BELL POTTER

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Speculative
See key risks on Page 3. Speculative securities may not be suitable for retail clients

19 June 2017

Highfield Resources Ltd. (HFR)

Holding pattern

Recommendation
Hold (Buy)
Price
$0.99
Valuation (12 months)
$1.10 (previously $1.75)
Risk
Speculative

GICS Sector

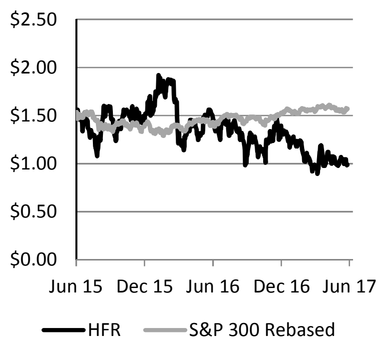
Materials

Expected Return	
Capital growth	**11.1%**
Dividend yield	**0%**
Total expected return	**11.1%**
Company Data & Ratios	
Enterprise value	**$305.2m**
Market cap	**$375.0m**
Issued capital	**378.8m**
Free float	**56%**
Avg. daily val. (52wk)	**$362,049**
12 month price range	**$0.85-$1.545**

Price Performance

	(1m)	(3m)	(12m)
Price (A$)	1.01	0.99	1.56
Absolute (%)	-1.49	0.51	-36.54
Rel market (%)	-0.74	-0.24	-47.79

Absolute Price



SOURCE: IRESS

Down the permitting rabbit-hole

We take the opportunity to update our assumptions for the development of HFR's Muga Potash Project in Spain. The project is going through the permitting process and has now been waiting for over 18 months for a declaration on the Environmental and Social Impact Assessment (ESIA) it submitted in November 2015. Following various information requests, extensions and responses by the company, HFR submitted a revised ESIA in April 2017, which we believe should receive a positive or negative declaration within 6 months of submission. Assuming a positive declaration, the Department of Mines can then consider awarding a Mining Concession to HFR, an important milestone for the commencement of construction.

Development timeline pushed back

The permitting process is always a risk in any jurisdiction and Spain has proven no different. Having said that, the progress vs expectations set by HFR has been disappointing. While we have left our broad project assumptions unchanged, we have pushed back our development timeline by ~2 years. With a positive environmental declaration possible by the end of CY17, our working assumption is for granting of a Mining Concession in early CY18, project financing and commencement of construction in 2HFY18, allowance for a 24 month construction and development period for achievement of first production in 2HFY20 (previously 2HFY18).

Investment thesis – Hold (Speculative), Valuation $1.10

While progress has been made on the permitting front and we have faith in the track record of experienced Managing Director, Peter Albert, uncertainty remains over the timing of project approvals. Together with our modelled cash flows being further delayed, resulting in an associated reduction of our NPV-based valuation to $1.10/sh, we lower our recommendation to Hold (Speculative). With ramp-up production only previously commencing at the end our forecast period (and now removed), our near-term earnings forecasts are unchanged.

Earnings Forecast

Year end 30 June	2016a	2017e	2018e	2019e
Sales (A$m)	-	-	-	-
EBITDA (A$m)	(13)	(13)	(18)	(9)
NPAT (reported) (A$m)	(11)	(10)	(16)	(12)
NPAT (adjusted) (A$m)	(11)	(10)	(16)	(12)
EPS (adjusted) (¢ps)	(0)	(0)	(0)	(0)
EPS growth (%)	na	na	na	na
PER (x)	(20.2)	(30.0)	(24.7)	(38.7)
FCF Yield (%)	-12%	-8%	-11%	-47%
EV/EBITDA (x)	(23.5)	(24.2)	(16.8)	(33.2)
Dividend (¢ps)	-	-	-	-
Yield (%)	0%	0%	0%	0%
Franking (%)	0%	0%	0%	0%
ROE (%)	-7%	-7%	-7%	-4%

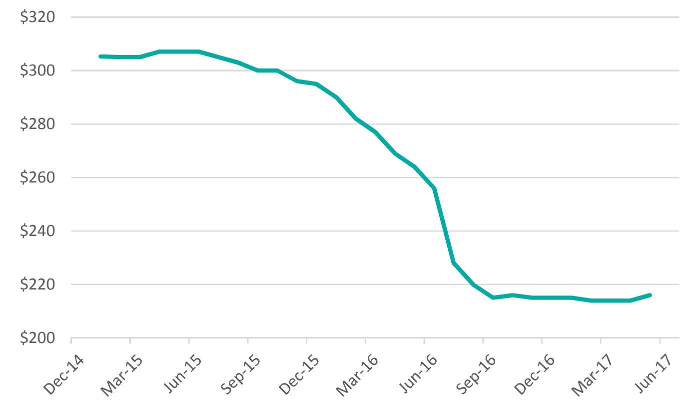
SOURCE: BELL POTTER SECURITIES ESTIMATES

Holding pattern

Down the permitting rabbit-hole

We take the opportunity to update our assumptions for the development of HFR's Muga Potash Project in Spain. The project is going through the permitting process and has now been waiting for over 18 months for a declaration on the Environmental and Social Impact Assessment (ESIA) it submitted in November 2015. Following various information requests, extensions and responses by the company, HFR submitted a revised ESIA in April 2017, which we believe should receive a positive or negative declaration within 6 months of submission. Assuming a positive declaration, the Department of Mines can consider awarding a Mining Concession to HFR, an important milestone for the commencement of construction. While we have left our broad project assumptions unchanged, we have pushed back our development timeline by ~2 years. With a positive environmental declaration possible by the end of CY17, our working assumption is for granting of a Mining Concession in early CY18, project financing and commencement of construction in 2HFY18, allowance for a 24 month construction and development period for achievement of first production in 2HFY20 (previously 2HFY18).

