INDUSTRY ASSOCIATION & BELL POTTER SECURITIES ESTIMATES

## Major global producers: POT, MOS, AGU, URKA & Belaruskali

Major global potash miners account for around 80% of global production.

**Table 7 - Major global potash producers**

Top producers (sales Mt)	2011	2012	2013	% of global trade (2011-13 average)
<b>Canpotex</b>	<b>18.3</b>	<b>15.2</b>	<b>17.4</b>	<b>38%</b>
<i>PotashCorp (NYSE:POT)</i>	<i>9.0</i>	<i>7.2</i>	<i>8.1</i>	<i>18%</i>
<i>Mosaic (NYSE:MOS)</i>	<i>7.5</i>	<i>6.7</i>	<i>7.8</i>	<i>17%</i>
<i>Agrium (NYSE:AGU)</i>	<i>1.8</i>	<i>1.3</i>	<i>1.5</i>	<i>3%</i>
<b>Former BPC</b>	<b>17.5</b>	<b>17.4</b>	<b>16.9</b>	<b>39%</b>
<i>Uralkali (LI:URKA)</i>	<i>8.6</i>	<i>9.4</i>	<i>9.9</i>	<i>21%</i>
<i>Belaruskali</i>	<i>8.8</i>	<i>8.1</i>	<i>7.0</i>	<i>18%</i>
<b>Other (est. residual)</b>	<b>12.9</b>	<b>9.5</b>	<b>8.3</b>	<b>23%</b>
<b>Traded market</b>	<b>48.7</b>	<b>42.2</b>	<b>42.6</b>	

SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

# Company development timeline

## Timeline from listing in February 2012 to present

### February 2012: IPO raises \$4m to focus on WA potash exploration

3 February 2012 – HFR is admitted to the Official List of the ASX Limited. The initial public offering issues 20m shares at a price of \$0.20/sh to raise \$4m. The company has three exploration tenements in Western Australia prospective for potash. Founding directors are Jonathan Murray (Non-Executive Chairman), Anthony Hall (Managing Director) and Mark Arundell (Executive Director).

HFR's initial focus is the McLarty Potash Project in the Kimberley region of Northern Western Australia.

On listing, the company has 44m fully paid ordinary shares on issue and 6m options exercisable at \$0.20/sh on or before 1 November 2016.

### June 2012: Acquisition of potash assets in Northern Spain through scrip deal

26 June 2012 – HFR announce an agreement to purchase 100% of the Navarra Potash Project in Northern Spain. The project includes 430km<sup>2</sup> of granted tenements located in a potash producing basin.

Under the proposed transaction, HFR will issue asset vendors with 50m ordinary shares and 100m performance shares which convert to ordinary shares on completion of certain milestones. Milestones include a JORC resource (50-150Mt grading 20-13% K<sub>2</sub>O) and receipt of approvals to construct an operating mine with capacity for 500kt potash. The vendor may also assume two Board positions at HFR.

Following deal completion (22 October 2012), HFR have 96m ordinary and 100m performance shares on issue. Vendors of the Navarra project have 54% of HFR equity (77% including performance rights).

The vendor nominates Derek Carter and Pedro Rodriguez to join the HFR board.

Navarra becomes HFR's priority project.

### February 2013: Three Spanish potash projects identified

25 February 2013 – HFR announce that its Navarra and Aragon potash projects will be divided into three distinct projects, each capable of being developed in parallel.

