

Highfield Resources^{1,7}

BUY

HFR-ASX

May 24, 2015

 Last: **A\$1.59**
 ▲ Target: **A\$2.20**

Resuming coverage post raise: Onward to build

Mine build equity funding largely in place

Highfield has raised A\$101m, issuing 56m shares at A\$1.80/sh to fund construction at the Muga potash project in Spain. Pre-production capex is US\$256m, plus GMPe US\$20m in working capital, US\$40m in VAT receivables, and ~US\$10m in expected finance costs, for a total requirement of ~US\$326m. Project debt funding of ~60% plus facilities for working capital and VAT should enable 65% gearing, providing US\$212m of debt. With cash of ~US\$95m, this only leaves a shortfall of ~US\$16m, with a variety of options open including a cost over-run facility.

Forward to build, multiple options available

We see EU project debt as the core / back-stop to fund Muga post 2H15 permitting, and the company has already received indicative term sheets. However, we think Highfield will have other options available this year, potentially including a strategic investment at asset level, off-take financing, royalty deals, or JV arrangements. These are difficult to quantify at this stage so we model vanilla debt, but we do note that such optionality should give investors confidence in the project funding.

Fully-funded fully-diluted upside to ~A\$5/sh

Looking to an “exit” valuation in production, we value Muga, Muga salt-slime, and SDP at an average of NPV_{10%+4yrs} at US\$305/t FOB Vancouver, EV/EBITDA for producers, and EV/production for close peer intrepid. Adding equity dilution at spot share price, and on a 65% gearing basis implies an in-production valuation of A\$4.99/sh, or 164% upside. Even this excludes projects such as Vipasca and Pintanto, and a strategic premium for the company’s basin controlling position.

Maintain BUY rating, lift PT to A\$2.20/sh from A\$2.15/sh

We add the cash and shares, maintaining our BUY rating but lifting our PT to A\$2.20/sh from A\$2.15/sh. At US\$305/t FOB Vancouver, we use 0.6xNAV for Muga, which we expect to lift toward 1xNAV as permits are granted and the mine comes into production, 0.5xNAV for SDP, and 0.25xNAV for the Muga slimes project, using published economics. We like Highfield on a buy and hold basis and see this as the “one to own” in the junior potash space.

What's Changed	Old	New
Rating	BUY	n.c.
Target	A\$2.15	A\$2.20

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)	1277 / 4.05

Share Data

Shares (mm, basic/itm f.d.)	310 / 398
52-week high/low	A\$2.08 / A\$0.485
3M avg daily vol (000)	581
3M avg daily val (000)	A\$785
Mkt cap incl. perf. sh (m)	A\$632
Net cash (debt) (m)	A\$96
FD EV (m)	701
Projected return (%)	38%

FINANCIAL DATA

Year to Jun	2016E	2017E	2018E
Revenue (m)	-	A\$0.0	A\$234
EBITDA (m)	A\$(5.3)	A\$(5.3)	A\$146
Income (m)	A\$(4.7)	A\$(20.9)	A\$86
EPS	nm	nm	0.22
CFPS	nm	nm	0.29
PER (x)	nm	nm	nm
EV/EBITDA (x)	-	-	3.5x

All amounts in US dollars unless otherwise stated

 Current Chart

 Previous Research

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Summary

Below we show our fully-funded fully-diluted calculation for Highfield, only incorporating the three projects for which economics have been released. This shows upside into production of 214%.

Figure 1. Fully-funded, fully-diluted upside scenarios

	Muga DFS	Muga slimes	SDP scoping	Total
Production (Mtpa)	1.12	0.14	0.52	1.78
Capex (US\$m)	370	124	233	727
Plateau EBITDA (US\$m)	240	51	110	401
Intrepid EV/production (US\$/t pa)		1,052		
Listed peers EV/EBITDA '15 (x)		7.31x		
Implied EV from EV/production (US\$m)^	1,298	142	547	1,987
Implied EV from EV/EBITDA (US\$m)^	1,794	371	806	2,971
1xNPV _{10%} 4yrs, +equity raised (US\$m)^	1,340	191	553	2,083
Average (US\$m)	1,477	235	635	2,347
Gearing (%)	65%	100%	65%	-
Less debt required (US\$m)	241	124	151	516
Cummulative arket cap in prod'n (US\$m)	1,237	1,347	1,831	1,831
Current market cap FD (US\$m)		501		
Plus equity required (US\$m)	-	-	82	82
Cummulative FD market cap (US\$m)**	501	501	583	583
Fully diluted equity upside to production (%)^	147%	169%	214%	214%
Per share equivalent (A\$/sh)	3.92	4.27	4.99	4.99
Annual return on equity over 4yrs (%)	49%	42%	54%	54%

