BCI Minerals

Earnings update

Iron ore price continues to power ahead

Metals & mining

On 14 June, BCI announced that its EBITDA guidance from Iron Valley for FY19 is now right at the top of the range of prior expectations. During the first nine months of the year, BCI's EBITDA from Iron Valley was A$6.0m from 5.5Mt of material shipped (ie A$1.09 per tonne). In the light of the continued strength of the iron ore price in the aftermath of the Brazilian tailings dams' disasters, it has now revised its guidance for the full year from A$6–12m to A$11–12m (or c A$1.57 per tonne, given our FY19 production estimates), implying EBITDA of A$5–6m (or c A$2.66–3.19/t) in Q419 alone. As a result, we have upgraded our EBITDA forecasts for BCI's Iron Valley stream of income for FY19 and FY20. Consistent with the strong iron ore price environment, between March and May, BCI's cash position declined by only A$0.6m, despite continued investment into Mardie.

Year end	Revenue (A$m)	PBT* (A$m)	EPS* (c)	DPS (c)	P/E (x)	Yield (%)
06/17	64.3	6.0	1.9	0.0	10.0	N/A
06/18	33.0	(16.9)	(4.3)	0.0	N/A	N/A
06/19e	63.8	(6.0)	(1.1)	0.0	N/A	N/A
06/20e	85.6	(13.1)	(3.3)	0.0	N/A	N/A

Note: *PBT and EPS are normalised, excluding amortisation of acquired intangibles, exceptional items and share-based payments.

Full effect of higher iron ore prices in FY20 & beyond

While the effect of the increase in iron ore prices in Q419 will have had a relatively modest A$0.9m effect on earnings for the year as a whole, the effect on earnings in FY20 is much larger. Hitherto, we have assumed an average price for 58% CFR iron ore of US$49.00/t for FY20. With the current price of standard grade 58% CFR iron ore around US$105/t, however, such an outcome for FY20 now appears extremely unlikely. In recognition of this, we have formally adjusted our price forecasts for 58% CFR iron ore, so that we assume it will decline steadily from current levels to reach our FY21 price by the end of June 2020, such that the average price for FY20 will be US$71.53/t (ie a discount of only 16.2% compared with the likely average price of US$85.35/t in Q419 and a 69.4% premium compared to the H119 average price of US$42.23/t). As a result, our forecast for Iron Valley EBITDA in FY20 has increased by 36.6% to A$15.3m.

Northern Australia Infrastructure Facility (NAIF)

Further to its Iron Valley earnings update, on 1 July, BCI also announced that the NAIF had advised that the Mardie project can proceed to the next (due diligence) phase of the assessment process for potential, concessional debt funding.

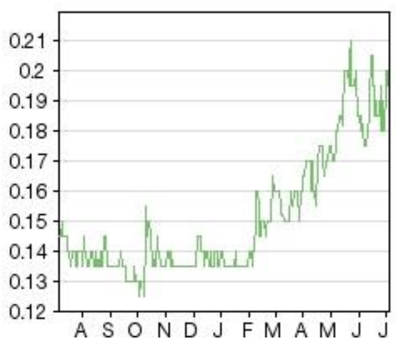
Valuation: Still 2x current share price

In the wake of its announcement, we value BCI at 35.60c (cf 35.13 previously). However, this increases to as much as 47.45c in the event that iron ore prices remain at current levels until the end of the life of operations at Iron Valley. Note that a further 2.43c should be added to all of these valuations to account for the value of BCI's Buckland iron ore assets.

5 July 2019

Price	**A$0.19**
Market cap	**A$76m**
	A$1.4560/US$
Net cash (A$m) at 31 May 2019	34.8
Shares in issue	397.6m
Free float	63%
Code	BCI
Primary exchange	ASX
Secondary exchange	N/A

Share price performance



%	1m	3m	12m
Abs	8.1	17.6	37.9
Rel (local)	2.0	9.3	27.2
52-week high/low		A$0.21	A$0.13

Business description

BCI Minerals has two major assets in Western Australia, including a 100% interest in the Mardie salt and potash project and a royalty-type interest in the Iron Valley iron ore mine operated by Mineral Resources. It also has exploration tenements in iron ore and other minerals.