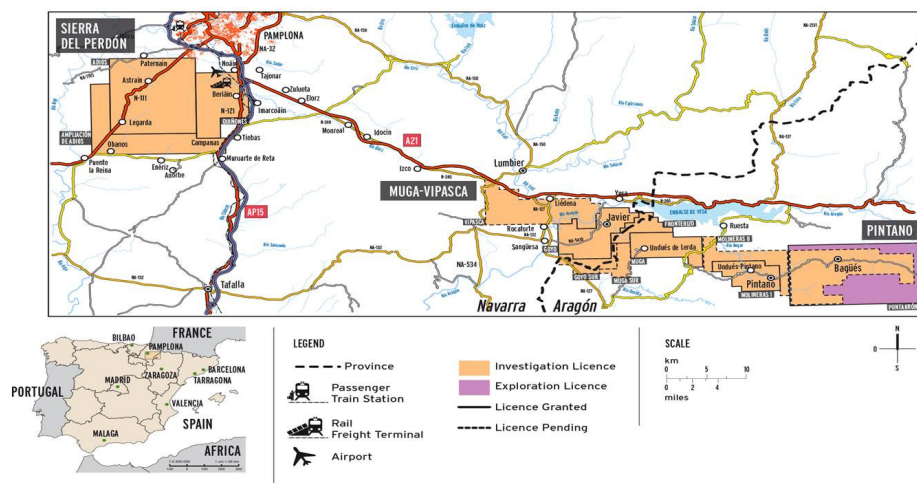
The Navarra Project is to be known as the Sierra del Perdon potash project. This more advanced project with historic workings is to be the subject of a scoping study.

The Aragon potash project is split into the Javier and Pintano potash projects. HFR expect to release a resource for Javier within 6 months, and an exploration target for Pinrano.

27 February 2013 – HFR release an exploration target for the Pintano project of 306-338Mt of sylvinite, equating to 44-76Mt of contained KCl (grades of 14.4-22.3% KCl). Mineralisation is expected within depths of 510-800m.



Figure 2 - HFR's four 100% owned potash projects in Spain



SOURCE: HFR PRESENTATION

Note: The Javier project mentioned above is subsequently renamed Muga-Vipasca.

#### April 2013: \$10m placement to EMR Capital, to become 17% shareholder

17 April 2013 – HFR announce it will issue 40m new shares to EMR capital to raise \$10m. The raising includes two tranches, at an average price of \$0.25/sh (compared with HFR close price before announcement of \$0.23/sh). Including ordinary issued and performance shares, EMR will have a 17% shareholding in HFR. EMR will also have the right to appoint a director to the board of HFR.

#### Who are EMR Capital?

EMR is a specialist resources private equity manager. EMR Board members include: Owen Hegarty (Chairman), founder and managing director of Oxiana Ltd and Non-Executive Director of Fortescue Metals Group Ltd; Jason Chang (Managing Director and CEO), former KPMG Partner; and Tony Manini (Director), geologist and business development executive (Rio Tinto Ltd and Oxiana Ltd); David Jones (Chairman, Audit Committee and Member, Investment Committee), private equity executive; and Colin MacKay (Director), lawyer and funds management executive.

15 August 2013 – HFR announce that Owen Hegarty will join the Board as a Non-Executive Director.

3 September 2013 – HFR announce it has exited the farm-in agreement with Broadway Resources to explore the McLarty Project in Western Australia. HFR will no exclusively focus on its Spanish potash projects.

#### October 2013: Maiden inferred JORC resource at Javier and target mine concept

8 October 2013 – HFR announce a maiden inferred JORC resource at Javier of 163.2Mt of sylvinites at 10.9% K<sub>2</sub>O (17.3% KCl). Mineralisation is at depths ranging 200m to more than 1,000m.

The company has maintained its Javier exploration target of 250-400Mt at 9-12% KCl, supporting resource upside.

HFR's target mine concept at Javier is for a 4.6Mtpa conventional underground mine with a 20 year mine life to produce 750-850ktpa KCl and 1,500-2,000ktpa NaCl. The company aims to complete a scoping study by December 2013 and a definitive feasibility study in 2014 for first production in 2016.



**November 2013: Maiden inferred JORC resource at Pintano**

20 November 2013 – HFR announce a maiden inferred JORC resource at Pintano of 187Mt of sylvinites at 11.2% K<sub>2</sub>O (17.8% KCl). Mineralisation is at depths ranging 500m to more than 2,000m. The company sees this resource as likely to add scale to the Javier project.

