EDISON

BCI Minerals

Q319 quarterly activities report

Increasing iron ore royalties supporting Mardie

Metals & mining

BCI Minerals reported a c 33.3% increase in royalty EBITDA during Q3 from operations at Iron Valley under the influence of higher iron ore prices in the aftermath of Vale's Feijao tailings dam disaster in January and the supply disruptions to exports from north-western Australia occasioned by a trio of cyclones in the region. Notwithstanding the disruptions, shipments from Iron Valley were steady at 1.8Mt (cf Edison's prior estimate of 7.5Mt for FY19, or 1.875Mt per quarter) – albeit comprising a higher proportion of lower-value 'fines' product as the operator sought to draw down existing fines stockpiles. We have updated our forecasts for FY19 to reflect these changes. More significantly however, BCI's share price remains at a >50% discount to our 'base case' valuation of 34.05c/share (see below) at a time when the DFS target parameters are becoming increasingly de-risked.

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	8.9	N/A
06/18	33.0	(16.9)	(4.3)	0.0	N/A	N/A
06/19e	59.8	(7.9)	(1.6)	0.0	N/A	N/A
06/20e	57.6	(3.6)	(0.5)	0.0	N/A	N/A

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

Mardie DFS advanced

At the same time that it has been benefiting from strength in the iron ore market, BCI has been advancing its Mardie salt and SOP project. So far in 2019, it has made three engineering appointments, being GR Engineering as lead DFS engineer and, recently, Australia's WorleyParsons and Switzerland's Salt Partners as specialist pond and plant design engineers. Having completed a PFS in 2018, BCI thus remains on track to complete a definitive feasibility study (DFS) later this year, ahead of a final investment decision on the project in early calendar 2020.

Approvals process being de-risked

A number of recent pronouncements suggest Western Australian state government support for the Mardie project. In particular, the minister for ports has provided 'in principle' approval for a port facility at Mardie, which contributes to de-risking the approvals process as well potentially giving BCI access to the improved economics of an expanded operation with a more optimal logistics solution, which we estimate could add 9.62 Australian cents to our 'base case' valuation (see below).

Valuation: 34.05c, potentially rising to 43.67c

In the wake of its quarterly activities report, we value the stream of dividends payable to BCI shareholders from Iron Valley and the development of Mardie at 31.62c (cf 30.66c previously). To this should be added a further 2.43c for its Buckland assets and potentially a further 9.62c as the (increasingly de-risked) expanded Mardie port development option becomes more likely, to take the total to 43.67c. Further upside then exists if iron ore prices remain at elevated levels beyond June.

16 April 2019

Price	**A$0.17**
Market cap	**A$66m**
	A$1.4000/US$
Net cash (A$m) at 31 March 2019	35.4
Shares in issue	397.6m
Free float	63%
Code	BCI
Primary exchange	ASX
Secondary exchange	N/A

Share price performance

%	1m	3m	12m
Abs	3.3	14.8	10.7
Rel (local)	2.0	6.2	3.3
52-week high/low		A$0.2	A$0.1

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

Mardie Port PFS optimisation	May 2019
Q419 activity report	July 2019
Mardie DFS	Q4 CY19
Mardie investment decision	Q1 CY20

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Edison profile page

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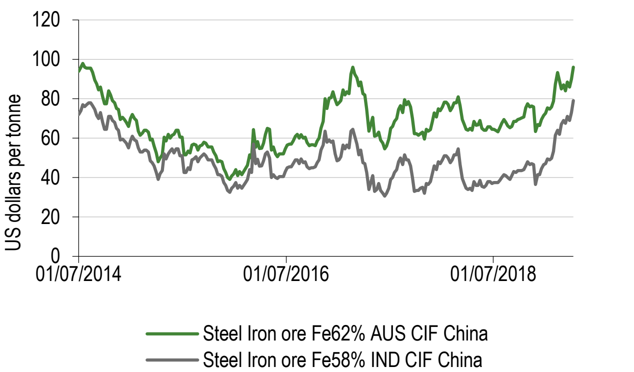
Q3 results review

BCI reported A$2.8m in EBITDA during Q3 from operations at Iron Valley (including a positive prior quarter adjustment of A$0.6m), influenced by:

- Benchmark prices for 58% iron ore, which we estimate were 35.5% higher than during the previous quarter and 42.0% higher than during H119, as a result of the supply squeeze apparent in the market after Vale's Feijao tailings dam disaster and the suspension of selected iron ore mining operations in Brazil and subsequent disruptions to Australian exports out of Port Hedland, in particular, as a result of Cyclone Veronica.
- In part, the effect of the stronger pricing environment in Q3 will have been mitigated by the decision of Iron Valley's operator, Mineral Resources (MIN), to increase the percentage of fines shipped during the quarter from a typical level of c 50% to 65% to draw down existing fines stockpiles. Note that Iron Valley's lump product typically commands a US$9.00/t price premium over its fines product.
- Notwithstanding Cyclone Veronica, MIN reported that it shipped 1.8m wet metric tonnes during the quarter (cf 3.7m wet metric tonnes during H1) putting it on track to ship 7.38m wet metric tonnes during the year (Edison updated estimate) compared with our prior estimate of 7.5m wet metric tonnes.

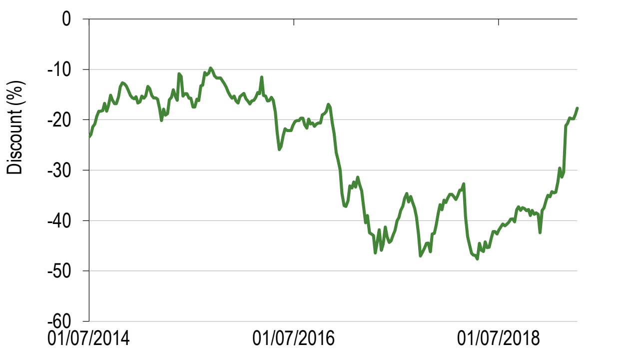
The prices of both standard grade 62% iron ore and 58% lower grade ore have continued to exhibit material strength since late January and into Q419, while the discount of the latter to the former has narrowed significantly (as predicted in our Outlook note, see BCI Minerals: Salt plus potash plus iron equals value, published on 7 February 2019):

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



Source: Refinitiv, Edison Investment Research

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



Source: Refinitiv, Edison Investment Research

While Q319 prices were materially higher for Iron Valley than those experienced in H119, since the upward momentum only began in late January, they nevertheless did not reflect the full extent of the actual movement in the spot prices over the period. For example, whereas we estimate that the average price for benchmark 58% iron ore was US$60/t in Q319 (vs US$42/t in H119), the spot price had actually reached US$79/t by early April. Similarly, whereas we estimate that the average price for benchmark 62% iron ore was US$83/t in Q319 (vs US$69/t in H119), the spot price had actually reached US$96/t by early April. In conjunction with its interim results (announced on 22 February) and the report of its third quarter performance, the assumption that iron ore prices will remain at elevated levels for the remainder of the quarter (and that the discount of 58% iron ore vs 62% iron ore will remain narrow) has caused us to revise our FY19 forecasts for BCI 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	40,084	60,306	52,529
Other revenue	366	(307)	(457)		(457)	
Total revenue from continuing operations	17,558	15,471	19,765	40,084	59,849	52,529
Forex gain/(loss)		0			0	
Cost of sales (estimate)	(14,146)	(12,972)	(16,254)	(33,543)	(49,797)	(43,104)
Depreciation and amortisation (estimate)	(1,459)	(1,459)	(1,459)	(1,459)	(2,917)	(2,917)
Selling and marketing	0	0	0	0	0	0
Administration expenses	(3,698)	(3,340)	(2,409)	(2,409)	(4,818)	(2,000)
Exploration and evaluation expenditure	(4,310)	(8,977)	(3,374)	(6,924)	(10,298)	(10,298)
Impairment of mine property and other assets	0	0	17,818		17,818	17,000
Loss before finance cost and income tax	(6,054)	(11,276)	14,088	(4,251)	9,837	11,210
Finance income	0	420	0			
Finance costs	(27)	27	0			
Net finance income	(27)	447	0	98	98	196
Loss before income tax	(6,081)	(10,829)	14,088	(4,153)	9,935	11,406
Income tax/(credit)	0	0	(1,510)	0	(1,510)	0
Marginal tax rate (%)	0.0	0.0	(10.7)	0.0	(15.2)	0.0
Profit after income tax from continuing operations	(6,081)	(10,829)	15,598	(4,153)	11,445	11,406
Weighted average number of ordinary shares (000s)	394,597.863	394,597.863	397,608.910	396,063.455	396,836.183	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	415,815.726	416,588.454	415,815.726
EPS (cents)	(1.54)	(2.74)	3.92	(1.05)	2.88	2.88
Fully diluted EPS (cents)	(1.54)	(2.74)	3.92	(1.00)	2.75	2.74

