Highfield Resources Ltd (HFR.ASX)

Revised DFS brings minor changes but enhances confidence

Event:

- **Revised DFS; PT change.**

Investment Highlights:

- **Updated Muga DFS only had minor changes to key metrics, with NPV €1.89b and IRR 25% (-4% and 0% vs 2019 DFS)**. The DFS revision was prompted by further derisking of Muga, post the grant of mine licence and ahead of finalising financing and requisite due diligence. At full production the DFS stated Muga could deliver EBITDA of €400M p.a.
- **Lower average LOM potash production by -9% (917ktpa vs 1,300ktpa)** was major reason for lower NPV due to both lower recovery (91% vs 94% prior) and K_2O grade (10.5% vs 10.7%). There was also a rise in capex (up 5%), a reduction in potash production (-9%) and decline in C1 costs (-7%).
- **Quality of Muga Mining Inventory improved, even though contained K_2O declined.** The inventory now contains less proportion of Exploration Target and Inferred Resources as part of the total (33% vs 44%) and higher Reserves and Measured and Indicated (67% vs 56%). This should improve confidence in the projects DFS. Project life remains unchanged at 30 years.
- **Stage 1 capex has increased by €30M to €398M**. However 86% of estimate is now based on signed contracts (mostly for process plant equipment), firm offers, and updated prices vs 59% for 2019 DFS, improving confidence in the figure. Phase 2 capex is up only €1M to €209M.
- **C1 cost reduced to €76/t from €82/t,** with higher salt credits offsetting higher mining and processing costs, keeping the project's position in lowest quartile of the MoP margin curve. Salt prices assumed are now €36/t for de-icing and €55/t for vacuum, based on Argus, vs €27/t and ca. €40/t previously.
- **Construction expected to start 1HCY22.** Key preparatory steps remain construction contract; procurement of long-lead items; award of local town hall construction licenses; and finalisation of debt package. HFR states that following feedback on a draft term sheet by potential lending syndicate, it is targeting debt of around €300M, compared to €185M previously in 2017. The increase is a function of the derisking of Muga with updated studies, regulatory approvals, and positive potash markets.

Earnings and Valuation:

- **Our risked share valuation (0.4x NPV_{10}) of HFR reduces to $1.43 from $1.56 previously**. This is due to reduction in Muga MoP production, higher capex, and lower valuation of Sierra del Perdon project, offset partially by higher salt credits and less dilutive equity raising, as we now assume 2/3 debt: 1/3 equity financing vs 50:50 previously. Our risked valuation assumes equity raised near current shareprice, while unrisked valuation of $3.48 (1.0x NPV_{10}) assumes equity raised without dilution.

Recommendation:

- **We maintain our Buy recommendation and reduce our 12-month share price target to $1.43 from $1.56 based on our risked valuation.**
- **Catalysts for the share price include:** 1) Finalisation of financing; 2) Award of town hall construction licenses; 3) FID; and 4) Commencement of construction.

Disclosures

The analyst owns 33,607 HFR shares.
Foster Stockbroking and associated entities (excluding Cranport Pty Ltd) own 645,217 HFR shares.
Cranport Pty Ltd owns 1,542,271 HFR shares.
Refer details end of report.
Foster Stockbroking acted as Joint Lead Manager to the $15M placement of 28.8M HFR shares at $0.52 in August 2021, and received fees for the service.

Recommendation	Buy
Previous	Buy
Risk	High
Price Target	**$1.43**
Previous	$1.56
Share price (A$)	**$ 0.58**
ASX code	HFR
52 week low-high	$0.425-$0.885
Valuation - risked (A$/share)	**$ 1.43**
Methodology	risked NPV
Capital structure	
Shares on Issue (M)	364
Market cap (A$M)	211
Net cash (debt) (A$M)	27
Options (M)	25
Diluted EV (A$M)	199
Ave daily volume ('000)	211

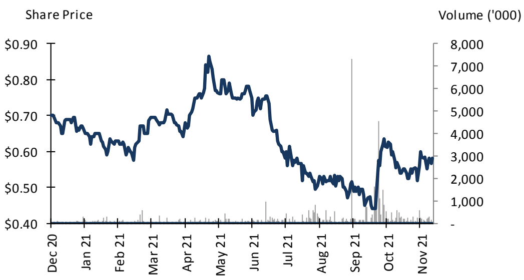
Earnings y/e Dec A$M	FY20a	FY21e	FY22e	FY23e
Sales	0	0	0	0
EBITDA adj	-6	-6	-6	-7
NPAT reported	-24	-6	-6	-5
NPAT adj	**-6**	**-6**	**-6**	**-5**
EPS adj. $*	**-0.02**	**-0.02**	**-0.01**	**-0.01**