**May 2014: Javier resource upgraded to 268Mt and PFS delivered**

16 May 2014 – HFR announce an updated JORC resource for the Javier project of 268Mt grading 11.2% K<sub>2</sub>O (17.8% KCl). The resource includes a measured and indicated component of 157Mt grading 11.3% K<sub>2</sub>O (18.0% KCl).

20 May 2014 – HFR announce the completion of a PFS for the Javier potash project. The study estimates a 20 year mine life project with average annual production of 860kt of potash (K60 product), an NPV of US\$1.06b (10% discount rate) and an unlevered IRR of 48.4%. Preproduction capital costs are estimated at less than US\$250m and total capital costs US\$308m.

HFR will progress the project through a definitive feasibility study, scheduled for completion in in early 2015.

**June 2014: HFR complete \$32m institutional placement**

13 June 2014 – HFR complete an institutional placement of 65m new shares at \$0.48-0.51/sh to raise \$32m. Major shareholder EMR Capital increases its fully diluted interest in HFR to 20%. Funds will be used to fast track development activities at HFR's Spanish potash projects.

**July 2014: Javier divided into two potash projects**

29 July 2014 – HFR announce that the Javier project will be divided into two discrete projects, Muga and Vipasca. The Muga project will be HFR's initial focus with relatively shallow mineralisation. HFR has two rigs operating on Muga to completing infill drilling.

4 August 2014 – HFR announce shallow intersections of potash mineralisation outside of the current Muga resource. Intersections include: 1.8m at 12.8% K<sub>2</sub>O (20.2% KCl) from 285.7m; 4.5m at 12.0% K<sub>2</sub>O (19.0% KCl) from 239.9m; and 1.8m at 16.1% K<sub>2</sub>O (25.6% KCl) from 240.1m. HFR expect to provide an updated JORC resource for Muga in the September 2014 quarter.

**October 2014: Additional high grade hits at Muga Project**

24 October 2014 – HFR announce further high grade intersections at Muga and that a dual decline strategy is being considered for the mine definitive feasibility study. The definitive feasibility study for Muga is now due in the March 2015 quarter and will incorporate most recent drilling.

**December 2014: Mine concession lodged, port MOUs signed & final drill program**

11 December 2014 – HFR lodge a mining concession application for the Muga project with the relevant jurisdictions.

18 December 2014 – A MOU is signed with the Port Authority of Pasajés. Pasajés is located within 150km by road from the Muga Project. The MOU confirms available port capacity of over 1Mtpa of product and a minimum capacity of 440ktpa of product.

29 December 2014 – Final drill results from the Muga Project are reported outlining shallow sylvinites mineralisation at depths of less than 255m from surface. The updated Muga-Vipasca mineral resource is now being finalised.

# Board and management

## Board of directors

### **Derek Carter – Non-Executive Chairman**

A geologist with over 40 years of experience in exploration and development, including nearly 20 years in management of ASX listed exploration companies. He has held senior positions in the Shell Group of Companies, including Chief Geologist in Spain and was the Managing Director of the ASX listed Minotaur Resources from its inception in 1993 to 2010.

### **Anthony Hall – Managing Director**

A qualified lawyer and company secretary with close to 20 years of commercial experience in venture capital, risk management, strategy and business development. Was responsible for the listing process of Highfield Resources in 2011 and prior to this worked in roles in the strategy, energy, risk management and legal industries.

### **Pedro Rodriguez – Development Director**

A geologist with over 30 years of experience in mining services in Spain. He has worked for six international mining companies including Billiton International, Navan-Almagrera and Newmont. Most recently he had direct responsibility to the Board of ALMAGRERA SA for delivering a mining chemical complex with more than 460 direct employees and revenues of US\$50m pa.

