

Highfield Resources^{1,7}

BUY

HFR AU

May 3, 2015

 Last: **A\$1.85**
 ▲ Target: **A\$2.15**

Salt scoping study released, price target lifted

Crystallisation plant for chemical salt and tailings potash

Highfield's scoping study for a slimes crystallisation plant at Muga in Spain outlines a 24 year mine producing 135ktpa of potash (~60% of EBITDA) and 259ktpa of salt for the chemicals industry, lifting group peak production to 1.8Mtpa MOP. C3 costs of US\$85/t would drive 65% operating margins and US\$65m pa of EBITDA in 2019 for a company estimated NPV_{10%} of US\$222m and 33% IRR. Construction would start post potash mine completion in 2017.

A real project, with HFR having advantages over peers

Today's proposed salt facility is entirely real in our view, being a common co-product facility at potash mines globally. Highfield has two advantages over peers – firstly is proximity to end markets and good existing transport infrastructure. Secondly is the silver-lining on the low recovery of the primary potash – this occurs because of the slimes / insoluble content, but means Highfield's tails have higher potash 'credits' than peers. In fact, Highfield's facility is technically a potash project with salt credits given potash will drive ~60% of revenue at spot, for cash costs of -US\$30/t net of salt credits.

Potential for mezzanine or offtake finance

Highfield has proposed construction post completion of the potash operation, which lowers technical risk, and opens the door to mezzanine financing of some kind. Specifically, offtake finance is very common in this industry, and we also see potential for debt or off balance sheet funding via JV/earn-in.

Maintain BUY rating and lift PT to A\$2.15/sh from A\$1.95/sh

We model the salt using capex and opex from Highfield, but do not escalate these, and apply spot salt prices as achieved by K+S in 4Q14 (US\$118/t), conservatively lower than Highfield's targeted US\$125/t from premium US markets and K+S and Compass average sales of ~US\$140 and US\$160/t in previous years. This drives a project NPV₁₀ of US\$141m including finance charges on 100% debt (US\$171m from construction start) – we add this to our SOTP valuation at 0.25xNAV using LT potash of US\$305/t (~spot) with Muga and SDP at 0.5xNAV, maintaining our BUY rating and lifting our price target to A\$2.15/sh from A\$1.95/sh. Updating our forward-looking fully funded fully-diluted (at spot) calculation shows an exit valuing including SDP and Muga expansion of A\$5.06/sh (from A\$4.97).

What's Changed	Old	New
Rating	BUY	n.c.
Target	A\$1.95	A\$2.15

Summary

Key asset:	Muga / SDP (Spain)
Potash resource (kt)	489Mt @ 11.4% K ₂ O
Peak Potash Production (kt)	1,779
FD 1xNPV _{10%} (US\$m / A\$/sh)	1223 / 4.52

Share Data

Shares (mm, basic/itm f.d.)	252 / 342
52-week high/low	A\$1.85 / A\$0.38
3M avg daily vol (000)	581
3M avg daily val (000)	A\$785
Mkt cap incl. perf. sh (m)	A\$627
Net cash (debt) (m)	A\$22
FD EV (m)	769
Projected return (%)	17%

FINANCIAL DATA

Year to Jun	2016E	2017E	2018E
Revenue (m)	-	A\$0.0	A\$234
EBITDA (m)	A\$(10.4)	A\$(10.4)	A\$141
Income (m)	A\$(18.9)	A\$(20.7)	A\$83
EPS	nm	nm	0.26
CFPS	nm	nm	0.35
PER (x)	nm	nm	nm
EV/EBITDA (x)	-	-	4.2x

All amounts in US dollars unless otherwise stated

 [Current Chart](#)
 [Previous Research](#)