** Adj =underlying*

Substantial shareholders	
EMR Capital Investment (No.2) Pte Ltd	29%
WWB Investments Pty Ltd	10%
BCI Minerals	7%
Australian Super Pty Ltd	7%

Board	
Richard Crookes	Non-Executive Chairman
Ignacio Salazar	Managing Director
Pauline Carr	Non-Executive Director
Roger Davey	Non-Executive Director
Brian Jamieson	Non-Executive Director

Share price graph



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Highfield Resources (HFR)

Full Year Ended 31 December

Profit and Loss A$M	2020a	2021e	2022e	2023e
Revenue	0	0	0	0
Operating costs adj.	6	6	6	7
EBITDA adj.	**-6**	**-6**	**-6**	**-7**
D&A	0	0	0	0
EBIT adj.	**-6**	**-6**	**-6**	**-7**
Net Interest exp / (income)	0	0	-1	-2
PBT adj.	**-6**	**-6**	**-6**	**-5**
Tax exp / (benefit) adj.	0	0	0	0
NPAT adj.	**-6**	**-6**	**-6**	**-5**
Non-recurring items	-18	0	0	0
NPAT reported	**-24**	**-6**	**-6**	**-5**
EPS diluted adj. ($)	**-0.02**	**-0.02**	**-0.01**	**-0.01**
Wtd ave share diluted (M)	330	368	785	785

Cashflow A$M	2020a	2021e	2022e	2023e
EBITDA adj.	-6	-6	-6	-7
Change in WC	1	0	0	0
Net interest	0	0	1	2
Tax	0	0	0	0
Share based expense	2	2	2	2
Other	0	0	0	0
Operating Cashflow	**-3**	**-4**	**-4**	**-2**
Purchase of PP&E	0	0	-153	-313
Acquisitions	0	0	0	0
Capitalised expenses	-17	0	0	0
Investments	0	0	0	0
Other	0	0	0	0
Investing Cashflow	**-17**	**0**	**-153**	**-313**
Equity issue	0	19	216	0
Debt proceeds	0	0	0	438
Debt repayments	0	0	0	0
Other	0	0	0	0
Financing Cashflow	**0**	**19**	**216**	**438**
Net Cashflow	**-20**	**15**	**59**	**122**

Balance Sheet A$M	2020a	2021e	2022e	2023e
Cash	20	35	94	217
Receivables	1	1	1	1
Inventories	0	0	0	0
PPE	0	0	153	466
Capitalised expl'n	112	112	112	112
Intangibles	0	0	0	0
Other	0	4	2	0
Total Assets	**133**	**152**	**362**	**796**
Accounts payable	5	5	5	5
Provisions	0	0	0	0
Debt	0	0	0	438
Other	0	6	6	6
Total Liabilities	**5**	**10**	**10**	**449**
Capital & reserves	202	221	437	437
Retained earnings	-73	-79	-85	-90
Total Equity	**129**	**142**	**352**	**347**

Valaution Multiples	2020a	2021e	2022e	2023e
P/E x	nm	nm	nm	nm
EV/EBITDA x	nm	nm	nm	nm

Company Valuation

DCF, WACC 10% nominal

Segment	Unrisked A$M	Unrisked A$/sh	Risked A$M	Risked A$/sh
Muga	926	$2.07	741	$0.98
Sierra del Perdon	370	$0.83	111	$0.15
Pintano	60	$0.13	18	$0.02
Corporate	-55	-$0.12	-44	-$0.06
Future equity	216	$0.48	216	$0.28
Options in-money-at val'n	16	$0.04	16	$0.02
Net cash	27	$0.06	27	$0.03
Total	**1,559**	**$3.48**	**1,084**	**$1.43**
Shares now M	364		364	
Future equity M	62	issued at val	372	issued at s'price
Options-in-money at val'n M	22		22	
Fully diluted shares M	**448**		**758**	

