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## Highfield Resources Ltd (HFR)

### Resource upgrade lifts tonnes & grade

**Recommendation**

**Buy** (unchanged)

**Price**

**\$0.90**

**Valuation**

**\$1.23** (previously \$1.15)

**Risk**

**Speculative**

**Expected Return**

Capital growth	<b>37%</b>
Dividend yield	<b>0%</b>
Total expected return	<b>37%</b>

**Company Data & Ratios**

Enterprise value	<b>\$247m</b>
Market cap	<b>\$272m</b>
Issued capital	<b>302m</b>
Free float	<b>51%</b>
Avg. daily val. (52wk)	<b>\$147k</b>
12 month price range	<b>\$0.35-\$0.91</b>
GICS sector	<b>Materials</b>

**Price Performance**

	(1m)	(3m)	(12m)
Price (A\$)	0.71	0.59	0.38
Absolute (%)	26.76	52.54	136.84
Rel market (%)	16.93	42.23	127.59

**Absolute Price**



SOURCE: IRESS

### Resource upgrade further de-risks Muga project

HFR's Muga (Spain) potash project JORC resource upgrade has increased measured and indicated ore tonnes by 52% to 239Mt and maintained a grade of 11.3% K<sub>2</sub>O. The total resource is now 302Mt at 11.5% K<sub>2</sub>O (previously 268Mt at 11.2% K<sub>2</sub>O) and includes 232Mt of high grade at 13.5% K<sub>2</sub>O (previously 154Mt at 12.9% K<sub>2</sub>O).

The upgrade further de-risks the Muga project, representing an increase of around 13Mt in K60 product in the measured and indicated category. To put this increase in context, HFR's prefeasibility study (PFS) estimated production 860ktpa K60 product through developing an 83Mt measured and indicated resource grading 13.3% K<sub>2</sub>O.

Our HFR valuation is now \$1.23/sh (previously \$1.15/sh). With recent share price strength, we now expect less financing dilution. HFR is a Speculative investment as it carries exploration, permitting, development and offtake risks.

### Definitive feasibility due in March 2015

HFR expect to complete and release the results of a definitive feasibility study (DFS) by the end of March 2015. A recently lodged Mining Concession application suggests a larger project than considered by the PFS. The application covered a dual decline mine with a processing plant to produce over 1Mtpa of K60 potash product. The resource upgrade supports the increased mining rates and mine life.

### Approvals and financing by mid-2015

Through to mid-2015, we expect HFR to receive government approvals and arrange financing. We are not anticipating a material increase from the US\$308m PFS capital cost estimate. Assuming HFR debt finance the project to 70%, the company will require an additional US\$110m in equity around mid-year.

### Investment thesis – Speculative Buy, valuation \$1.23/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. HFR is fully funded to the completion of the Muga DFS.

**Earnings Forecast**

Year end 30 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	15
EPS growth (%)	na	na	na	106%
PER (x)	(52.5)	(44.5)	12.0	5.8
FCF Yield (%)	-4%	-69%	-25%	16%
EV/EBITDA (x)	(33.8)	(21.2)	3.7	2.8
Dividend (cps)	-	-	-	-
Yield (%)	0%	0%	0%	0%
Franking (%)	0%	0%	0%	0%
ROE (%)	-8%	-6%	18%	29%

SOURCE: BELL POTTER SECURITIES ESTIMATES

# Investment risks

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.

# Resource upgrade lifts grade & tonnes

**Table 1 - HFR resource upgrade summary**

	Previous 16-May-14		New 25-Feb-15		Change	
	Mt	%K <sub>2</sub> O	Mt	%K <sub>2</sub> O	Mt	%K <sub>2</sub> O
<b>Total</b>						
Measured	17	11.3	42	11.8	144%	0.5
Indicated	140	11.3	197	11.2	41%	-0.1
<b>Measured &amp; Indicated</b>	<b>157</b>	<b>11.3</b>	<b>239</b>	<b>11.3</b>	<b>52%</b>	<b>A</b>
Inferred	111	11.1	63	12.2	-43%	1.1
<b>Total</b>	<b>268</b>	<b>11.2</b>	<b>302</b>	<b>11.5</b>	<b>13%</b>	<b>0.3</b>
<b>P0 &amp; PAB potash bed resource</b>						
Measured	11	11.3	29	11.3	155%	0.0
Indicated	90	11.4	135	10.7	50%	-0.7
<b>Measured &amp; Indicated</b>	<b>102</b>	<b>11.4</b>	<b>164</b>	<b>10.8</b>	<b>61%</b>	<b>-0.6</b>
Inferred	70	11.2	17	10.5	-75%	-0.7
<b>Total</b>	<b>172</b>	<b>11.3</b>	<b>181</b>	<b>10.8</b>	<b>5%</b>	<b>-0.5</b>
<b>High-grade component (undiluted)</b>						
Measured	9	13.0	32		248%	
Indicated	74	13.4	146		97%	
<b>Measured &amp; Indicated</b>	<b>83</b>	<b>13.4</b>	<b>178</b>	<b>13.4</b>	<b>113%</b>	<b>C</b>
Inferred	71	12.4	54		-24%	
<b>Total</b>	<b>154</b>	<b>12.9</b>	<b>232</b>	<b>13.5</b>	<b>51%</b>	<b>B&amp;D</b>

SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

## Picking apart the resource upgrade

- A-** Total measured and indicated resource tonnes have increased by 52% or 82Mt. Assuming recoveries of 84.6% (PFS estimate), this measured and indicated component represents K60 product of around 38Mt, an increase of 13Mt (excluding mining dilution).
- B-** The high-grade component total resource increased by 51% or 78Mt. Assuming recoveries of 84.6%, the high-grade component represents K60 product of 44Mt, an increase of 12Mt (excluding mining dilution).
- C-** HFR's May 2014 PFS was mostly based on the high-grade measured and indicated resource of 83Mt at a grade of 13.4% K<sub>2</sub>O. This component has over doubled to 178Mt, while maintaining the same grade.
- D-** HFR have indicated that the DFS mine design will likely consider the high-grade resource of 232Mt at 13.5% K<sub>2</sub>O, diluted to 256Mt at 12.3% K<sub>2</sub>O. Assuming recoveries of 84.6%, this diluted resource points to K60 product of around 44Mt.

## Muga DFS expected to improve on the PFS parameters

A PFS for HFR's potash development focussing on high grade mineralisation was completed in May 2014. The key parameters from this PFS are provided in Table 3.

However, HFR's Mining Concession application (December 2014) parameters suggest that the Muga project will be larger than examined in the PFS.

**Table 2 - Mining Concession Application versus PFS**

	PFS (May 2014)	Mining Concession Application (December 2014)
Mine access	Single decline	Dual decline
Ore extraction rates	4.7Mtpa	800t per hour, or around 7Mtpa
Potash (K60) production	860ktpa	+1Mtpa

SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

The key parameters and estimated economic returns (HFR estimates) from the May 2014 PFS are outlined in the following table.

<b>Table 3 - PFS (May 2014) summary of parameters &amp; economic returns (HFR estimates)</b>	
Definitive feasibility study due	2014
Construction Phase 1	2015-16
Production Phase 1, Construction Phase 2	2016-17
Full production	From 2018
Measured & indicated resource	83.3Mt at 13.3% K <sub>2</sub> O
Inferred resource	70.7Mt at 12.4% K <sub>2</sub> O
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 May 2014 PFS 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.

### 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.

### Valuation upgrade: \$1.23/sh (previously \$1.15/sh)

*We have upgraded our HFR valuation though now assuming less dilution from an equity rising in mid-2015 (\$110m at \$0.80/sh compared with previously \$0.60/sh).*

We expect to next assess our valuation on completion of the DFS in March 2015. This milestone provides upside risk to our current valuation, as it is expected to outline a materially larger potash project.

Our current 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 to account for permitting and development risks. We will reduce this discount as permitting and development milestones are met.
- A \$110m equity raising at \$0.80/sh in mid-2015 (current share price \$0.90/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.

Potash prices (FOB Vancouver) are currently over US\$300/t.