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

Mardie salt and potash project update

In addition to the operating and financial performance of Iron Valley during the quarter, BCI has also provided an update on developments at its Mardie salt and potash project.

Engineering appointments

So far, during 2019, BCI has made three material engineering appointments. The one remaining, material design contract outstanding is the Mardie port design and engineering contract, which is expected to be awarded next month, following recent receipt of Western Australian (WA) state government support for a new port facility there.

GR Engineering

On 22 March, BCI appointed GR Engineering as lead DFS engineer, responsible for the co-ordination and integration of the key process and engineering design packages and the preparation of detailed capex and opex estimates.

GR Engineering is a reputable Perth-based engineering group with significant experience in study management, engineering design and the construction of resource projects in Western Australia and globally, both as an EPCM and an EPC contractor.

It will also design and supervise the construction of pre-FID (final investment decision) site works and supporting infrastructure throughout the remainder of 2019.

WorleyParsons

As per its quarterly activities report, BCI has also appointed WorleyParsons to complete the process and engineering design of the evaporation and crystallisation ponds as well as the sulphate of potash (SOP) plant.

WorleyParsons is a global engineering services consultant providing engineering, procurement and construction management services in a range of industries. More specifically, it has more than 20 years' experience of engineering in the fertiliser industry, including completing design and engineering engagements for brine-based SOP projects globally, which has allowed it to assemble a Potash Centre of Excellence in Saskatoon, Canada.

Salt Partners

Finally, Salt Partners has been appointed to complete the process and basic engineering design of the salt plant at Mardie. BCI's engagement of Salt Partners continues an existing relationship between the two. Salt Partners was responsible for the salt plant designs used in the Mardie pre-feasibility study, although the detailed engineering of this project component for the DFS will be completed by the Mardie DFS lead engineer, GR Engineering.

Salt Partners is a firm of engineering contractors based in Switzerland. It has decades of experience in salt production, processing and hypersaline biotechnology. Salt Partners has established a proprietary salt purification process – Hydrosal – which produces high-purity salt with low product losses, which has been adopted by numerous plants around the world.

Mardie DFS site activities

Construction of a small-scale evaporation trial pond is currently underway at site. The trial will comprise pan evaporators plus a 1:40,000 scale version of the entire project layout, including the eight evaporation ponds and one series of the primary salt crystallisers and SOP crystallisers. The trial is being conducted on a small, raised 'island' off the Mardie mudflats in order to protect it from the potential effects of preternatural weather. As a result, the ponds and crystallisers will be lined with plastic in order to simulate the low-permeability conditions of the mudflats. Nevertheless, the trial is being designed to provide site-specific evaporation data at a range of densities and simulate the full evaporation process at a reduced scale, as well as producing raw salt and kainite-type mixed salts for salt and SOP processing test-work and marketing samples.

In the meantime, a geotechnical drilling and test-work programme in order to confirm the optimal locations for the evaporation ponds and infrastructure, including the alignment of the proposed export jetty, is nearing completion.

Tenure and approvals

A number of recent pronouncements have indicated WA state government support for the Mardie project. The minister for ports, in particular, has provided approval for BCI to commence the planning process for the development of a multi-user port facility at Mardie (as opposed to the port being located at Cape Preston East, which was originally conceived to also accommodate output from BCI's erstwhile iron ore assets at Kumina, etc, and was the assumption on which its Mardie PFS was based). This 'in principle' approval for a port at Mardie follows positive discussions with various government bodies over a number of months. Developing port facilities at Mardie is BCI's preferred logistics solution for the project, as it eliminates material road haulage costs to the alternative Cape Preston East port. In receiving 'in principle' approval therefore, BCI's expanded target DFS for Mardie (see Improvements vs the PFS on page 21 of our initiation note, BCI Minerals: Salt plus potash plus iron equals value, published on 7 February 2019) becomes a more realistic possibility (ie it contributes to its de-risking). While this expanded target scenario does not yet represent our base case valuation (which continues to be based on the Mardie PFS for the time being), we estimate that its adoption would add c 30.4%, or 9.62c (updated from 9.32c due to updated dilution assumptions), to our valuation of the present value of the dividends payable to BCI shareholders of 31.62c (see below) to take it to 41.24c. Simultaneously, BCI is working with the Pilbara Ports Authority and other government departments to establish the tenure and agreements required for BCI to develop the multi-user Mardie Port as a foundation proponent.