Commodity Assumptions		2020a	2021e	2022e	2023e
Prices:					
Potash, MoP, Europe FOB	US$/t	265	385	313	312
Salt vacuum	US$/t	64	65	65	68
Salt de-icing	US$/t	36	42	43	44
A$	US$	0.69	0.76	0.75	0.75
Euro	US$	1.14	1.19	1.15	1.18
Shipments:					
Potash, MoP	kt	0	0	0	0
Salt	kt	0	0	0	0
AISC	US$/t	-	-	-	-

Resources	Ore Mt	K_2O%	K_2O Mt
Muga	282	11.8%	33
Sierra del Perdon	82.1	10.6%	9
Pintano	71	11.9%	8
Total	**435**	**11.6%**	**50**

Reserves	Ore Mt	K_2O%	K_2O Mt
Muga	104	10.2%	11

Capital structure	M
Ordinary shares	364
Options	25
Fully diluted	**389**

Source: Company; Foster Stockbroking estimates

UPDATED MUGA DFS PROVIDES GREATER CONFIDENCE

Minor changes to NPV and IRR

- Highfield resources (HFR) released an updated DFS for Muga, updating the previous study from over two years ago in October 2019. As shown in Figure 1, the key metrics – NPV and IRR – only had minor changes of -4% and 0% respectively. Meanwhile there was some modest lift in capex (up 5%), a reduction in potash production (-9%) and decline in C1 costs (-7%). Project life remains unchanged at 30 years.
- The DFS revision was prompted by further derisking of Muga, post the grant of mine licence and ahead of finalising financing and requisite due diligence. The DFS stated that Muga at full production can deliver EBITDA of €400M p.a.

Figure 1: Muga Updated December 2021 DFS

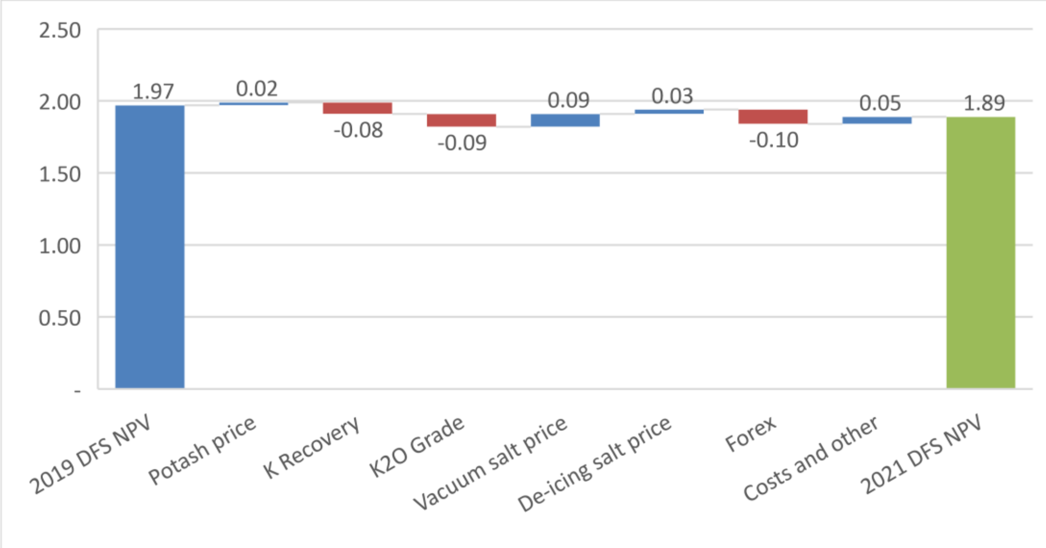
Item	Unit	Oct 2019	Dec 2021	*Chng*
Costs:				
Capex pre-production (Stage 1)	€M	368	398	*8%*
Capex Stage 1+2 (ex-sustaining)	**€M**	**576**	**607**	***5%***
C1	**€/t**	**82**	**76**	***-7%***
Production:				
LOM	yrs	30	30	*0%*
Ore processed LOM average	Mtpa	6.0	5.8	*-3%*
Production potash K60 granular LOM ave.	**Mtpa**	**1.003**	**0.917**	***-9%***
K recovery	%	94%	91%	*-3%*
Head grade K_2O	%	10.7%	10.5%	*-2%*
Vacuum salt production	ktpa	507	530	*5%*
De-icing salt production	ktpa	380	283	*-25%*
Financials:				
IRR_8 post-tax	%	25%	25%	*0%*
NPV_8 post-tax	**€M**	**1,970**	**1,890**	***-4%***
"	**US$M**	**2,140**	**2,120**	***-1%***
Potash price LOM	€/t	438	440	*0%*
"	US$/t	477	493	*3%*
Euro:USD		1.09	1.12	*3%*
Tax rate Navarra	%	28%	28%	*0%*

Source: Company; Foster Stockbroking estimates.