Table 4 - Bell Potter HFR valuation			Table 5 - Bell Potter valuation sensitivity						
Ordinary shares m	201		Potash price FOB Vancouver US\$/t	Risk discount					
Performance shares m	100				40%	30%	20%	10%	Unrisked
Options in the money m	39		US\$200/t	0.35	0.38	0.41	0.43	0.46	
<b>Diluted m</b>	<b>340</b>		US\$250/t	0.66	0.74	0.82	0.90	0.98	
	<b>\$m</b>	<b>\$/sh</b>	US\$300/t	0.97	1.10	<b>1.23</b>	1.37	1.50	
Project (unrisked NPV10)	627	1.84	US\$350/t	1.28	1.47	1.65	1.83	2.02	
Project (risk discount 40%, NPV10)	502	1.47	US\$400/t	1.59	1.83	2.06	2.30	2.54	
Corporate overheads	-67	-0.20	SOURCE: BELL POTTER SECURITIES ESTIMATES						
Total	435	1.28							
Cash & options	45	0.13							
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								
Equity requirement \$m	109								
Share issue price \$/sh	0.80								
New shares issued m	136								
Diluted shares on issue m	477								
Cash & options	153	0.32							
<b>Total</b>	<b>589</b>	<b>1.23</b>							

SOURCE: 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 6 - Quarterly cash flow								
	Jun-13(a)	Sep-13(a)	Dec-13(a)	Mar-14(a)	Jun-14(a)	Sep-14(a)	Dec-14(a)	Mar-15(e)
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

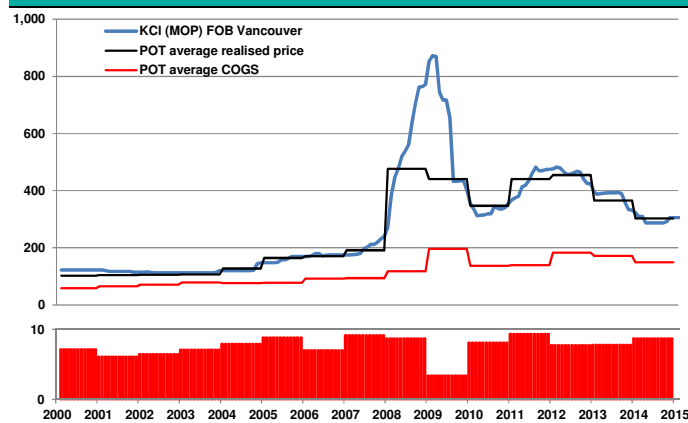
In 2012-13, the Canpotex producers operated at 60-70% capacity and Uralkali at 70-80% capacity. Excess capacity from the majors is 11-13Mtpa, around 25% of the global traded market. Low cost excess capacity is a barrier to entry for new large-scale projects.

## 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 7 - 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 8 - 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.

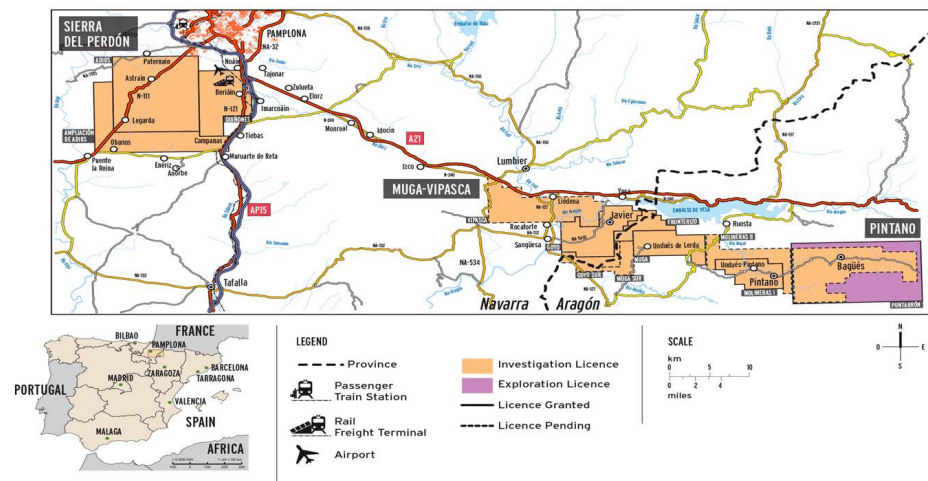
The Navarra Project is to be known as the Sierra del Perdon potash project. This more advanced project with historic workings is to be the subject of a scoping study.

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.

**February 2015: Major resource upgrade**

24 February 2015 – Major resource upgrade (subject of this report).

# 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 50m performance shares issued to vendors of HFR's Spanish potash projects. These performance shares are the remaining of the initial 100m performance shares, which 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 40m options currently on issue, of which 39m are in-the-money.