In the meantime, all of the environmental surveys and studies required to support the assessment of the Mardie project have now been completed. The next key step in the Environmental Protection Authority (EPA) process is the Environmental Review Document, which has now been prepared and is due to be submitted to the WA EPA within a matter of days, which will keep BCI on track for full ministerial approval of the project by early 2020.

Heritage

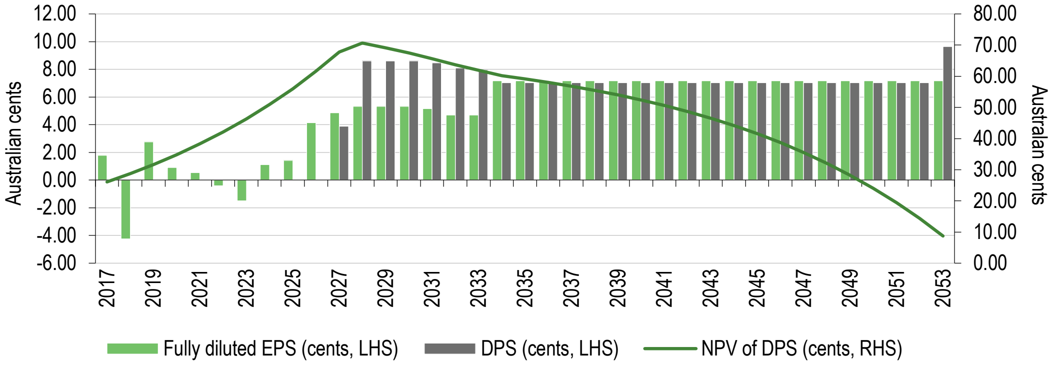
BCI has native title agreements in place with the Yaburara & Mardudhunera (YM) and Kuruma Marthudunera (KM) peoples that allow for production at Mardie. Of the planned project footprint, 90% is within the YM claim area, to which end BCI has received the required heritage-related consents to proceed with construction and operations. A heritage survey with the KM people is planned in April 2019 over the remaining 10% of the project footprint area.

Valuation

BCI has stated that it will advance development funding options and ownership structures for the project in detail during the preparation of the Mardie DFS. Notwithstanding the de-risking of the Mardie port option therefore, pending the publication of the DFS at Mardie, our valuation continues to be based on the parameters defined in its pre-feasibility study (the results of which were published in June 2018). Within this context, project development capex of A$335m is "likely to be funded from a combination of project debt, equity, product offtake pre-commitments and via build-own-operate (or similar) models where feasible." However, it has also said that it "will consider all feasible funding structures for the equity component including raising equity in BCI for investment into the project, or raising direct equity into the project."

Assuming that BCI were to fund Mardie via equity into the company, we estimate that it would have to raise c A$100m in FY20 in order to maintain a maximum leverage ratio (net debt/[net debt+equity]) of no more than 50% in FY23 when net debt to fund the project would peak at c A$192m (some of the equity having been provided by retained earnings from income from Iron Valley). Conducted at the current share price, this would involve the issue of an additional c 644.4m shares, in which case Edison's long-term estimates of BCI's earnings, (maximum potential) dividends per share and valuation trajectory are as follows:

Exhibit 4: BCI EPS and (maximum potential) DPS forecasts, FY17–53 (cents)



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

Discounting at Edison's customary discount rate of 10% per year, the value of these dividend flows to shareholders is 31.62 Australian cents (cf 30.66c/share previously) fully diluted as at 1 July 2018 (the change being principally as a result of BCI's prevailing share price rising to 16c from 13.5c previously). Note that our valuation, on this basis, peaks at 70.66 Australian cents (cf 68.46c previously) in FY28, when EPS would be 5.43 Australian cents, therefore putting it on a contemporary P/E ratio of 13.0x. Self-evidently, this valuation could increase further to the extent that iron ore prices remain at elevated levels beyond June 2019. Moreover, as noted previously, optimisation and expansion of the parameters defined in Mardie PFS will add c 30.4%, or 9.62c (updated estimate as mentioned above), to our valuation to take it to 41.24c. We will update our project assumptions and valuation following the publication of the DFS.