Reduced potash production the major impact

- The major factor for the lower NPV was lower average LOM potash production: to 917ktpa from 1,300ktpa, due to both lower recovery (91% vs 94% prior) and K_2O grade (10.5% vs 10.7%). Together grade and recovery impacted NPV by -€0.17b. Other impacts on NPV are shown in Figure 2.
- The lower head grade arose from the recent revised Mining Inventory for Muga. This resulted in an 8% decline in contained K_2O due to both lower ore and grade (Figure 3). There was also a reduction in contained K_2O from Inferred Resources and Exploration Target used in the DFS inventory. This was due to the drilling undertaken since the prior DFS and Reserves, input from Spanish mining engineering consultants IGAN Consulting Group, as well as the award of mining licence which imposed restrictions on areas that could be mined.

Figure 2: Muga DFS NPV Delta 2021 vs 2019, €b



Source: Company.

Figure 3: Change in Muga DFS Mine Inventory

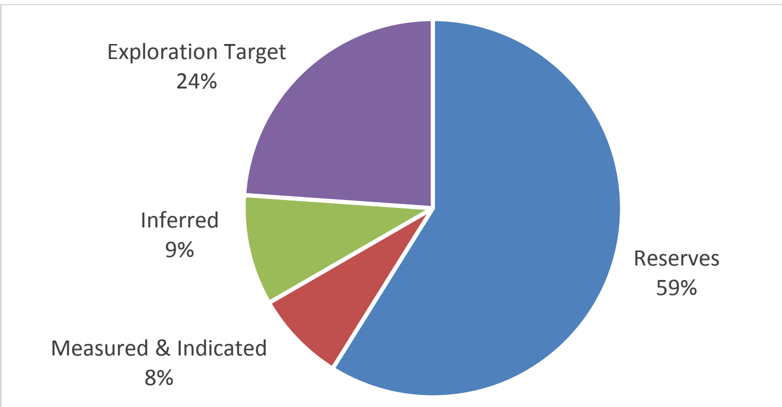
Inventory	Ore Mt	Old Grade K_2O	Cont K_2O kt	Ore Mt	New Grade K_2O	Cont. K_2O kt	Chng in grade	Chng in cont K_2O
Reserves	109.0	10.2%	11.1	104.3	10.2%	10.6	0%	-4%
Measured & Indicated	0.0	-	0.0	11.0	12.9%	1.4	nm	nm
Inferred	22.0	10.3%	2.3	16.0	10.8%	1.7	5%	-24%
Exploration Target	49.0	12.8%	6.3	43.0	10.0%	4.3	-22%	-31%
Total	**180.0**	**10.9%**	**19.7**	**174.3**	**10.4%**	**18.1**	**-5%**	**-8%**

Source: Company; Foster Stockbroking estimates.

Quality of inventory improves

- While the Mining Inventory's contained K_2O declined, the quality of the inventory improved, with less proportion of Exploration Target and Inferred Resources as part of total inventory than before (33% vs 44%) and higher Reserves and Measured and Indicated (67% vs 56%). This should improve confidence in the projects DFS.