### **Richard Crookes – Non-Executive Director**

A geologist with over 25 years of experience in the resources and investments industry. Prior to joining EMR Capital as an Investment Manager, he was an Executive Director in Macquarie Bank's Metals Energy Capital Division and Chief Geologist and Mining Manager of Ernest Henry Mining (now Xstrata).

### **Owen Hegarty – Non-Executive Director**

A mining executive with 40 years of experience in the global mining industry, including 25 years with Rio Tinto where he was Managing Director of Rio Tinto Asia and Managing Director of the Group's Australian copper and gold business. He is a director of various listed and unlisted resources' companies including his position as the Chairman of specialist resources private equity firm, EMR Capital, Highfield's largest shareholder and cornerstone investor.

Source: Company website (<http://www.highfieldresources.com.au/DirectorsAndManagement.html>)

# Capital structure & major shareholders

## Capital structure

Total HFR shares on issue include ASX listed shares on issue plus 100m performance shares issued to vendors of HFR's Spanish potash projects. These performance shares convert to issued shares on the completion of various milestones including a JORC resource (50-150Mt grading 20-13% K<sub>2</sub>O) and receipt of approvals to construct an operating mine with capacity for 500ktpa potash.

There are 37m options currently on issue, of which 21m are in-the-money.

**Table 8 - HFR capital structure**

Shares on issue	m	201
Performance shares	m	100
<b>Total shares on issue</b>	<b>m</b>	<b>301</b>
Share price	\$/sh	0.79
Market capitalisation	\$m	237
Net cash	\$m	25
<b>Enterprise value (undiluted)</b>	<b>\$m</b>	<b>212</b>
Options (in the money)	m	39
Issued shares (diluted for options)	m	340
Market capitalisation (diluted)	m	268
Net cash + options	\$m	45
<b>Enterprise value (diluted)</b>	<b>\$m</b>	<b>223</b>

SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

## Major shareholders

EMR assumed a 17% shareholding in HFR in an April 2013 capital raising. The fund has since increased its diluted equity position to 20% and has one nominated Board position (Owen Hegarty).

**Table 9 - HFR major shareholders**

Major shareholders	%	m shares
Spanish in-country management	21%	63
Australian based management	8%	24
EMR Capital	20%	60
Other shareholders	51%	153
Total	100%	301

SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

## Who are EMR Capital?

EMR is a specialist resources private equity manager. EMR Board members include: Owen Hegarty (Chairman), founder and managing director of Oxiana Ltd and Non-Executive Director of Fortescue Metals Group Ltd; Jason Chang (Managing Director and CEO), former KPMG Partner; and Tony Manini (Director), geologist and business development executive (Rio Tinto Ltd and Oxiana Ltd); David Jones (Chairman, Audit Committee and Member, Investment Committee), private equity executive; and Colin MacKay (Director), lawyer and funds management executive.

# Highfield Resources Ltd (HFR)

## Company description

HFR is progressing its 100% owned Muga-Vipasca project (Northern Spain) through permitting and a definitive study for development from mid-2015. A PFS supported an 860ktpa (K60) potash project, focused on a high-grade section of the company's 268Mt resource. Permitting and a definitive feasibility for Muga-Vipasca are underway, for project financing and the commencement of development from mid-2015.

## Investment thesis – Buy (Speculative) Valuation \$1.15/sh

HFR provides unique leverage to an agricultural linked commodity with a solid demand outlook. The company's key project is expected to use conventional mining and processing technologies. Permitting and definitive feasibility studies are underway for development to commence from mid-2015. HFR is fully funded to the completion of the Muga-Vipasca definitive feasibility study. HFR is a Speculative investment as it carries exploration, permitting, development and offtake risks.

## Valuation – risked discounted cash flow of key project

Our HFR valuation of US\$1.15/sh is based on the company's Muga-Vipasca (formerly Javier) PFS and assumes:

- A more conservative potash price outlook of US\$300/t, compared with HFR's estimate around US\$400/t (nominal).
- A 20% risk discount to take into account permitting and development risks. We will roll this discount off as permitting and development milestones are completed.
- A \$110m capital raising at \$0.60/sh in mid-2015 (compared with current share price \$0.60/sh) to take into account project financing dilution.