**Table 9 - HFR capital structure**

Shares on issue	m	252
Performance shares	m	50
<b>Total shares on issue</b>	<b>m</b>	<b>302</b>
Share price	\$/sh	0.90
Market capitalisation	\$m	272
Net cash	\$m	25
<b>Enterprise value (undiluted)</b>	<b>\$m</b>	<b>247</b>
Options (in the money)	m	39
Issued shares (diluted for options)	m	341
Market capitalisation (diluted)	m	307
Net cash + options	\$m	45
<b>Enterprise value (diluted)</b>	<b>\$m</b>	<b>262</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 10 - 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 \$1.23/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. 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 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 11 - 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	15		
Depreciation	\$m	(0)	(0)	(0)	(7)	(10)	EPS growth	%	na	na	na	na	106%		
EBIT	\$m	(6)	(7)	(12)	59	78	PER	x	-38.4x	-52.5x	-44.5x	12.0x	5.8x		
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	-25.0x	-25.0x	-1.5x	-4.0x	6.2x		
							EV/EBITDA	x	-43.4x	-33.8x	-21.2x	3.7x	2.8x		
							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>								
							<b>Javier / Muga-Vipasca</b>	<b>Mt</b>	<b>K2O %</b>	<b>KCl %</b>	<b>K2O Mt</b>	<b>KCl Mt</b>			
							<b>Total resource</b>	<b>269</b>	<b>11.2</b>	<b>17.8</b>	<b>30.1</b>	<b>47.9</b>			
							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>BALANCE SHEET</b>								
							<b>Year ending June</b>								
							<b>ASSETS</b>								
							Cash & short term investments	\$m	12	23	152	54	117		
							Accounts receivable	\$m	1	0	0	6	8		
							Property, plant & equipment	\$m	0	0	218	355	351		
							Exploration & evaluation	\$m	37	42	47	52	57		
							Other	\$m	2	4	8	-	6		
							<b>Total assets</b>	\$m	<b>53</b>	<b>70</b>	<b>424</b>	<b>468</b>	<b>540</b>		
							<b>LIABILITIES</b>								
							Accounts payable	\$m	2	1	1	12	16		
							Borrowings	\$m	-	-	254	254	254		
							Other	\$m	-	-	-	-	-		
							<b>Total liabilities</b>	\$m	<b>2</b>	<b>1</b>	<b>255</b>	<b>266</b>	<b>270</b>		
							<b>SHAREHOLDER'S EQUITY</b>								
							Share capital	\$m	35	57	166	166	166		
							Reserves	\$m	25	25	25	25	25		
							Retained earnings	\$m	(9)	(14)	(22)	11	79		
							<b>Total equity</b>	\$m	<b>51</b>	<b>68</b>	<b>170</b>	<b>202</b>	<b>270</b>		
							Weighted average shares	m	236	278	368	436	436		
							<b>CAPITAL STRUCTURE</b>								
							Shares on issue	m					202.0		
							Performance shares	m					100.0		
							<b>Total shares on issue</b>	<b>m</b>					<b>302.0</b>		
							<b>Share price</b>	<b>\$/sh</b>					<b>0.90</b>		
							Market capitalisation	\$m					271.8		
							Net cash	\$m					25.0		
							<b>Enterprise value (undiluted)</b>	<b>\$m</b>					<b>246.8</b>		
							Options (in the money)	m					38.8		
							Issued shares (diluted for options)	m					340.8		
							Market capitalisation (diluted)	m					306.7		
							Net cash + options	\$m					44.6		
							<b>Enterprise value (diluted)</b>	<b>\$m</b>					<b>262.1</b>		
							<b>MAJOR SHAREHOLDERS</b>								
													%	m	
							Spanish in-country management						21%	63.4	
							Australian based management						8%	24.2	
							EMR Capital						20%	60.4	
							Other shareholders						51%	154.0	
							<b>Total</b>						100%	302.0	
							<b>PROJECT ASSUMPTIONS</b>								
							<b>Year ending June</b>								
							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						252		
							Performance shares m						50		
							Options in the money m						39		
							<b>Diluted m</b>						<b>341</b>		
													\$m	\$/sh	
							Project (unrisked NPV10)						627	1.84	
							Project (risk discount 20%, NPV10)						502	1.47	
							Corporate overheads						(67)	(0.20)	
							<b>Total</b>						435	1.28	
							Cash & options						45	0.13	
							<b>Total</b>						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>0.80</b>	
							New shares issued m							136	
							<b>Diluted shares on issue m</b>							<b>477</b>	
							Cash & options							153	0.32
							<b>Total</b>							<b>589</b>	<b>1.23</b>

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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