Brock Salier, PhD
brock.salier@gmpeurope.com

+44-207-016-1904

James Bell (associate)
james.bell@gmpeurope.com

+44-207-647-2806

Summary

Highfield released the results of a Scoping Study for a proposed slimes crystallisation plant (K62 plant) at the Muga project in Spain. This envisages processing of the 25-35Mt of slimes tailings in a crystallisation plant to produce saleable high-purity potash (K62 Muriate of Potash) and vacuum salt (NaCl) for the chemicals industry. Capex of US\$124m delivers a plant capable of processing 1.3Mtpa of slimes with average yearly production of ~135kt of granular K62 potash and a by-product of 160kt pa of high-purity vacuum salt. Targeted C3 costs of US\$85/t would drive 65% operating margins and US\$65m pa of EBITDA from the first full year of production. The company envisages construction starting post Muga potash completion in 2017, for first production in 2019 with the plant delivering a post-tax NPV10% of US\$222m and IRR of 33%.

Figure 1. GMP modelled salt economics against Highfield scoping

Muga salt (100%)	HFR scoping	GMP old	GMP new
Mining inventory - slimes tailings (Mt)	31	-	31
Annual ROM feed (Mt)	1.30	-	1.30
Mine life (years)	24	-	24
Slimes grade (K ₂ O %)	7.3%	-	7.3%
Slimes grade (NaCl %)	21.0%	-	21.0%
Potash recovery (%)	88.6%	-	88.6%
Salt recovery (%)	94.9%	-	94.9%
Plateau production (K62 MOP, 000t)	135	-	135
Plateau production (salt, 000t)	259	-	259
Opex (US\$/t FOB)	61.21	-	64.21
Salt price (US\$/t)	125	-	119
Capex (US\$m)	124	-	129
Discount rate (%)	10%	-	10%
EUR / USD	1.05	-	1.10
Cost escalation (%)	2%	-	0
Potash price escalation (%)	2%	-	0
First production	2019	-	1QCY20
NPV to today (US\$m)	-	-	141
NPV to construction start (US\$m)	222	-	171
IRR (%)	33%	-	0
EBITDA first full year (US\$m)	56	-	51

Source: GMP

Substantial future upside to >A\$5.00/sh

Overleaf we show the fully-funded fully-diluted upside, on the base assumption that all future equity is raised at spot. This shows upside of ~200% to four year forward NPV, or ~25% pa on Muga and Muga slimes alone, with ~40-50% pa once SDP and an expansion at Muga are accounted for.

Figure 2. Fully-funded fully-diluted per share upside

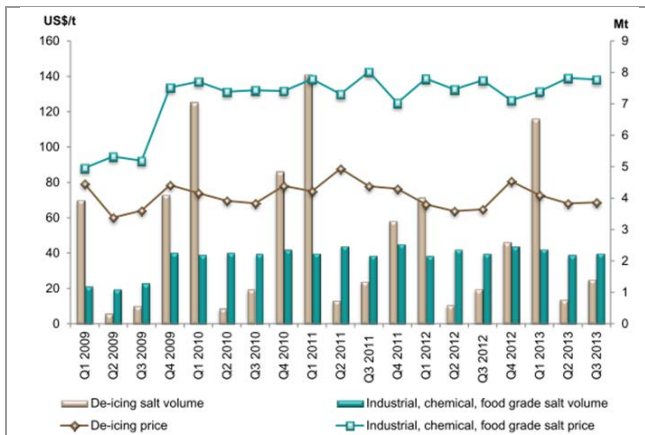
	Muga DFS	Muga slimes	SDP scoping	Muga expa'n*	Total
Production (Mtpa)	1.10	0.14	0.52	0.55	1.10
Capex (US\$m)	370	124	233	185	912
Plateau EBITDA (US\$m)	240	56	110	120	526
Intrepid EV/production (US\$/t pa)			1,097		
Listed peers EV/EBITDA '15 (x)			7.16x		
Implied EV from EV/production (US\$m)^	1,249	148	570	603	2,570
Implied EV from EV/EBITDA (US\$m)^	1,758	401	790	859	3,808
1xNPV _{10%} +3/4yrs, +equity raised (US\$m)^	1,294	171	564	446	2,475
Average (US\$m)	1,434	240	642	636	2,951
Gearing (%)	60%	100%	60%	60%	
Less debt required (US\$m)	222	124	140	111	597
Market cap in prod'n (US\$m)	1,211	116	502	525	2,354
Current market cap FD (US\$m)			497		
Plus equity required (US\$m)	148	-	93	74	315
Cumulative FD market cap (US\$m)**	645	645	738	812	812
Fully diluted equity upside to production (%)^	88%	106%	148%	190%	190%
Per share equivalent (A\$/sh)	3.45	3.45	4.26	5.06	5.06
Annual return on equity (%)	29%		37%	47%	47%