Next events

Q419 activity report	July 2019
FY19 results	August 2019
Mardie DFS	Q4 CY19
Mardie investment decision	Q1 CY20

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Edison profile page

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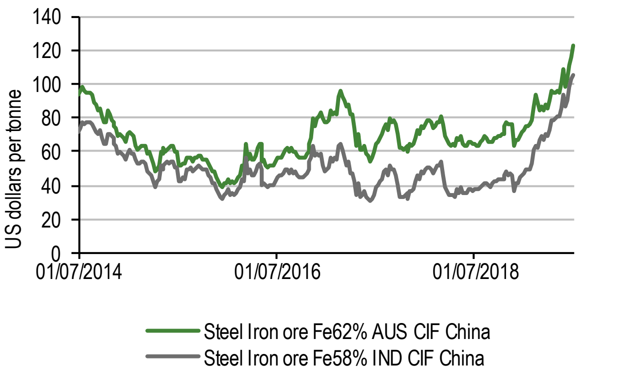
Iron Valley earnings update

Not wholly surprisingly, given the recent strength in the iron ore market, on 14 June, BCI issued an earnings update for Iron Valley to the effect that its EBITDA expectations from that operation are now right at the top of the prior range for the company's financial year to end-June 2019. During the first nine months of the year, BCI's EBITDA from Iron Valley was A$6.0m from 5.5Mt of material shipped (equivalent to A$1.09 per tonne) and, until the announcement, BCI's formal EBITDA guidance for the full year had been in the range A$6–12m. In light of the continued strength of the iron ore price since March, BCI has revised its EBITDA guidance for FY19 to the top of the range, at A$11–12m, which (given our FY19 production estimate of 7.33Mt for the full year) equates to c A$1.57 per tonne).

In its announcement, BCI observed that the price of 62% Fe cost freight (CFR) iron ore had averaged US$96 per dry metric tonne (dmt) in April and May compared with an average of US$74/dmt for the first nine months of the year (a 29.7% increase). In addition, the discount of the price of 58% CFR iron ore (a close proxy to the price received by Iron Valley for its product) to the 62% product had narrowed 'materially'; the price has continued to strengthen to in excess of US$120/t at the time of writing.

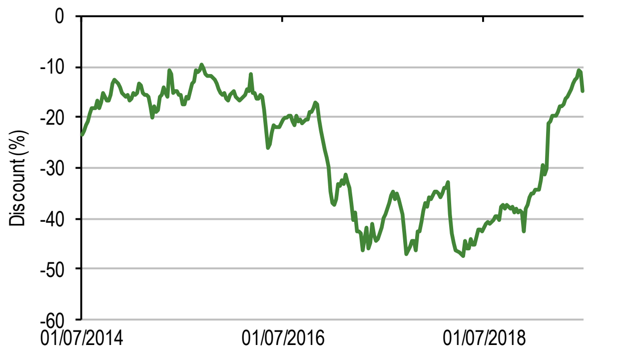
Graphs of the prices of standard grade 62% and 58% CFR iron ore (and the discount of the latter to the former) are provided in Exhibits 1 and 2, below, which bear out BCI's analysis.