## Key risks: Permitting, development, operation and marketing

Risks associated with an investment in HFR include, but are not limited to:

- **Government approvals and permitting:** To commence development and operate a mine in Spain, HFR must receive a Mining Concession and Construction Approval. HFR must also maintain its license to operate.
- **Mine and infrastructure development:** Project development is a key risk in terms of time and cost over-runs. Delays and cost over-runs can substantially impact the economic returns of its projects.
- **Mining, processing and logistical activities:** HFR will be mining using conventional underground methods. Underground mining, operating of processing plants and haulage equipment carry risks.
- **Potash markets:** HFR will be exposed to price and volume risk. It will be a price-taker in the global traded market for potash.
- **Offtake relationships:** HFR will likely need an offtake partner to market and distribute its potash products. These arrangements typically carry a level of commercial and working capital risks.
- **Foreign exchange risks:** HFR will have operations in Spain (Euro), likely be selling product in US dollars, and be reporting to Australian investors.

- **Infrastructure access:** HFR's project requires access to infrastructure and purchase agreements with infrastructure providers. Infrastructure includes roads, rail and ports.
- **Sovereign risks:** HFR's assets are located in Spain, the company is listed in Australia and will have customers from a broad range of foreign jurisdictions. HFR is subject to the sovereign risks of those countries.
- **General capital and operating cost fluctuations:** Markets for exploration, development and mining inputs can fluctuate widely and cause significant differences between planned and actual operating and capital costs. Key operating costs are linked to energy and labour markets.
- **Financing and capital management risk:** Financing and capital management includes access to debt and equity finance, maintaining covenants on debt finance, managing dividend payments, and managing debt repayments.
- **Corporate/M&A risk:** Risks associated with M&A activity including differences between the entity's and the market's perception of value associated with completed transactions.