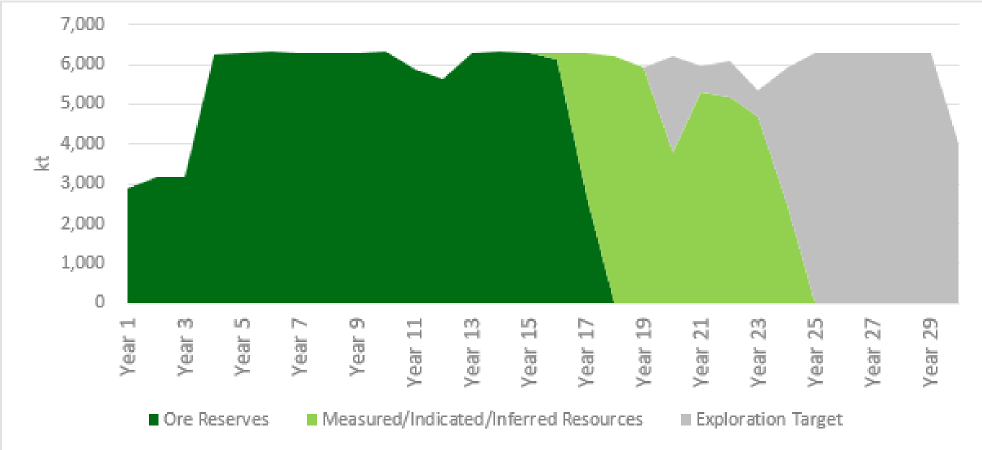
Figure 4: Muga DFS Mine Inventory



Source: Company; Foster Stockbroking estimates.

- As per the previous DFS, the mine plan in initial 18 years is based on Reserves, followed sequentially by Measured, Indicated, and Inferred, and then the Exploration Target. Maximum ore processed is approximately same as before (6.2Mtpa) to deliver circa 1Mtpa product.

Figure 5: Muga Mine Plan Schedule by Ore Classification



Source: Company.

- HFR notes the Measured and Indicated included refer to pillars in exclusion zones under towns, but that these could be potentially mined if backfilling demonstrates by that time that it provides enough support and no surface impact.

Capex increases, but so has confidence

- Stage 1 capex has increased from by €30M to €398M, mostly due to increase in process plant capex and preliminaries, unsurprisingly due to cost inflation. 86% of total Stage 1 capex is now based on signed contracts (mostly for process plant equipment), firm offers, and updated prices vs 59% in the 2019 study, improving confidence the figure. Phase 2 capex has hardly changed – up only €1M to €209M.

Figure 6: Source of DFS capex costs

Source	DFS 2019	DFS 2021
Signed contracts	0%	17%
Frim offer	47%	41%
Estimated with measured quantities & current prices	12%	28%
Estimated by designer	41%	14%
All	**100%**	**100%**

Source: Company.

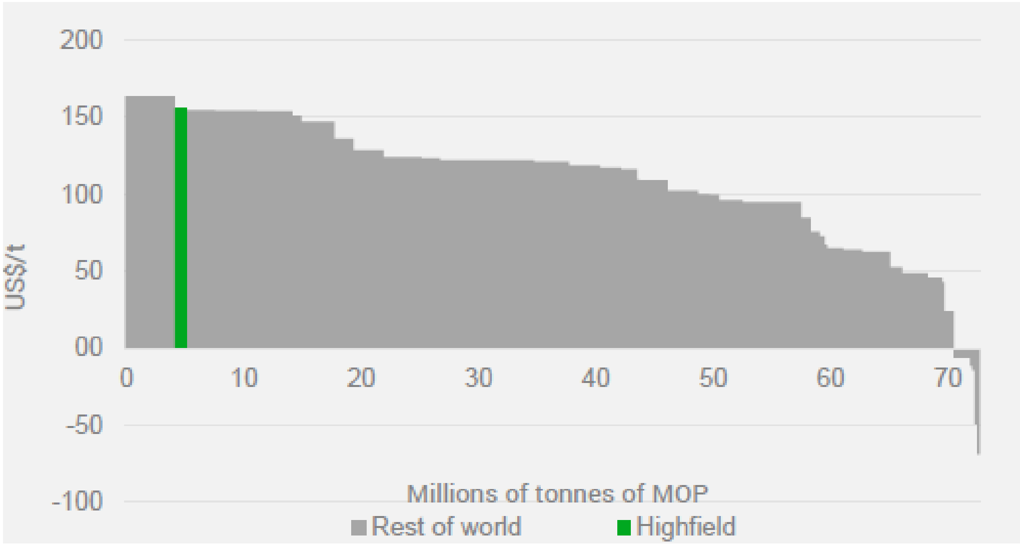
Mining and processing approach little changed

- Mining method is little changed from 2019, while there are minor adjustments to processing. This includes updated leaching efficiency on coarse particles based on test by KUTEC Engineering (Germany), and confirmed by GEA Engineering, that crystalliser product grades are 98% KCl and 99.8% for vacuum salt. Cooling towers have also been introduced to ensure optimal performance of the crystalliser independent of climate. With the updates and further test data, a new recovery of 91% K was estimated vs the 94% previously. Product will have grade >95% KCl, the standard required for fertiliser grade MoP (K60).