Figure 1 – Muriate of Potash (MOP) price – standard grade, FOB Vancouver spot (US$/t)



SOURCE: BLOOMBERG – WORLD BANK DATA

Changes to our valuation

We have made the following changes to our valuation, including:

- Pushing our development schedule, capital expenditure profile and production ramp-up assumptions out by approximately two years; and
- Updated our model for our latest FX and potash price assumptions, the current capital structure and latest equity raising assumptions.

Upcoming catalysts

HFR has several important catalysts approaching for its Muga Potash Project, including:

- Receipt of a positive environmental declaration from MAPAMA, the central environmental permitting authority;
- Granting of the mining concession for the Muga Project;
- Receipt of final credit approvals for the project finance facility;
- Execution of offtake agreements for Muga mine production; and
- Commencement of construction.

Highfield Resources Ltd (HFR)

Company description

HFR is progressing its 100% owned Muga-Vipasca project (Northern Spain) through financing and permitting for development in 2016. An optimised DFS, updated in November 2015, demonstrated the technical and financial viability of a 1.1Mtpa (K60) potash project, with a 47 year life-of-mine based solely on the on an Ore Reserve of 253Mt at 11.5% K_2O. Pre-production capital costs are estimated at €267m including a 6% contingency. Permitting and project financing are underway, with an expected construction and development period of 24 months once approvals are received.

Investment thesis – Hold (Speculative), Valuation $1.10

While progress has been made on the permitting front and we have faith in the track record of experienced Managing Director, Peter Albert, uncertainty remains over the timing of project approvals. Together with our modelled cash flows being further delayed and an associated reduction in our NPV-based valuation to $1.10/sh, we lower our recommendation to Hold (Speculative). With only ramp-up production previously falling at the end our forecast period (and now removed) we make no material earnings changes for the near-term.

Valuation – risked discounted cash flow of key projects

Our HFR valuation is based on the company's Muga project DFS and Sierra del Perdon scoping study. Our assumptions include:

- A more conservative potash price outlook of US$290/t, compared with HFR's estimates of around US$370/t (nominal).
- A 25% risk discount applied to the Muga NPV to take into account permitting and development risks. We will roll this discount off as permitting and development milestones are completed.
- A 80% risk discount applied to the Sierra del Perdon NPV to take into account resource, permitting and development risks. We will roll this discount off as permitting and development milestones are completed.

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 potash mining 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 exposed 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.

Highfield Resources Ltd.
as at 19 June 2017

Recommendation	Hold, Speculative
Price	$0.99
Target (12 months)	$1.10

Table 1 - Financial summary

PROFIT AND LOSS

Year ending June	Unit	2015a	2016a	2017e	2018e	2019e
Revenue	$m	-	-	-	-	-
Expense	$m	(10)	(13)	(13)	(18)	(9)
EBITDA	$m	**(10)**	**(13)**	**(13)**	**(18)**	**(9)**
Depreciation	$m	(0)	(0)	(0)	(0)	(0)
EBIT	$m	(10)	(13)	(13)	(18)	(9)
Net interest expense	$m	1	2	2	2	(3)
PBT	$m	**(9)**	**(11)**	**(10)**	**(16)**	**(12)**
Tax expense	$m	-	-	-	-	-
NPAT	**$m**	**(9)**	**(11)**	**(10)**	**(16)**	**(12)**

CASH FLOW

Year ending June	Unit	2015a	2016a	2017e	2018e	2019e
OPERATING CASHFLOW						
Receipts	$m	-	-	1	-	-
Payments	$m	(6)	(4)	(13)	(9)	(9)
Tax	$m	-	-	-	-	-
Net interest	$m	1	2	2	2	(3)
Other	$m	2	1	-	-	-
Operating cash flow	$m	**(4)**	**(1)**	**(10)**	**(7)**	**(12)**
INVESTING CASHFLOW						
Capex	$m	(0)	(0)	-	(29)	(203)
Exploration & evaluation	$m	(9)	(24)	(15)	(8)	(8)
Other	$m	(4)	(1)	(10)	(7)	(12)
Investing cash flow	$m	**(13)**	**(25)**	**(25)**	**(44)**	**(223)**
FINANCING CASHFLOW						
Share issues/(buy-backs)	$m	120	0	-	190	-
Debt proceeds/(repayments)	$m	-	-	-	350	-
Dividends	$m	-	-	-	-	-
Other	$m	-	-	-	-	-
Financing cash flow	$m	**120**	**0**	**-**	**540**	**-**
Change in cash	$m	107	(25)	(25)	496	(223)