Exhibit 1: 62% iron ore price (US$/t) vs 58% iron ore price, July 2014 to present



Source: Refinitiv, Edison Investment Research

Exhibit 2: Discount of 58% iron ore price vs 62% iron ore price, July 2014 to present (%)



Source: Refinitiv, Edison Investment Research

Consequences – Q419 and FY19

While our erstwhile forecasts for Q419 had largely discounted the higher iron ore prices, they had not done so completely in that they assumed an average 58% iron ore price of US$78.54/t during the quarter, whereas (on current trends) the price actually looks likely to have averaged US$85.35/t, as the shortage of iron ore supply in the wake of the Brazilian mines' tailings dams' disasters continues to squeeze prices higher. Over approximately the same timeframe, the Australian dollar also weakened, which has accentuated the effect of the rising iron ore prices. Adjusting for these two effects alone increases our June 2019 quarter estimate of EBITDA for Iron Valley to A$5.6m (equivalent to A$2.98 per tonne of product) and our earnings expectations for the company for the full year, as follows:

Exhibit 3: Revised Edison estimates of BCI's FY19 income statement

Year end June (A$000s)	H118	H218	H119	H219e	FY19e (current)	FY19e (previous)
Revenue from continuing operations						
Sale of goods	17,192	15,778	20,222	44,049	64,271	61,194
Other revenue	366	(307)	(457)	0	(457)	(457)
Total revenue from continuing operations	17,558	15,471	19,765	44,049	63,814	60,737
Forex gain/(loss)		0			0	
Cost of sales (estimate)	(14,146)	(12,972)	(16,254)	(35,674)	(51,927)	(49,796)
Depreciation and amortisation (estimate)	(1,459)	(1,459)	(1,459)	(1,459)	(2,917)	(2,918)
Selling and marketing	0	0	0	0	0	
Administration expenses	(3,698)	(3,340)	(2,409)	(2,409)	(4,818)	(4,818)
Exploration and evaluation expenditure	(4,310)	(8,977)	(3,374)	(6,924)	(10,298)	(10,298)
Gain on disposal of mine property and other assets	0	0	17,818	0	17,818	17,818
Profit/(loss) before finance cost and income tax	(6,054)	(11,276)	14,088	(2,416)	11,672	10,725
Finance income	0	420	0		0	
Finance costs	(27)	27	0		0	
Net finance income	(27)	447	0	98	98	98
Profit/(loss) before income tax	(6,081)	(10,829)	14,088	(2,318)	11,770	10,823
Income tax/(credit)	0	0	(1,510)	0	(1,510)	(1,510)
Marginal tax rate (%)	0.0	0.0	(10.7)	0.0	(12.8)	(14.0)
Profit after income tax from continuing operations	(6,081)	(10,829)	15,598	(2,318)	13,280	12,333
Weighted average number of ordinary shares (000s)	394,597.863	394,597.863	397,608.910	397,600.000	397,604.455	396,063.455
Derivatives (000s)				19,752.271	19,752.271	19,752.271
Fully diluted weighted average number of ordinary shares (000s)	394,597.863	394,597.863	397,608.910	417,352.271	417,356.726	415,815.726
EPS (cents)	(1.54)	(2.74)	3.92	(0.58)	3.34	3.11
Fully diluted EPS (cents)	(1.54)	(2.74)	3.92	(0.56)	3.18	2.97

Source: Edison Investment Research, BCI Minerals. Note: Company reported basis.

Assumption of elevated iron ore prices extended into FY20

While the effect of the increase in iron ore prices for the remainder of FY19 has a relatively modest A$0.9m effect on earnings for FY19 as a whole, the effect on earnings in FY20 is much larger. Hitherto, we have maintained our forecasts for FY20 based on the analysis set out in our Outlook/initiation note, Salt plus potash plus iron equals value, published on 7 February, which predicted an average price for 58% CFR iron ore of US$49.00/t for FY20. With the current price of standard grade 58% CFR iron ore around US$105/t, however, and with no end in sight to the disruption caused by the interruption of Brazilian supply in the market, such an outcome for FY20 is extremely unlikely. In recognition of this, we have now formally adjusted our price forecasts for 58% CFR iron ore, so that we assume the price will decline steadily from its current level to reach our FY21 price by the end of June 2020 (thus allowing us to leave our FY21 average price assumption unchanged at US$45.95/t). Under these circumstances, the average price for 58% CFR iron ore in FY20 will be US$71.53/t (ie a discount of only 16.2% compared with the likely average price of US$85.35/t in Q419 and an 69.4% premium compared to the H119 average price of US$42.23/t), with a profile over the year as follows:

Exhibit 4: Price of standard grade 58% CFR iron ore, July 2014 to July 2020e

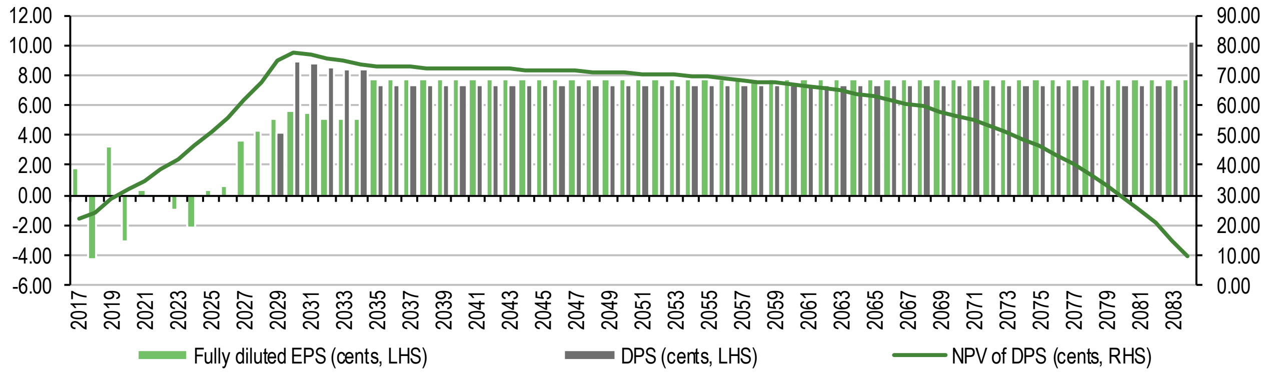
Source: Refinitiv, Edison Investment Research

The effect of this change to our forecast price increases our forecast for Iron Valley EBITDA in FY20 by 36.6% to A$15.3m (albeit this will be reinvested into Mardie such that BCI itself will remain loss making, on an underlying basis during the year – see Exhibit 8). Self-evidently, to the extent that iron ore prices remain stronger for longer than anticipated, both our forecasts for FY20 and our valuation (see the Sensitivities section, below) will be subject to potential future upgrades.

Consequences – valuation

We have left the remainder of our assumptions unchanged other than the fact that we now expect funding and capex to occur early in FY21, rather than late in FY20. That being the case, our long-term estimates of BCI's earnings, (maximum potential) dividends per share and valuation trajectory are then as follows:

Exhibit 5: BCI EPS and (maximum potential) DPS forecasts, FY18–83e



Source: Edison Investment Research. Note: Income derived from Iron Valley and Mardie, combined; no contribution assumed from Buckland or any other assets.

Discounting at our customary discount rate of 10% per year, the (fully diluted) value of these cash flows to shareholders is 35.60 Australian cents (cf 35.13c previously) as at 1 July 2019, of which 18.79c may be attributable to BCI's non-Mardie assets and 16.81 to Mardie. This compares with our valuations at the time of our Outlook/initiation note (see Salt plus potash plus iron equals value, published on 7 February) of 19.51c and 11.15c, respectively as follows:

Exhibit 6: BCI discounted dividend valuation, by component

	June 2019		February 2019		
Component	**Australian cents per share**	**Percent of total (%)**	**Australian cents per share**	**Percent of total (%)**	**Change (%)**
Iron Valley, cash and corporate	18.79	52.8	19.51	63.6	+3.9
Mardie	16.81	47.2	11.15	36.4	+68.9
Total	**35.60**	**100.0**	**30.66**	**100.0**	**+27.6**

Source: Edison Investment Research

Investors should note that the increase in the value per share of Mardie derives not only from its intervening PFS optimisation study (announced on 17 May 2019), but also from the reinvestment of Iron Valley cash flows into the project.

