

Kidman Resources (KDR) Lithium Valuation – Opportunity In News Flow

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Key Points

- We have positively revised (+96%) our valuation and price target for KDR, with the inclusion of potential lithium concentrate production into our risked NAV based price target.
- KDR are well down the track to defining potentially one of Australia's largest hard rock lithium projects. The drilling has progressed rapidly. Now we await news on the maiden resource, metallurgy results and plant access agreement, to start de-risking the project. The risk level remains high but there is the potential for value add news flow in the short term.
- **We maintain a Buy Recommendation with a revised price target of \$0.96/sh (previous \$0.50/sh), 75% upside to current share price. Our unrisked NAV increases to \$505m (\$1.61/sh).**

Earl Grey Potential Grows

- **Rapid Progress:** We recently visited the Mt Holland Project (Western Australia) and observed a large amount of work in progress and undertaken since we last visited the project in early August. The drilling that will feed into the maiden resource has been completed. Drilling is continuing, with the results likely to expand the maiden resource and also increase the JORC classification.
- Latest drilling results from Earl Grey show that the potential for the project continue to deliver a significant hard rock lithium project. KDR has announced the extension of the Earl Grey pegmatite to a "down dip" length now of 1.9km, that remains open in a number of directions.
- In valuing the Earl Grey lithium potential we have modelled a potential operation producing a 6% Spodumene concentrate, utilising the Poseidon Nickel (POS) Lake Johnston plant. Assumed mining rate is 1.5mtpa of ore producing ~250ktpa of concentrate for sale. Operating costs are assumed at ~A\$350/t FOB and sales at US\$500/t. (A\$667/t). As the Earl Grey prospect is located on a granted Mining Lease we anticipate feasibilities to be completed by mid CY17, construction in 2HCY17 and first production in early CY18.

Catalysts: strong news flow over the next few months is planned, including;

- Ongoing assay results from the lithium drilling
- Metallurgical test work results – expected late CY16-early CY17.
- Maiden lithium resource – expected in December 2016
- Drilling results from Prince of Wales prospect
- Agreement with Poseidon Nickel on utilising the Lake Johnston plant.

Recommendation

Buy

Previous Recommendation	Buy
Risk Rating	Very High
Current Share Price	\$0.53
12 Month Price Target	\$0.96 (previous \$0.50)
Price Target Methodology	Risked NAV
Total Return (Capital + Yield)	84%
NAV Valuation	\$0.96/sh
Market capitalisation	\$166m
Liquidity – Daily Value	\$1.5m

Investment Summary

The recent pull back in the KDR share price after a rapid rise in part can be attributed to an unwinding of the short Pilbara Minerals (PLS) and long KDR position taken by a number of traders, plus also speculative investors exiting. We now see a good time to accumulate ahead of a number of key, potential company making, announcements. Namely a maiden lithium resource and development details.

Financial Forecasts & Valuation Metrics

	FY17E	FY18E	FY19E	FY20E
Revenue	0	71	245	256
NPAT	-3.5	14.5	62.1	67.3
EPS (cps)	-1.0	3.6	15.3	16.6
EPS Growth	0.7	>100%	>100%	0.1
DPS (c)	0.0	0.0	6.1	6.6
EV / EBITDA (x)	-70.6	10.3	2.2	1.6
PER (x)	-51.0	14.8	3.5	3.2
Dividend Yield	0.0	0.0	11.6	12.5
Gearing	-190.5	751.8	63.9	-34.2
Interest Cover (x)	-4.8	12.8	36.5	55.9

Source: PAC Partners estimates

Previous Research

Previous Research:

- Initiation: [KDR Initiation May 2016](#),
- Update: [KDR Drilling 10 May 2016](#),
- Update: [KDR 19 May 2016 PAC Partners](#)
- Update: [KDR 23 May 2016 PAC Partners](#)
- Update: [KDR 20 June 2016 PAC Partners](#)
- Update: [KDR 18 July 2016 PAC Partners](#)

Earl Grey Rapidly Progressing

Maiden lithium resource keenly anticipated

Since the identification of lithium bearing pegmatites at the Mt Holland tenement KDR has gone on to undertake a large drill programme, currently continuing, with the aim a defining a maiden resource late in CY17. In conjunction KDR has commenced key metallurgical test work along with environmental studies, with the aim of rapidly advancing the Earl Grey Project to production status.