Source: GMP, *Capacity increased by 50% for 40% of initial capex, ie third decline and plant line, ^Muga NPV / implied EV includes cash and cash from options, **Assumes entire equity raised at current share price

Salt market overview

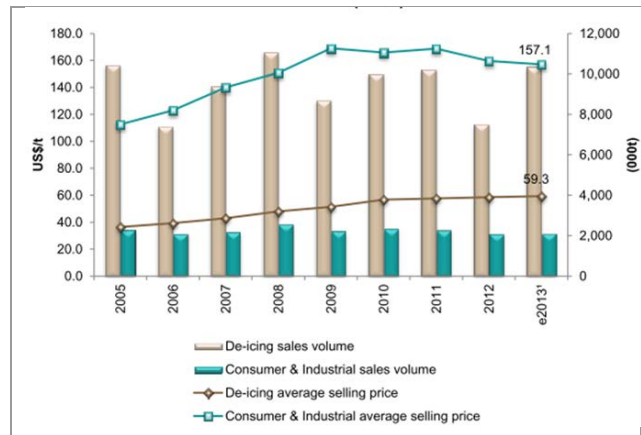
The global salt market is ~320Mt, of which ~60% is for industrial use via chlor-alkali and soda ash production. The chlor-alkali industry produces chlorine and caustic soda for PVC alumina / paper / chemicals, respectively. This requires purity of >99.9%, hence Highfield's use of a crystallisation plant (raw tails suitable for 'patchy' road salt use only). Highfield's EU peer K+S is the largest producer of salt globally at 31Mtpa. Of note – Highfield's proposed 259ktpa represents only ~0.2% of supply into the chlor-alkali industry. EU sales by K+S have averaged ~US\$140/t from 2009 to 2013, although this fell to US\$118/t in the most recent quarter. US producer Compass sees a premium, averaging ~US\$160/t over the same period.

Figure 3a. Average salt sales value for K+S 2009-2013



Source: K+S

Figure 3b. Average salt sales value for Compass



Source: Compass

Catalysts

- 2H15: Muga permits and finance
- 2016: SDP PFS/DFS
- 4Q15: Muga construction start
- CY17: Initial Muga production