Costs improve with higher salt credit

- Muga's C1 cost reduced to €76/t from €82/t, mostly due to a higher salt credit offsetting higher mining and processing costs. Salt prices assumed are now €36/t for de-icing and €55/t for vacuum, based on Argus, vs €27/t and ca. €40/t previously.

Figure 7: 2024 MoP Margin Cost Curve (Real)



Source: Company; CRU; Argus.

Sensitivity at spot potash prices

- Potash prices were hardly changed in DFS, still based on CRU forecasts. The company stated that using current real flat spot potash price results in post-tax NPV_8 of €2.8b and 42% IRR, showing the significant upside inherent at Muga. Current spot prices include €575/t for Europe CIF and US$800/ Brazil CIF. Assuming a 75:25 blend of Europe:Brazil sales by Muga, this implies approximately a weighted average spot price of US$750/t, or €665/t.

Figure 8: Muga DFS sensitivity to Spot Potash

Parameter	Unit	Base case	Spot case	Chng
Potash price	€/t	440	Spot*	n/a
Post-tax NPV_8	€b	1.89	2.8	48%
IRR	%	25%	42%	68%

*Source: Company. *Not disclosed by HFR. Foster Stockbroking assumes wtd ave spot of €665/t.*

- Market strategy is unchanged, HFR targeting 50% of Stage 1 and Stage 2 product to regional and local European markets (mostly Spain and France), 25% into northern Europe, and 25% to export (we assume mostly Brazil and to lesser extent USA).

TIMETABLE

Construction expected to start 1HCY22

- HFR still assumes project will commence construction in 1H CY2022, following key preparatory steps. These are:
    - **Agreement on construction contract.** This is being negotiated with Spanish company Acciona, the preferred construction contractor.

- **Successful procurement of long-lead items.** Includes starting construction of bolter miner.
- **Award of local town hall construction licenses.** These are pending from the town halls of Sanguesa (Navarra) and Undue (Aragon), the two towns closet to mine site. Licences from the water authorities are also required.
- **Finalisation of debt package.** The company stated that following feedback on a draft term sheet by potential lending syndicate, it is targeting debt size of around €300M, compared to €185M previously in 2017. This increase has been a function of the derisking of Muga with updated studies, regulatory approvals, and positive potash markets. HFR has also engaged with strategic investors who have shown interest in Muga, given its attractive world class characteristics. These are at early stage.

- If construction commences mid-CY2022, we expect with the two-year construction time-frame that first potash from Muga will be produced in mid-CY2024**.**

COMMODITY PRICE FORECASTS

Salt prices upgraded

- The major change to our commodity forecasts is an upgrade to our salt prices, especially that for vacuum salt. Previously we conservatively modelled all Muga's salt to be priced similar to that for de-icing. However we now base our forecasts on the assumptions used by HFR, which in turn are based on Argus Media industry analysis. Our de-icing salt forecasts have also lifted. Meanwhile our long-term potash and currency forecast are unchanged, while we have marked-to-market FY21 potash price.