Resource, how big?

Ever since the first drilling results were released by KDR at Earl Grey there has been speculation in the market place as to what the resource at Earl Grey will be, with numbers between 80-120Mt touted. If the resource comes in within this range then this will place it as one of the largest hard rock lithium resources in Australia.

Market speculation of a 80-120Mt resource.

We see that a resource in this range as possible based on the results released to date. Whilst a circa 100Mt resource is significant it is worth remembering that at a mining rate of 1.5-2.0Mtpa this would put a potential mine life of decades. In our modelling we have assumed ~24Mt mined over a 16 year mine life.

Size not everything!

We are encouraged that KDR has put a line in the sand for the current drilling with respect to expanding the overall mineralised area and is instead focussing on closing in the drill spacing to define a resource that can allow feasibility studies to be completed.

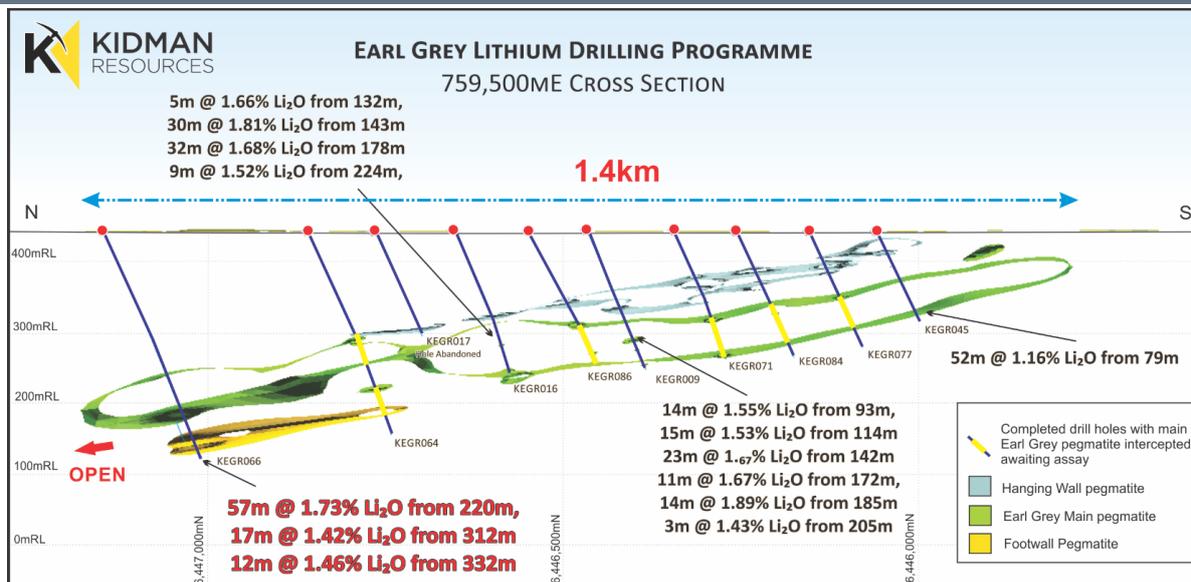
There is little value to be gained by getting the bragging rights to the biggest deposit, with more value for shareholders is in getting a Reserve and then into production quickly.

The reporting of small amounts of pegmatite material at surface had led to an interpretation that a conceptual starter pit would be into lithium bearing pegmatites from the start. It now appears that there is a number of smaller pegmatites that are coincident with the main pegmatite and positioned above the main vein. These smaller veins are not insignificant as they are ~5-10m thick.

Surface lithium grades unknown at this stage

Also during our recent site visit we observed weathering of the pegmatite within ~30m of the surface, what is uncertain at this stage is if the weathering reduces the grade of lithium in the pegmatite. Our assumption is that it will and that a pre-strip will be required of either barren or low grade material prior to accessing the main lithium mineralisation. If this assumption is correct then a modest amount of working capital will be required.

Earl Grey Cross Section



Source Company Report

Permitting underway

In addition to the drilling and resource work KDR is currently updating the environmental studies at Earl Grey to feed into the permitting process.