Table 10 - Financial summary

PROFIT AND LOSS						FINANCIAL RATIOS							
Year ending June	Unit	2014a	2015e	2016e	2017e	2018e	Year ending June	Unit	2014a	2015e	2016e	2017e	2018e
Revenue	\$m	-	-	-	126	168	<b>VALUATION</b>						
Expense	\$m	(6)	(7)	(12)	(60)	(80)	NPAT	\$m	(6)	(5)	(7)	33	68
<b>EBITDA</b>	\$m	<b>(6)</b>	<b>(7)</b>	<b>(12)</b>	<b>66</b>	<b>88</b>	Reported EPS	c/sh	(2)	(2)	(2)	7	14
Depreciation	\$m	(0)	(0)	(0)	(7)	(10)	EPS growth	%	na	na	na	na	106%
EBIT	\$m	(6)	(7)	(12)	59	78	PER	x	-33.7x	-46.1x	-41.5x	11.6x	5.6x
Net interest expense	\$m	0	1	1	(12)	(17)	DPS	c/sh	-	-	-	-	-
<b>PBT</b>	\$m	<b>(6)</b>	<b>(7)</b>	<b>(11)</b>	<b>47</b>	<b>62</b>	Franking	%	0%	0%	0%	0%	0%
Tax expense	\$m	-	2	3	(14)	6	Yield	%	0%	0%	0%	0%	0%
<b>NPAT</b>	\$m	<b>(6)</b>	<b>(5)</b>	<b>(7)</b>	<b>33</b>	<b>68</b>	FCF/share	c/sh	(0)	(0)	(1)	(0)	0
							P/FCFPS	x	-22.0x	-21.9x	-1.4x	-3.9x	6.0x
							EV/EBITDA	x	-37.4x	-29.1x	-18.3x	3.2x	2.4x
							EBITDA margin	%	0%	0%	0%	52%	52%
							EBIT margin	%	0%	0%	0%	47%	47%
							Return on assets	%	-13%	-8%	-3%	7%	13%
							Return on equity	%	-14%	-8%	-6%	18%	29%
							<b>LIQUIDITY &amp; LEVERAGE</b>						
							Net debt (cash)	\$m	(12)	(23)	102	200	136
							ND / E	%	-23%	-33%	60%	99%	51%
							ND / (ND + E)	%	-29%	-50%	37%	50%	34%
							EBITDA / Interest	x	33.0x	14.0x	11.4x	5.4x	5.3x
							<b>RESOURCE</b>						
							Javier / Muga-Vipasca	Mt	K20 %	KCI %	K20 Mt	KCI Mt	
							Total resource	269	11.2	17.8	30.1	47.9	
							Measured	17	11.3	17.9	2.0	3.1	
							Indicated	140	11.3	18.0	15.8	25.2	
							Inferred	111	11.1	17.6	12.4	19.6	
							<b>High grade resource</b>	<b>154</b>	<b>12.9</b>	<b>20.5</b>	<b>19.9</b>	<b>31.6</b>	
							Measured	9	13.0	20.7	1.2	1.9	
							Indicated	74	13.4	21.2	9.9	15.7	
							Inferred	71	12.4	19.8	8.8	14.0	
							<b>PROJECT ASSUMPTIONS</b>						
							Year ending June		2016e	2017e	2018e	2019e	2020e
							Currency	US\$/A\$	0.85	0.85	0.85	0.85	0.85
							Potash FOB Vancouver (MOP/KCL)	US\$/t	300	300	300	300	300
							Potash price realised (FOB Spain)	US\$/t	332	332	332	334	334
							C1 costs	US\$/t		139	143	146	150
							Project EBITDA	US\$m		62	82	161	159
							Mined / milled	Mt		2	2	5	5
							Grade	%		13%	13%	13%	13%
							Recovery	%		85%	85%	85%	85%
							Product grade	%		60%	60%	60%	60%
							<b>Production (MOP / K60)</b>	<b>kt</b>		<b>323</b>	<b>430</b>	<b>860</b>	<b>860</b>
							<b>VALUATION</b>						
							Ordinary shares m						201
							Performance shares m						100
							Options in the money m						39
							<b>Diluted m</b>						<b>340</b>
													\$m
							Project (unrisked NPV10)						627
							Project (risk discount 20%, NPV10)						502
							Corporate overheads						(67)
							Total						435
							Cash & options						45
							Total						480
													1.41
							<b>Project capital raising assumption</b>						
							Project capital requirement US\$m						308
							Project capital requirement A\$m						362
							Equity / (Debt + Equity) %						30%
							Debt requirement \$m						254
							<b>Equity requirement \$m</b>						<b>109</b>
							<b>Share issue price \$/sh</b>						<b>0.60</b>
							New shares issued m						181
							<b>Diluted shares on issue m</b>						<b>521</b>
							Cash & options						154
							<b>Total</b>						<b>589</b>
													1.13
							<b>MAJOR SHAREHOLDERS</b>						
													%
							Spanish in-country management						21%
							Australian based management						8%
							EMR Capital						20%
							Other shareholders						51%
							Total						100%
													m
													63.1
													24.0
													60.1
													153.3
													300.5

SOURCE: BELL POTTER SECURITIES ESTIMATES

**Recommendation structure**

**Buy:** Expect >15% total return on a 12 month view. For stocks regarded as 'Speculative' a return of >30% is expected.

**Hold:** Expect total return between -5% and 15% on a 12 month view

**Sell:** Expect <-5% total return on a 12 month view

*Speculative Investments are either start-up enterprises with nil or only prospective operations or recently commenced operations with only forecast cash flows, or companies that have commenced operations or have been in operation for some time but have only forecast cash flows and/or a stressed balance sheet.*

*Such investments may carry an exceptionally high level of capital risk and volatility of returns.*

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