Figure 9: Commodity Revisions, nominal

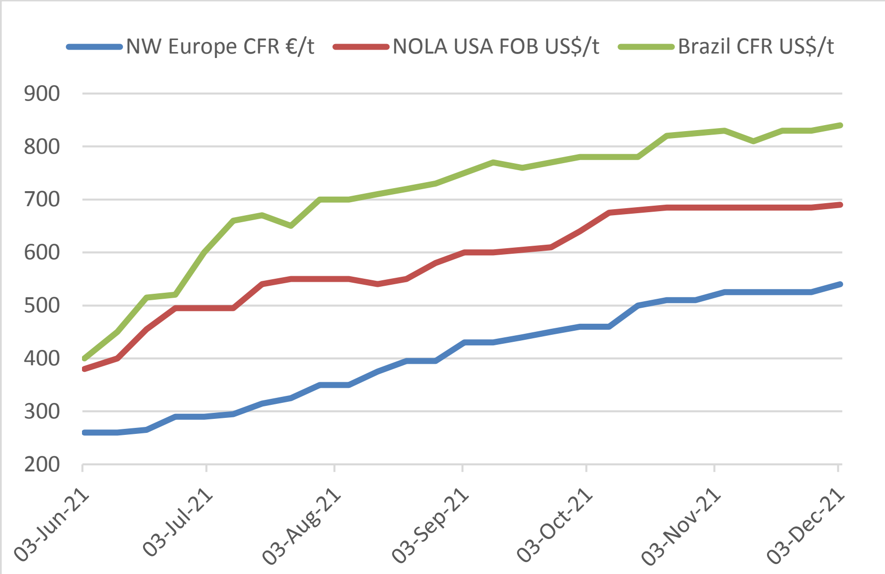
Commodity		FY20a	FY21e	FY22e	FY23e	FY24e	LT
Potash MoP fob, US$/t	**New**	**265**	**385**	**313**	**312**	**322**	**319**
	Old	*265*	*343*	*313*	*312*	*322*	*319*
	Chng	*0%*	*12%*	*0%*	*0%*	*0%*	*0%*
Vacuum salt fob, US$/t	**New**	**64**	**65**	**65**	**68**	**71**	**73**
	Old	36	33	33	34	35	35
	Chng	*77%*	*98%*	*94%*	*99%*	*104%*	*105%*
De-icing salt fob, US$/t	**New**	**36**	**42**	**43**	**44**	**46**	**47**
	Old	36	33	33	34	35	35
	Chng	*0%*	*26%*	*29%*	*30%*	*32%*	*34%*
€:US$	**New**	**1.14**	**1.19**	**1.15**	**1.18**	**1.21**	**1.22**
	Old	*1.14*	*1.19*	*1.18*	*1.21*	*1.22*	*1.22*
	Chng	*0%*	*0%*	*-3%*	*-2%*	*-1%*	*0%*
US$:A$	**New**	**0.69**	**0.76**	**0.75**	**0.75**	**0.74**	**0.74**
	Old	*0.69*	*0.77*	*0.76*	*0.76*	*0.75*	*0.74*
	Chng	*0%*	*-1%*	*-1%*	*-1%*	*-1%*	*0%*

Source: Foster Stockbroking estimates.

Spot prices remain above our forecast

- Potash markets remain strong, with MoP prices recently as high as US$840/t CFR Brazil and €540/t (US$610/t) North-West Europe CFR. We believe this represents upside risk to our price forecasts.

Figure 10: Regional MoP Potash Prices



Source: Bloomberg.

VALUATION

We value HFR $1.43 by risked NPV_{10}

- Our risked share valuation of HFR reduces to $1.43 from $1.56 (0.4x NPV_{10})previously. This is due to reduction in Muga's MoP production, higher capex, and lower valuation of Sierra del Perdon project due to licence extension risk, offset partially by higher salt credits and less dilutive equity raising, as we now assume 2/3 debt: 1/3 equity financing vs 50:50 previously. Our risked valuation assumes equity raised near current share price, while unrisked valuation of $3.48 assumes equity raised without dilution.

Figure 11: HFR Valuation NPV_{10}

Segment	Unrisked A$M	A$/share	Risked A$M	A$/share	Risk Factor
Muga	926	$2.07	741	$0.98	80%
Sierra del Perdon	370	$0.83	111	$0.15	30%
Pintano	60	$0.13	18	$0.02	30%
Corporate	-55	-$0.12	-44	-$0.06	80%
Future equity	216	$0.48	216	$0.28	100%
Options in-money-at val	16	$0.04	16	$0.02	100%
Net cash	27	$0.06	27	$0.03	100%
Total	**1,559**	**$3.48**	**1,084**	**$1.43**	**41%**
Shares now M	364		364		
Future equity M	62	Issued at val	372	Issued at current sprice	
Options-in-money at val M	22		22		
Fully diluted shares M	**448**		**758**		

Source; Foster Stockbroking estimates.

- Our unrisked Muga valuation of A$926M is lower than that of DFS' A$2.86b due to: 1) Higher WACC (10% vs 8%); 2) Lower LOM potash price assumption (US$319/t vs US$493/t); and higher LT Euro (1.22 vs 1.12). The lower forecast potash and high Euro is reason for our Muga EBITDA at maximum production being around €170M vs DFS' €400M.

RECOMMENDATION

Maintain Buy, 12-month PT $1.43

- We maintain our Buy on HFR with revised 12-month price target of $1.43, in-line with risked valuation (0.4x NPV_{10}) vs $1.56 previously.
- Key catalysts for stock are finalisation of debt, construction contractor package, award of town hall construction licenses, and Muga FID.

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