Drilling to demonstrate the potential scale, but remaining focused on the near term

KDR has identified a number of other pegmatites on their Mt Holland tenements and is undertaking drilling on three priority targets. The purpose of the drilling is to determine the lithium potential and at this stage not undertake resource definition drilling.

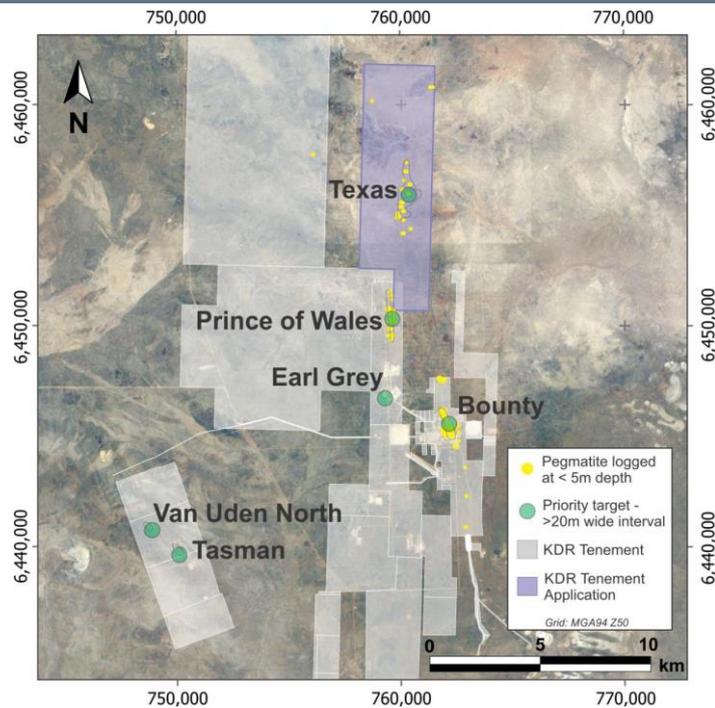
Earl Grey Extensions: Drilling to the north of the existing Earl Grey pit has shown that the pegmatite now extends over a 1.9km “down dip” length. These results could feed into a future resource upgrade but more importantly confirm the scale of the pegmatite

Prince of Wales: The prince of wales prospect is located ~2.5kms to the north of the Earl Grey project. Historic drilling for gold reported pegmatites near the surface but no assays for lithium were undertaken. What the drilling did confirm was the pegmatite is at least 2.2km long and up to 340m wide.

Texas: Applications for drilling have been lodged with drilling expected to commence early in CY17.

Historic exploration at Texas for gold outlined a 6.3km length pegmatite target but no lithium sampling was undertaken.

Mt Holland Pegmatite Targets



Source: Company report

Earl Grey Lithium Model Assumptions

In the absence of a defined resource and potential production parameters it is possible to model a number of different development options for the Earl Grey project. These range from possible agreement with Poseidon Nickel (POS) to utilise the Lake Johnston Plant through to KDR establishing their own plant at Mt Holland.

Given the extra time and capital associated with establishing a plant at Mt Holland we have assumed that an agreement with POS will be reached where the ore is trucked to Lake Johnston and then processed before a concentrate is trucked to a port, likely to be Esperance.

A future development could include KDR undertaking construction of a lithium carbonate plant at Mt Holland with an associated capital cost of ~\$200m+.

Assumptions

- A resource is defined in the range of circa 100Mt, with a 15+ year mine life
- Construction and pre strip starting mid 2017 and first production early 2018
- Trucking ore 110km to Poseidon Nickel’s Lake Johnston plant
- Ore processed under toll treatment arrangement, with a plant throughput rate of 1.5Mtpa and recoveries of 75%
- Concentrate production of ~250,000tpa and trucked (340km) to Esperance
- Total All In Cash Cost LOM ~A\$350/t
- Capex A\$40m (includes working capital), with 50% debt funding.
- Sales (FOB) US\$500/t at an AUD:USD FX rate of 0.75 for A\$660/t

Earl Grey Lithium Modelled Production

	FY18	FY19	FY20	FY21	FY22
Concentrate Production (t)	79,102	246,797	253,125	253,125	253,125
C1 Cash Cost (A\$/t)	329	336	329	320	316
All In Cash Cost (A\$/t)	433	392	379	368	358
Sales Price (A\$/t)	667	667	667	667	667