Source: GMP estimates

*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

Highfield Resources (HFR AU)	Share price	A\$1.59/sh		Stock rating:	BUY	Implied return:	38%				
Analyst: Brock Salier	Market cap <u>FD</u>	A\$632m	US\$495m	Target price:	A\$2.20/sh	Market P/NAV:	0.39x				
Ratio analysis	FY16E	FY17E	FY18E	FY19E	FY20E	Commodity price (year to Jun)	FY16E	FY17E	FY15E	FY16E	FY17E
Average shares outstanding (m)	310	310	310	310	310	Potash (US\$/t FOB Vanc.)	-	305	305	305	305
EPS (US\$/sh)	(1.2)	(5.3)	22.0	29.5	47.1	Potash (US\$/t CIF NW Eur)	-	345	345	345	345
CFO PS before wkg cap (US\$/sh)	(1.2)	(5.3)	28.7	37.5	56.2	Other data					
FCF PS before wkg cap (US\$/sh)	40.6	(57.1)	(12.1)	(1.8)	27.7	Basic shares (m)	310.3	12M high:	A\$2.08/sh		
Dividend (US\$/sh)	-	-	-	-	17.9	Fully diluted shares (m)	397.6	12M low:	A\$0.49/sh		
PER (x)	-	-	5.7x	4.2x	2.6x	Resource / Reserve	Total				
EV/EBITDA (x)	-	-	3.5x	2.6x	1.7x	Resource (M&I + Inf)	489.3Mt @ 11.4% K2O / 17.4% KCl				
P/CFO (x)	-	-	4.3x	3.3x	2.2x	Reserves (P&P)	-				
P/FCF (x)	-	nm	-	-	4.5x	Production (100% basis)	FY16E	FY17E	FY18E	FY19E	FY20E
Income statement (yr to Jun)	FY13A	FY14A	FY15E	FY16E	FY17E	Javier production (kt)	-	0	562	750	1,124
Revenue (A\$m)	-	-	-	-	0.0	SDP production (kt)	-	-	-	260	520
Cost of sales (A\$m)	-	-	-	-	(0.0)	Total prod'n (kt)	-	0	562	1,009	1,644
Finance income (costs) (A\$m)	0.2	0.2	(4.1)	0.6	(15.6)	FOB costs (US\$/t)	-	95	95	95	95
D&A (A\$m)	(0.0)	-	-	-	(0.0)	FOB costs (US\$/t ex salt)	-	116	116	125	117
Gross profit (A\$m)	0.1	0.2	(4.1)	0.6	(15.6)						
Central SG&A (A\$m)	(1.6)	(5.3)	(5.3)	(5.3)	(5.3)	Production (kt)					
Share based payments (A\$m)	(2.0)	(1.5)	-	-	-	Legend:					
FX (A\$m)	0.0	0.2	(0.0)	-	-	□ Muga slimes					
Impairment / depreciation (A\$m)	-	(0.7)	-	-	-	□ Javier KCl					
Income Tax (A\$m)	-	-	-	-	-	● FOB cost (US\$/t)					
Net attributed profit (A\$m)	(3.5)	(7.1)	(9.5)	(4.7)	(20.9)						
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)	(5.1)	(4.7)	(20.9)						
Tax and other (A\$m)	0.0	-	-	-	-						
Change in working cap (A\$m)	-	-	2.8	29.7	0.8						
CFO (A\$m)	(1.5)	(5.4)	(2.3)	25.0	(20.1)						
Purchase of PP&E (A\$m)	(0.0)	(0.1)	(6.4)	(134.4)	(203.3)						
Exploration and other (A\$m)	(1.0)	(6.7)	(8.7)	(3.0)	-						
CFI (A\$m)	(1.0)	(6.8)	(15.1)	(137.4)	(203.3)						
Net share proceeds (A\$m)	5.1	14.0	94.0	-	-						
Debt proceeds (repayment) (A\$m)	-	-	-	271.1	-						
CCF (A\$m)	5.1	14.0	94.0	271.1	-						
Net change in cash (A\$m)	2.6	5.5	76.6	158.8	(223.4)						
Balance sheet (yr to Jun)	FY13A	FY14A	FY15E	FY16E	FY17E						
PP&E (A\$m)	0.1	0.1	6.3	140.7	344.0						
Exploration and other (A\$m)	24.2	39.7	49.0	52.0	52.0						
Total non-current assets (A\$m)	24.3	39.8	55.3	192.7	396.0						
Cash (A\$m)	6.2	11.6	87.8	246.6	23.1						
Inventory and AR (A\$m)	0.2	1.4	0.8	0.8	0.0						
Total current assets (A\$m)	6.4	13.0	88.6	247.4	23.1						
Total non-current liabilities (A\$m)	-	-	-	-	-						
AP, tax and provision (A\$m)	0.3	2.0	4.1	33.9	33.9						
Debt (US\$m)	-	-	-	271.1	271.1						
Current liabilities (A\$m)	0.3	2.0	4.1	305.0	305.0						
NET ASSETS (A\$m)	30	51	140	135	114						
Issued capital (A\$m)	21.0	34.8	133.1	133.1	133.1						
Accum'd profits & other (A\$m)	9.4	16.1	6.6	1.9	(19.0)						
TOTAL EQUITY (A\$m)	30	51	140	135	114						

Estimate share valuation				
	US\$m	NAVx	US\$m	A\$/sh
Muga	792	0.60	475	1.51
Muga salt	141	0.25	35	0.11
SDP	290	0.50	144.8	0.46
Pintano	-	-	-	-
Cash	96.0	0.60	58	0.18
Cash from options	19.9	0.60	12	0.04
Debt	-	0.60	-	-
SG&A and central costs	(62)	0.60	(37)	(0.12)
Valuation (fully diluted)	1,277	-	688	2.18

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	1.07	1.35	1.69	1.92	2.21
10% discount	1.42	1.76	2.18	2.46	2.81
8% discount	1.89	2.32	2.83	3.18	3.61
To NAVx @ 8%	US\$250	US\$275	US\$305	US\$325	US\$350
0.25xNAV	1.42	1.76	2.18	2.46	2.81
0.50xNAV	1.42	1.76	2.18	2.46	2.81
0.45xNAV	1.42	1.76	2.18	2.46	2.81

Source: GMP estimates, Company data

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