Exhibit 5: 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	59,849	57,560
Cost of Sales	(278,465)	(158,210)	(55,190)	(47,442)	(64,913)	(58,629)
Gross Profit	2,746	(6,931)	9,134	(14,413)	(5,064)	(1,069)
EBITDA	2,746	(6,931)	9,134	(14,413)	(5,064)	(1,069)
Operating Profit (before amort. and except.)	(26,090)	(12,622)	5,665	(17,330)	(7,981)	(3,986)
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)	9,837	(3,986)
Net Interest	(3,505)	(951)	311	420	98	403
Profit Before Tax (norm)	(29,595)	(13,573)	5,976	(16,910)	(7,883)	(3,583)
Profit Before Tax (FRS 3)	(203,411)	(52,869)	5,669	(16,910)	9,935	(3,583)
Tax	44,912	(27,086)	0	0	1,510	0
Profit After Tax (norm)	12,382	(39,847)	5,971	(16,910)	(6,373)	(3,583)
Profit After Tax (FRS 3)	(158,499)	(79,955)	5,669	(16,910)	11,445	(3,583)
Average Number of Shares Outstanding (m)	174.8	196.2	316.7	394.6	396.1	719.8
EPS - normalised (c)	7.1	(20.3)	1.9	(4.3)	(1.6)	(0.5)
EPS - normalised and fully diluted (c)	7.1	(19.5)	1.9	(4.3)	(1.5)	(0.5)
EPS - (IFRS) (c)	(90.7)	(40.8)	1.8	(4.3)	2.9	(0.5)
Dividend per share (p)	0.0	0.0	0.0	0.0	0.0	0.0
Gross Margin (%)	1.0	-4.6	14.2	-43.6	-8.5	-1.9
EBITDA Margin (%)	1.0	-4.6	14.2	-43.6	-8.5	-1.9
Operating Margin (before GW and except.) (%)	-9.3	-8.3	8.8	-52.5	-13.3	-6.9
BALANCE SHEET						
Fixed Assets	154,904	86,546	78,059	85,768	78,669	154,452
Intangible Assets	60,237	33,618	33,063	43,615	39,433	44,433
Tangible Assets	94,667	52,928	44,996	42,153	39,236	110,019
Investments	0	0	0	0	0	0
Current Assets	102,374	23,204	46,429	20,270	41,719	59,452
Stocks	9,886	61	0	0	82	79
Debtors	24,427	13,694	10,053	7,213	14,757	14,193
Cash	67,671	9,449	36,376	13,057	26,880	45,180
Other	390	0	0	0	0	0
Current Liabilities	(77,222)	(21,769)	(12,107)	(9,373)	(12,279)	(11,424)
Creditors	(70,947)	(19,749)	(12,107)	(9,373)	(12,279)	(11,424)
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	102,056	196,425
CASH FLOW						
Operating Cash Flow	(77,686)	(19,721)	11,860	(11,957)	(9,785)	(1,356)
Net Interest	(1,120)	0	0	0	98	403
Tax	44,912	(27,086)	0	0	1,510	0
Capex	(10,987)	(8,075)	(2,220)	(10,074)	(5,000)	(78,700)
Acquisitions/disposals	24,338	0	(5,151)	(1,288)	27,000	0
Financing	6,118	1,510	24,403	0	0	97,953
Dividends	(18,652)	0	0	0	0	0
Net Cash Flow	(33,077)	(53,372)	28,892	(23,319)	13,823	18,300
Opening net debt/(cash)	(94,473)	(61,396)	(7,429)	(36,376)	(13,057)	(26,880)
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)	(26,880)	(45,180)

Source: BCI Minerals accounts, Edison Investment Research

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