Highfield Resources (HFR AU)	Share price	A\$1.84/sh		Stock rating:	BUY	Implied return:	17%
Analyst: Brock Sallier	Market cap	A\$627m	US\$490m	Target price:	A\$2.15/sh	Market P/NAV:	0.41x
Ratio analysis	FY16E	FY17E	FY18E	FY19E	FY20E		
Average shares outstanding (m)	252	252	252	252	252		
EPS (US\$/sh)	(6.0)	(6.5)	26.1	36.4	57.6		
CFO PS before wkg cap (US\$/sh)	(5.7)	(6.3)	34.9	46.4	68.8		
FCF PS before wkg cap (US\$/sh)	(43.2)	(65.8)	(0.0)	(3.1)	26.9		
Dividend (US\$/sh)	-	-	-	-	22.0		
PER (x)	-	-	5.5x	3.9x	2.5x		
EV/EBITDA (x)	-	-	4.2x	3.1x	2.0x		
P/CFO (x)	-	-	4.1x	3.1x	2.1x		
P/FCF (x)	-	nm	-	-	5.3x		
Income statement (yr to Jun)	FY13A	FY14A	FY15E	FY16E	FY17E		
Revenue (A\$m)	-	-	-	-	0.0		
Cost of sales (A\$m)	-	-	-	-	(0.0)		
Finance income (costs) (A\$m)	0.2	0.2	(10.4)	(8.6)	(10.3)		
D&A (A\$m)	(0.0)	-	-	-	(0.0)		
Gross profit (A\$m)	0.1	0.2	(10.4)	(8.6)	(10.3)		
Central SG&A (A\$m)	(1.6)	(9.6)	(9.6)	(9.6)	(9.6)		
Share based payments (A\$m)	(2.0)	(1.5)	(0.8)	(0.8)	(0.8)		
FX (A\$m)	0.0	0.2	0.0	-	-		
Impairment / depreciation (A\$m)	-	(0.7)	-	-	-		
Income Tax (A\$m)	-	-	-	-	-		
Net attributed profit (A\$m)	(3.5)	(11.3)	(20.7)	(18.9)	(20.7)		
Cash flow (yr to Jun)	FY13A	FY14A	FY15E	FY16E	FY17E		
Revenue less cost of sales (A\$m)	-	-	-	-	0.0		
SG&A + finance income (A\$m)	(1.5)	(5.4)	(9.4)	(18.1)	(19.9)		
Tax and other (A\$m)	0.0	-	-	-	-		
Change in working cap (A\$m)	-	-	(1.3)	31.6	0.8		
CFO (A\$m)	(1.5)	(5.4)	(10.7)	13.5	(19.1)		
Purchase of PP&E (A\$m)	(0.0)	(0.1)	-	(147.8)	(189.9)		
Exploration and other (A\$m)	(1.0)	(6.7)	(10.0)	(3.0)	-		
CFI (A\$m)	(1.0)	(6.8)	(10.0)	(150.8)	(189.9)		
Net share proceeds (A\$m)	5.1	14.0	200.8	-	-		
Debt proceeds (repayment) (A\$m)	-	-	189.2	-	-		
CFF (A\$m)	5.1	14.0	390.0	-	-		
Net change in cash (A\$m)	2.6	5.5	369.3	(137.3)	(209.0)		
Balance sheet (yr to Jun)	FY13A	FY14A	FY15E	FY16E	FY17E		
PP&E (A\$m)	0.1	0.1	0.1	147.9	337.8		
Exploration and other (A\$m)	24.2	39.7	49.8	52.8	52.8		
Total non-current assets (A\$m)	24.3	39.8	49.9	200.7	390.6		
Cash (A\$m)	6.2	11.6	380.8	243.6	34.5		
Inventory and AR (A\$m)	0.2	1.4	0.8	0.8	0.0		
Total current assets (A\$m)	6.4	13.0	381.6	244.3	34.5		
Total non-current liabilities (A\$m)	-	-	-	-	-		
AP, tax and provision (A\$m)	0.3	2.0	-	31.6	31.6		
Debt (US\$m)	-	-	189.2	189.2	189.2		
Current liabilities (A\$m)	0.3	2.0	189.2	220.8	220.8		
NET ASSETS (A\$m)	30	51	242	224	204		
Issued capital (A\$m)	21.0	34.8	247.0	247.8	248.6		
Accum'd profits & other (A\$m)	9.4	16.1	(4.6)	(23.6)	(44.3)		
TOTAL EQUITY (A\$m)	30	51	242	224	204		

Commodity price (year to Jun)	FY16E	FY17E	FY18E	FY19E	FY20E
Potash (US\$/t FOB Vanc.)	-	305	305	305	305
Potash (US\$/t CIF NW Eur)	-	345	345	345	345

Other data					
Basic shares (m)	252.0		12M high:	A\$1.85/sh	
Fully diluted shares (m)	341.5		12M low:	A\$0.38/sh	

Resource / Reserve	Total
Resource (M&I + Inf)	489.3Mt @ 11.4% K2O / 17.4% KCl
Reserves (P&P)	-