BALANCE SHEET

Year ending June	Unit	2015a	2016a	2017e	2018e	2019e
ASSETS						
Cash & short term investments	$m	119	94	68	565	342
Accounts receivable	$m	2	1	-	-	-
Property, plant & equipment	$m	0	0	0	29	232
Exploration & evaluation	$m	44	63	78	86	94
Other	$m	4	-	-	-	-
Total assets	$m	**169**	**158**	**147**	**680**	**668**
LIABILITIES						
Accounts payable	$m	1	3	3	2	2
Borrowings	$m	-	-	-	350	350
Other	$m	2	1	0	0	0
Total liabilities	$m	**3**	**4**	**3**	**352**	**352**
SHAREHOLDER'S EQUITY						
Share capital	$m	166	166	166	366	366
Reserves	$m	19	18	18	18	18
Retained earnings	$m	(19)	(29)	(40)	(56)	(68)
Total equity	$m	**166**	**154**	**144**	**328**	**316**
Weighted average shares	m	215	216	311	394	477

CAPITAL STRUCTURE

Shares on issue	m	328.8
Performance shares	m	50.0
Total shares on issue	**m**	**378.8**
Share price	**$/sh**	**0.99**
Market capitalisation	$m	375.0
Net cash	$m	69.8
Enterprise value (undiluted)	**$m**	**305.2**
Options (in the money)	m	13.4
Issued shares (diluted for options)	m	392.2
Market capitalisation (diluted)	m	388.3
Net cash + options	$m	79.7
Enterprise value (diluted)	**$m**	**308.5**

MAJOR SHAREHOLDERS

	%	m
EMR Capital	27%	104.0
Spanish in-country management	11%	41.7
Australian based management	6%	22.7
Other shareholders	56%	210.4
Total	**100%**	**378.8**

FINANCIAL RATIOS

Year ending June	Unit	2015a	2016a	2017e	2018e	2019e
VALUATION						
NPAT	$m	(9)	(11)	(10)	(16)	(12)
Reported EPS	c/sh	(0)	(0)	(0)	(0)	(0)
EPS growth	%	na	na	na	na	na
PER	x	-22.6x	-20.2x	-30.0x	-24.7x	-38.7x
DPS	c/sh	-	-	-	-	-
Franking	%	0%	0%	0%	0%	0%
Yield	%	0%	0%	0%	0%	0%
FCF/share	c/sh	(0)	(0)	(0)	(0)	(0)
P/FCFPS	x	-16.4x	-8.5x	-12.1x	-8.9x	-2.1x
EV/EBITDA	x	-29.7x	-23.5x	-24.2x	-16.8x	-33.2x
EBITDA margin	%	0%	0%	0%	0%	0%
EBIT margin	%	0%	0%	0%	0%	0%
Return on assets	%	-8%	-6%	-7%	-4%	-2%
Return on equity	%	-9%	-7%	-7%	-7%	-4%
LIQUIDITY & LEVERAGE						
Net debt (cash)	$m	(119)	(94)	(68)	(215)	8
ND / E	%	-71%	-61%	-47%	-65%	2%
ND / (ND + E)	%	-250%	-155%	-90%	-189%	2%
EBITDA / Interest	x	-11.9x	-5.4x	-5.4x	-7.6x	3.1x

RESOURCE

Javier-Vipasca	Mt	K2O %	KCl %	K2O Mt	KCl 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
High grade resource	**154**	**12.9**	**20.5**	**19.9**	**31.6**
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

PROJECT ASSUMPTIONS

Year ending June		Yr 0	Yr 1	Yr 2	Yr 3	Yr 4
Currency	US$/A$	0.75	0.75	0.75	0.75	0.75
Potash FOB Vancouver (MOP/KCL)	US$/t	290	290	290	290	297
Potash price realised (FOB Spain)	US$/t	305	307	307	308	316
Project CAPEX	US$m	(22)	(152)	(132)	(134)	(4)
C1 costs	US$/t	138	142	145	149	153
Project EBITDA	US$m	0	0	49	86	109
Mined / milled	Mt	-	-	1.8	3.3	4.0
Grade	%	12%	12%	12%	12%	12%
Recovery	%	87%	87%	87%	87%	87%
Product grade	%	60%	60%	60%	60%	60%
Production (MOP / K60)	**kt**	**0**	**0**	**300**	**544**	**667**

VALUATION

Ordinary shares m	328.8
Performance shares m	50.0
Options in the money m	45.6
Diluted m	**424.4**
Equity raising assumption (m)	202.7
Total shares out (m)	**627.2**

	$m	$/sh
Muga (risk discount 25%, NPV10)	531.7	1.40
SdPerdon (risk discount 80%, NPV10)	35.4	0.09
Corporate overheads	(160.0)	(0.42)
Sub total	407.1	1.07
Cash & options	79.7	0.19
Diluted	**486.9**	**1.15**
Equity raise assumption	202.7	0.32
Total	**689.6**	**1.10**

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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