To this should then be added a further 2.43c for BCI's Buckland iron ore assets to take the total to 41.54c.

Sensitivities

All other things being equal, our earnings forecasts and Iron Valley valuation will be affected by the extent to which iron ore prices remain high beyond FY20, which is quantified in Exhibit 7 for a number of future iron ore pricing scenarios. However, the major benefit to BCI of a higher, future iron ore pricing environment will be the increased funding contribution made by Iron Valley earnings retained within BCI towards Mardie – thereby either reducing the amount of financial risk associated with the project (shown here in the form of a decreased net debt funding requirement) or, alternatively, reducing the amount of future equity dilution required to achieve a maximum leverage ratio of 50% and thereby increasing the value of subsequent dividends to equity shareholders (not shown here):

Exhibit 7: BCI Minerals valuation sensitivity to future Iron Valley iron ore pricing scenarios

Scenario	Valuation (Australian cents per share)	Incremental change (cps)	Incremental change (%)	Maximum net debt funding requirement (A$m)	Maximum leverage* (%)
Base case	35.60			272.4	50.0
Iron ore price remains at FY20 level until end of life of mine	38.95	+3.35	+9.4	239.0	43.7
Iron ore price remains at Q419 level until end of life of mine	43.99	+5.04	+12.9	179.3	32.6
Iron ore price remains at US$105/t until end of life of mine	47.45	+3.46	+7.9	138.2	25.1

Source: Edison Investment Research. Note: *Defined as (net debt)/(net debt+equity).

NAIF (Northern Australia Infrastructure Facility)

Further to its Iron Valley earnings update (and also its Mardie PFS optimisation announcement in mid-May which confirmed the viability of a dedicated port at Mardie), on 1 July, BCI announced that the NAIF had completed its assessment of the Mardie project and advised that it has proceeded to the due diligence phase of the assessment process.

NAIF is a A$5bn facility set up by the federal Australian government to provide loans (which may be of a concessional nature – eg lower coupon, longer tenor, subordinated etc) to projects that, among other things, develop and improve the infrastructure of northern Australia. This initial term of the fund is for the five years until end-June 2021 and, anecdotally, it is therefore thought to be keen to deploy its funds under management expeditiously. Mardie is located entirely within the definition of Northern Australia under the NAIF Act 2016. In addition, at least A$227m of its total capex of A$498m (ie 46%) can be immediately identified as relating to infrastructure.

The fund has a formal, staged assessment process and a range of eligibility criteria before its board will consider making an investment decision to grant financial assistance to any project. Within this context however, the Mardie project may be said to have cleared the second stage of the process and will now work with the NAIF during the Due Diligence stage, during which BCI will develop a formal Investment Proposal for the fund to consider. At the same time, BCI's Managing Director, Alwyn Vorster, has been quoted as saying that BCI is also making "solid progress" in developing product off-take support, including a number of non-binding Memoranda of Understanding with several "credible" salt end users in Asia.