Production (100% basis)	FY16E	FY17E	FY18E	FY19E	FY20E
Javier production (kt)	-	0	562	750	1,124
SDP production (kt)	-	-	-	260	520
Total prod'n (kt)	-	0	562	1,009	1,644
FOB costs (US\$/t)	-	95	95	95	95
FOB costs (US\$/t ex salt)	-	116	116	125	117

The chart displays production and cash costs from FY16E to FY22E. Production (kt) is shown as stacked bars: Muga slimes (light blue), Javier KCl (dark blue), and SDP KCl (grey). Cash cost (US\$/t) is shown as a line with diamond markers. The left Y-axis represents Production (kt) from 0 to 2,000. The right Y-axis represents Cash Cost (US\$/t) from 90 to 140. Production starts at 0 in FY16E and FY17E, then rises to 562 kt in FY18E, 1,009 kt in FY19E, and 1,644 kt in FY20E. Cash cost starts at 95 US\$/t in FY18E and remains relatively stable around 110-115 US\$/t through FY22E.

Estimate share valuation				
	US\$m	NAVx	US\$m	A\$/sh
Muga	803	0.50	402	1.48
Muga salt	141	0.25	35	0.13
SDP	319	0.50	159.3	0.59
Pintano	-	-	-	-
Cash	21.7	0.50	11	0.04
Cash from options	20.4	0.50	10	0.04
Debt	-	0.50	-	-
SG&A and central costs	(82)	0.50	(41)	(0.15)
Valuation (fully diluted)	1,223	-	576	2.13

Valuation sensitivities (A\$/sh) to potash price (US\$/t FOB Vancouver)					
To discount rate	US\$250	US\$275	US\$305	US\$325	US\$350
12% discount	0.96	1.26	1.62	1.87	2.17
10% discount	1.32	1.69	2.13	2.42	2.79
8% discount	1.81	2.26	2.80	3.15	3.60

To NAVx @ 8%					
	US\$250	US\$275	US\$305	US\$325	US\$350
0.25xNAV	0.88	1.13	1.42	1.62	1.86
0.50xNAV	1.32	1.69	2.13	2.42	2.79
0.45xNAV	1.24	1.58	1.99	2.26	2.60

Source: GMP estimates

Disclosures

The information contained in this report is drawn from sources believed to be reliable but the accuracy or completeness of the information is not guaranteed, nor in providing it do GMP Securities L.P., GMP Securities Europe LLP or GMP Securities Australia Pty Limited (collectively referred to as "GMP") assume any responsibility or liability whatsoever. Information on which this report is based is available upon request. This report is not to be construed as a solicitation of an offer to buy or sell any securities. GMP and/or affiliated companies or persons may as principal or agent, buy and sell securities mentioned herein, including options, futures or other derivative instruments thereon. Griffiths McBurney Corp. ("GM Corp."), an affiliate of GMP accepts responsibility for the contents of this research subject to the foregoing. U.S. clients wishing to effect transactions in any security referred to herein should do so through GM Corp. GMP Securities L.P. will provide upon request a statement of its financial condition and a list of the names of its Directors and senior officers.

Company-Specific Disclosures:

- 1 GMP has, within the previous 12 months, provided paid investment banking services or acted as underwriter to the issuer.
- 2 GMP is a market maker for the securities of the subject issuer.
- 3 GMP owns 1% or more of this issuer's securities.
- 4 GMP Securities, LLC, an affiliate of GMP, discloses the following in relation to this issuer as required by the Financial Industry Regulatory Authority ("FINRA") Rule 2711: as applicable.
- 5 The analyst is related to an officer, director or advisory board member of the issuer, but that individual has no influence in the preparation of this report.
- 6 The analyst has visited the operations of this issuer. The issuer and/or GMP clients paid all or a portion of the travel expenses associated with the analyst's site visit to its operations.
- 7 The analyst who prepared this report has viewed the operations of this issuer.
- 8 The analyst who prepared this research report owns this issuer's securities.
- 9 RESERVED
- 10 RESERVED

Each research analyst and associate research analyst who authored this document and whose name appears herein certifies that:

(1) the recommendations and opinions expressed in the research report accurately reflect their personal views about any and all of the securities or issuers discussed herein that are within their coverage universe; and (2) no part of their compensation was, is or will be, directly or indirectly, related to the provision of specific recommendations or views expressed herein.