Source: PAC Partners estimates

Poseidon Nickel's Lake Johnston Plant



Source: Company Report

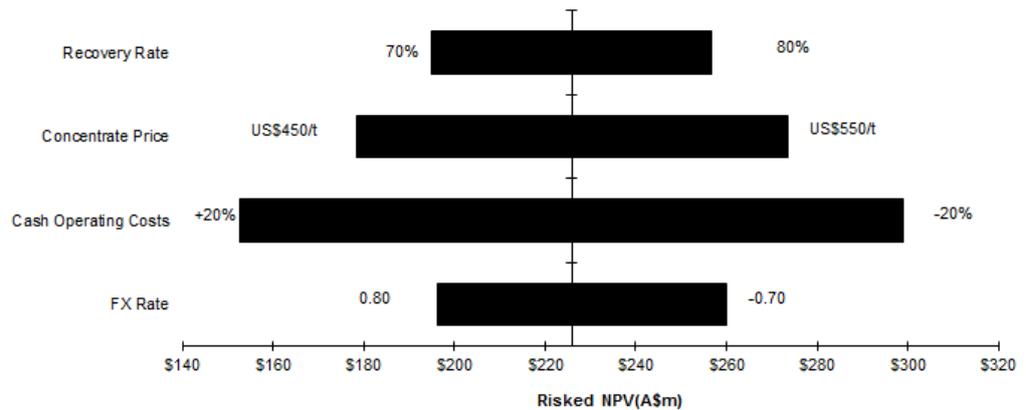
Sensitivity Analysis

Our base case risked valuation for Earl Grey is \$222m or \$0.72/sh.

Given the early stage of the Earl Grey project and the broad ranging assumptions in our modelling we have looked at the sensitivity to our valuation based on the a likely range of variation for key inputs. Namely; recovery rates, concentrate sales price, operating costs and exchange rate changes.

The impact on the project NPV and also value per share is summarised in the following charts.

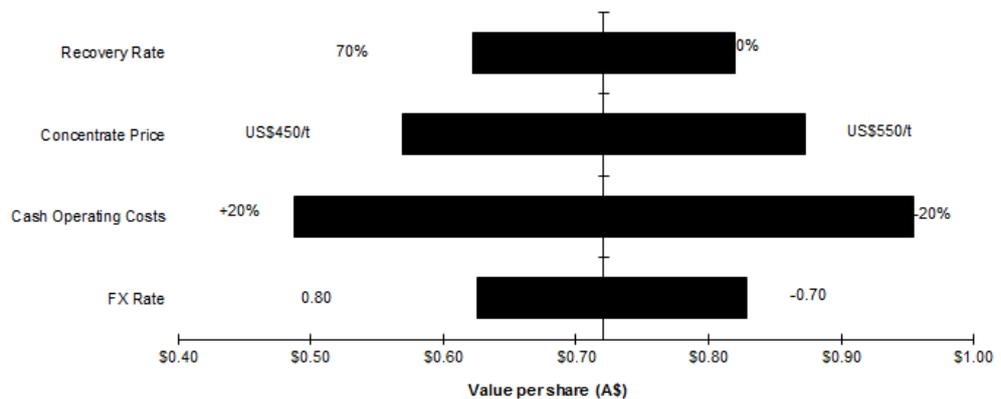
Earl Grey Risked NPV Sensitivity Analysis



Source: PAC Partners estimates

Earl Grey Value Per Share Sensitivity Analysis

Value per share ranges from \$0.59 to \$0.94/sh



Source: PAC Partners estimates

Changes to Valuation

- **Earl Grey lithium Value:** The major change to our valuation and price target is from the inclusion of a risked valuation of \$239m (\$478m un-risked) for the Earl Grey Project. Previously a nominal \$50m valuation had been used, largely based on peer comparison.
- **Exploration potential:** We have increased our valuation of the exploration of the KDR portfolio from \$20m to \$30m to reflect the potential to add value from the other identified pegmatites within the Mt Holland project area.
- **Burbanks Mine:** The value of the Burbanks Mine has been lowered from \$25m to \$10m in line with the halting of mining activity at the site. Reducing our DCF based valuation to a holding value of the asset.