Exhibit 8: Financial summary

A$'000s	2015	2016	2017	2018	2019e	2020e
June	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS						
Revenue	281,211	151,279	64,324	33,029	63,814	85,645
Cost of Sales	(278,465)	(158,210)	(55,190)	(47,442)	(67,043)	(96,298)
Gross Profit	2,746	(6,931)	9,134	(14,413)	(3,229)	(10,653)
EBITDA	2,746	(6,931)	9,134	(14,413)	(3,229)	(10,653)
Operating Profit (before amort. and except.)	(26,090)	(12,622)	5,665	(17,330)	(6,146)	(13,570)
Intangible Amortisation	0	0	0	0	0	0
Exceptionals	(170,881)	(40,108)	(302)	0	17,818	0
Other	(2,935)	812	(5)	0	0	0
Operating Profit	(199,906)	(51,918)	5,358	(17,330)	11,672	(13,570)
Net Interest	(3,505)	(951)	311	420	98	510
Profit Before Tax (norm)	(29,595)	(13,573)	5,976	(16,910)	(6,048)	(13,060)
Profit Before Tax (FRS 3)	(203,411)	(52,869)	5,669	(16,910)	11,770	(13,060)
Tax	44,912	(27,086)	0	0	1,510	0
Profit After Tax (norm)	12,382	(39,847)	5,971	(16,910)	(4,538)	(13,060)
Profit After Tax (FRS 3)	(158,499)	(79,955)	5,669	(16,910)	13,280	(13,060)
Average Number of Shares Outstanding (m)	174.8	196.2	316.7	394.6	397.6	397.6
EPS - normalised (c)	7.1	(20.3)	1.9	(4.3)	(1.1)	(3.3)
EPS - normalised and fully diluted (c)	7.1	(19.5)	1.9	(4.3)	(1.1)	(3.1)
EPS - (IFRS) (c)	(90.7)	(40.8)	1.8	(4.3)	3.3	(3.3)
Dividend per share (p)	0.0	0.0	0.0	0.0	0.0	0.0
Gross Margin (%)	1.0	N/A	14.2	N/A	N/A	N/A
EBITDA Margin (%)	1.0	N/A	14.2	N/A	N/A	N/A
Operating Margin (before GW and except.) (%)	N/A	N/A	8.8	N/A	N/A	N/A
BALANCE SHEET						
Fixed Assets	154,904	86,546	78,059	85,768	78,669	85,752
Intangible Assets	60,237	33,618	33,063	43,615	39,433	49,433
Tangible Assets	94,667	52,928	44,996	42,153	39,236	36,319
Investments	0	0	0	0	0	0
Current Assets	102,374	23,204	46,429	20,270	44,080	28,466
Stocks	9,886	61	0	0	87	117
Debtors	24,427	13,694	10,053	7,213	9,992	10,090
Cash	67,671	9,449	36,376	13,057	34,000	18,259
Other	390	0	0	0	0	0
Current Liabilities	(77,222)	(21,769)	(12,107)	(9,373)	(12,804)	(17,334)
Creditors	(70,947)	(19,749)	(12,107)	(9,373)	(12,804)	(17,334)
Short term borrowings	(6,275)	(2,020)	0	0	0	0
Long Term Liabilities	(20,773)	(11,307)	(5,225)	(6,054)	(6,054)	(6,054)
Long term borrowings	0	0	0	0	0	0
Other long term liabilities	(20,773)	(11,307)	(5,225)	(6,054)	(6,054)	(6,054)
Net Assets	159,283	76,674	107,156	90,611	103,891	90,830
CASH FLOW						
Operating Cash Flow	(77,686)	(19,721)	11,860	(11,957)	(2,665)	(6,251)
Net Interest	(1,120)	0	0	0	98	510
Tax	44,912	(27,086)	0	0	1,510	0
Capex	(10,987)	(8,075)	(2,220)	(10,074)	(5,000)	(10,000)
Acquisitions/disposals	24,338	0	(5,151)	(1,288)	27,000	0
Financing	6,118	1,510	24,403	0	0	0
Dividends	(18,652)	0	0	0	0	0
Net Cash Flow	(33,077)	(53,372)	28,892	(23,319)	20,943	(15,741)
Opening net debt/(cash)	(94,473)	(61,396)	(7,429)	(36,376)	(13,057)	(34,000)
HP finance leases initiated	0	0	0	0	0	0
Other	0	(595)	55	0	0	0
Closing net debt/(cash)	(61,396)	(7,429)	(36,376)	(13,057)	(34,000)	(18,259)

Source: Company sources, Edison Investment Research

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