GMP Analysts are not registered and/or qualified as research analysts with the FINRA and/or the New York Stock Exchange and may not be associated persons of GMP Securities, LLC and therefore may not be subject to FINRA Rule 2711 restrictions on communications with a subject company, public appearances and trading securities held by a research analyst account as defined by FINRA but are subject to the applicable regulatory rules as mentioned in the next paragraph.

All relevant disclosures required by regulatory rules (including The Investment Industry Regulatory Organization of Canada, Financial Conduct Authority and Australian Securities & Investments Commission), GMP's recommendation statistics and research dissemination policies can be obtained at www.gmpsecurities.com or by calling the relevant GMP office's Compliance Department.

GMP Analysts are compensated competitively based on several criteria. The Analyst compensation pool is comprised of several revenue sources, including secondary trading commissions, new issue commissions, investment banking fees, and directed payments from institutional clients. GMP prohibits any director, officer or employee of GMP from holding any office in publicly traded companies or any office in private companies in the financial services industry.

The GMP research recommendation structure consists of the following ratings:

Buy: A Buy rating reflects 1) bullish conviction on the part of the analyst; and 2) typically a 15% or greater return to target.

Speculative Buy: A Speculative Buy rating reflects 1) bullish conviction on the part of the analyst accompanied by a substantially higher than normal risk, including the possibility of a binary outcome; and 2) typically a 30% or greater return to target.

Hold: A Hold rating reflects 1) a lack of bullish or bearish conviction on the part of the analyst; and 2) typically a return of 0 to 20%.

Reduce: A Reduce rating reflects 1) bearish conviction on the part of the analyst; and 2) typically a 5% or lower return to target.

Tender: Clients are advised to tender their shares to a takeover bid or similar offer.

Country-Specific Disclaimers:

Australia: GMP Securities Australia Pty Limited (“GMP Australia”). ACN 149 263 543; Australian Financial Services License No: 403684. Level 9, 190 St. Georges Tce, Perth, WA, Australia 6000 Tel + (618) 6141 6300 Fax + (618) 9226 1370.

Any advice contained in this document has been prepared without taking into account your objectives, financial situation or needs. Before acting on any advice in this document, GMP Australia recommends that you consider whether the advice is appropriate for your circumstances. GMP Australia recommends that you obtain and consider the relevant “Product Disclosure Statement” or other disclosure documents before making any decision about a product including whether to acquire or to continue to hold it.

Canada: GMP Securities L.P. is a member of the Investment Industry Regulatory Organization of Canada and a participant of the TSX, TSX Venture and the Montreal Exchange. It is registered with all the provincial self-regulatory authorities of Canada. 145 King Street West, Suite 300 Toronto, Ontario M5H 1J8 Tel: (416) 367-8600 Fax: (416) 943-6134.

United Kingdom: GMP Securities Europe LLP is authorised and regulated by the Financial Conduct Authority and is a member of the London Stock Exchange. 5 Stratton Street, London W1S 4GA Tel 0044 20 7647 2800 Fax 0044 20 7647 2801.

This information is issued for the benefit of persons who qualify as eligible counterparties or professional clients and should be made available only to such persons and is exempt from the restriction on financial promotion in s21 of the Financial Services and Markets Act 2000 in reliance on provision in the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 particularly Article 19(5) for Investment Professionals and Article 49(2) for entities of prescribed net worth.

Other countries: circulation of this report may be restricted by laws and regulations in other countries and persons in receipt of this document must satisfy any relevant legal requirements in that country.

© GMP. All rights reserved. Reproduction in whole or in part without permission is prohibited.