This has increased our price target from \$0.50/sh to \$0.96/sh (unrisked \$1.61/sh)

Valuation Summary

Sum Of The Parts Valuation Summary

	Un-risked		Risked	
	Value (A\$m)	A\$/Share	Value (A\$m)	A\$/Share
Burbanks	\$10	\$0.03	\$10	\$0.03
Mt Holland	\$53	\$0.17	\$29	\$0.09
Earl Grey	\$407	\$1.30	\$226	\$0.72
Corporate	-\$8	-\$0.02	-\$8	-\$0.02
Debt	-\$7	-\$0.02	-\$7	-\$0.02
Cash	\$20	\$0.06	\$20	\$0.06
Exploration	\$30	\$0.10	\$30	\$0.10
Total NAV (A\$m)	\$505	\$1.61	\$300	\$0.96

Source: PAC Partners estimates

Risks

In addition to the risks outlined in our Initiation note ([KDR Initiation May 2016](#)) the following risks are also relevant:

Metallurgy: Metallurgical testing of representative lithium bearing pegmatite material from Earl Grey is yet to be completed. Recovery rates will be a key result.

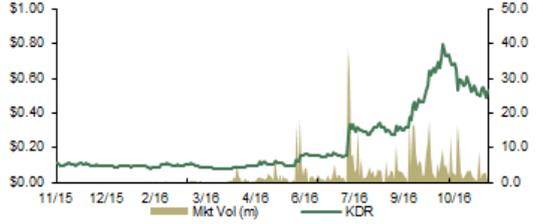
Concentrate quality: the iron content and morphology remains unknown and therefore the price premium/discount for the concentrate is yet to be defined.

Permitting: Whilst the Earl Grey area is on a granted mine lease there will be some additional permits required. Road transport may also require additional permits depending on the size of haul trucks planned.

Commercial agreement with POS: We have assumed that an agreement will be reached with POS to access the Lake Johnston plant. However an agreement is yet to be reached and therefore timing and terms are unknown.

Offtake agreement: This is the key risk associated with realising the lithium potential of Mt Holland. At this stage it is likely to be too early for KDR to engage meaningfully with potential customers. As the project advances we would expect to see more clarity on the level of interest from potential customers.

Operating and Capital Costs: Given that feasibility studies have not been undertaken there is risk that costs will vary from our estimates.

COMPANY SUMMARY					FINANCIAL SUMMARY							
Kidman Resources Limited					Year End - Jun							
KDR.AX					KEY METRICS							
14/11/2016					EPS Growth (%)	70.2%	>100%	>100%	8.4%	8.6%	-20.2%	
Price Information					PER (x)	-51.03	14.75	3.46	3.19	2.94	3.68	
Price (\$/Share)	\$0.53	Target Price (\$/Share)	\$0.96			Dividend Yield (%)	0	0	12	13	14	11
Mkt Cap (\$m)	\$166				EV/EBITDA (x)	-70.6	10.3	2.2	1.6	0.9	0.7	
Enterprise Value (\$m)	\$153				EV (\$m)	203	293	245	182	114	61	
Share Price & Volume Chart					ROE (%)	83.9%	-975.0%	214.7%	94.6%	60.3%	34.4%	
					ROA (%)	-38.8%	26.0%	63.3%	75.6%	99.0%	100.2%	
Commodity / FX forecasts					ROIC (%)	-23.6%	17.1%	76.5%	100.5%	138.4%	140.9%	
		FY17E	FY18E	FY19E	FY20E	PROFIT & LOSS (AUD \$m)						
Gold Price (US\$)		1,300	1,300	1,300	1,300	Revenue	0	71	245	256	261	186
AUD:USD		0.75	0.75	0.75	0.75	EBITDA	-3	28	110	117	125	92
Production					Depreciation & Amortisation	0	5	18	19	19	8	
		FY17E	FY18E	FY19E	FY20E	EBIT	-2.9	23.4	91.2	97.8	105.3	83.6
Burbanks Prod. (oz)						Net Interest Expense	-0.6	-1.8	-2.5	-1.8	-1.0	-0.4
Mt Holland Prod (oz)			10,484	46,252	49,335	Income Tax Expense	0.0	-7.1	-26.6	-28.8	-31.3	-25.0
NPV by parts					NPAT Reported	-3.5	14.5	62.1	67.3	73.0	58.2	
		Un Risked		Risked		NPAT Adjusted	-3.5	14.5	62.1	67.3	73.0	58.2
		A\$m	Per Share	A\$m	Per Share	PER SHARE DATA (cps)						
Burbanks		\$10.0	\$0.03	\$10.0	\$0.03	Shares on Issue (m)	335	405	405	405	405	405
Mt Holland		\$52.8	\$0.17	\$29.1	\$0.09	EPS Reported	-1.0	3.6	15.3	16.6	18.0	14.4
Earl Grey		\$407.0	\$1.30	\$225.9	\$0.72	EPS Adjusted	-1.0	3.6	15.3	16.6	18.0	14.4
Corporate		-\$7.5	-\$0.02	-\$7.5	-\$0.02	DPS	0.0	0.0	6.1	6.6	7.2	5.8
Debt		-\$7.2	-\$0.02	-\$7.2	-\$0.02	BALANCE SHEET (AUD \$m)						
Cash		\$20.0	\$0.06	\$20.0	\$0.06	Cash	-24	-37	0	51	108	157
Exploration		\$30.0	\$0.10	\$30.0	\$0.10	Debtors & Inventory	0	7	13	13	13	8
Total NAV (A\$m)		\$505.1	\$1.61	\$300.2	\$0.96	PP&E	12	88	74	59	43	38
					Intangibles	0	0	0	0	0	0	
					Total Assets	-12	63	97	133	174	207	
					Borrowings	1	41	30	19	7	3	
					Creditors	0	11	19	19	19	13	
					Total Liabilities	2	52	50	38	27	16	
					Net Assets	-13	10	47	95	147	191	
					BALANCE SHEETS RATIOS							
					Gearing - Debt/Equity (%)	-190.5	751.8	63.9	-34.2	-68.2	-80.5	
					Interest Cover (x)	-4.8	12.8	36.5	55.9	110.8	199.4	
					NTA per Share (cps)	-4.0	2.6	11.7	23.4	36.3	47.1	
					CASH FLOW (AUD \$m)							
					EBITDA	-1	24	116	131	133	97	
					Interest & Tax	0	-9	-29	-29	-26	-13	
					Working Capital Change	0	0	0	0	0	0	
					Operating Cash Flow	-3	12	83	98	104	82	
					Maintenance Capex	-5	-6	-5	-4	-4	-3	
					Free Cash Flow	-8	6	78	94	100	79	
					Capex	-4	-74	0	0	0	0	
					Equity Issues / (Buy Backs)	23	30	0	0	0	0	
					Proceeds from Borrowings	-39.7	28.7	-13.5	-13.5	-11.3	-4.9	
					Other	-2.0	-3.3	-3.0	-3.0	-3.0	-2.0	
					Net Cash Flow	-31	-13	37	51	57	49	
					Resources							
						Tonnes (Mt)	Au grade (g/t)	Au (oz)				
					Van Uden	5.4	1.38	238,000				
					Blue Vein	4.8	2.39	372,500				
					Twinnings Group (Earl Grey, J)	3.6	1.10	128,000				
					Bushpig	0.7	1.16	28,000				
					Razorback	0.3	1.13	10,000				
					Victory	0.4	1.20	15,000				
					Bounty South	0.1	1.42	3,000				
					Bounty Main - open cut	1.4	1.86	84,000				
					Bounty North - open cut	0.7	1.40	32,000				
					Bounty East - open cut	0.5	1.20	18,000				
					Mt Holland Sub Total	17.9	1.78	928,500				
					Bounty Main - underground	2.0	3.69	235,000				
					Bounty North - underground	0.1	2.52	11,000				
					Mt Holland Total	20.0		1,174,500				

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Recommendation Criteria

Investment View

PAC Partners Investment View is based on an absolute 1-year total return equal to capital appreciation plus yield.

Buy	Hold	Sell
>20%	20% – 5%	<5%

A Speculative recommendation is when a company has limited experience from which to derive a fundamental investment view.

Risk Rating

PAC Partners has a four tier Risk Rating System consisting of: Very High, High, Medium and Low. The Risk Rating is a subjective rating based on: Management Track Record, Forecasting Risk, Industry Risk and Financial Risk including cash flow analysis.

Disclosure of Economic Interests

The views expressed in this research report accurately reflect the personal views of Andrew Shearer about the subject issuer and its securities.

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