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Pilbara climbs the $1B value wall

PILBARA Minerals (PLS) was a A$140 million company a little more than two years ago. In recent days, its value has clicked over to more than $1 billion, writes **Barry FitzGerald**.

Barry Fitzgerald | 04 Oct 2017 | 10:00 | Feature

Pilbara Minerals managing director Ken Brinsden

It has been remarkable stuff and goes to the group's rapid-fire ability to match up its world-class Pilgangoora lithium (and tantalum) deposit, 120kms south of Port Hedland, to the boom in demand fuelled by the global revolution in electric vehicles and off-grid battery storage of electricity.

The nudge to beyond $1 billion (its market cap is $1.07 billion at 64.5c on a fully diluted basis) came with Pilbara's September 27 offtake deal with China's Great Wall Motor Company for up to 150,000tpa of spodumene concentrate.

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The offtake deal was important at a number of levels. Firstly, there was what it said about the market dynamics.

Because it is believed to represent the first direct investment by an auto maker in to an upstream supplier of lithium raw materials, it said a lot about the emerging scramble by end users of lithium ion batteries to secure future supplies against mounting evidence of super-charged growth in demand.

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Pilbara managing director Ken Brinsden told MiningNews.net that the scramble by end-users to secure raw material supplies comes as "supply growth is not happening as quickly as people had previously assumed".

"Add that to demand growth exploding as lithium ion batteries become the rechargeable batteries of choice for applications like electrification of the transport industry and energy storage, and the net effect is end-users scrambling for supply and investors looking for leverage to the sector," Brinsden said.

On demand side of things, it is worth noting that General Motors – the world's third biggest auto maker with sales of 10m vehicles last year – said this week it was following the lead of other industry heavyweights by planning for an all electric future. No timing on that, but with 20 EV releases by 2023, the General has called time on combustion engines.

And then there was the recent wrap-up by UBS of its tour of 18 Chinese and Korean participants in the lithium-ion battery supply chain. "Manufacturers are scaling capacity 4-5 times by 2020, and potentially up to 10 times by 2025," UBS said.

On lithium specifically, UBS said that while supplies of lithium were thought to be sufficient, it suspected the speed of new battery capacity build will create faster demand growth than it had previously expected.

The UBS tour wrap preceded Pilbara's offtake agreement with Great Wall. But it sensed raw material deals with end users were in the offing, and agreed with Brinsden's assessment of where things are headed: "Raw material buyers are increasingly looking to invest upstream to secure access to required raw materials."

So much for what the Great Wall offtake agreement said about market dynamics. The real game changer for Pilbara though is the big valuation uplift triggered for the company by the binding supply agreement.

The uplift comes from the supply deal underpinning Pilgangoora's stage two expansion from its initial 314,000 tonnes of spodumene annually from the current $234 million development, due to start in the second quarter of next year.

The expansion would take spodumene output to 800,000 tonnes annually by about 2021, at an additional cost estimated by analysts at $175-$200 million, with offtakers to kick in cash pre-payments or debt finance for much of the cost.

The expansion has a dramatic impact on Pilbara's earnings capacity which is why Pilbara shares are up 20% since the agreement was announced, carrying the group's market cap to beyond $1 billion in the process.

While there is no formal go-ahead yet for the stage two expansion, analysts are now factoring it in anyway.

They are drawing confidence from the fact that with a previous offtake agreement for an expansion with Gangfeng Lithium, Pilbara has now covered 300,000 tonnes of the additional production, with the remainder to be covered by that raw materials "scramble" mentioned earlier.

Macquarie said that incorporating the expanded production case has transformed its earnings outlook for Pilbara.

"Capitalising costs in FY18 earnings results in an earnings loss now being forecast, and a slower ramp up translates to a 40% cut to FY19 earnings (to $50 million). However our earnings forecasts for FY20, FY21 and FY22 rise by 94% (to $184 million), 160% (to $264m) and 161% (to $275 million) respectively," Macquarie said.

"The (Great Wall) transaction demonstrates the accelerated growth in potential customers and in our view is a clear demonstration that electric vehicle manufacturers are becoming increasingly concerned over securing raw material supply."

"We now assume an expanded production scenario for Pilgangoora which should see Pilbara grow spodumene production to about 800,000 tonnes within four years," Macquarie said.

It has a 12-month price target on the stock of 75c. It assumes a long-term spodumene price of US$650 a tonne which compares with a range in contract prices for FY18 of $841 a tonne to $950 a tonne. It estimates economies of scale would reduce C1 costs of an expanded Pilgangoora from A$330 to $300 a tonne (not including royalties and by-product credits from tantalum sales).

Hartleys has also reworked its Pilbara valuation in light of the Great Wall supply deal derisking a stage two expansion to 800,000 tonnes of spodumene.

It now has a 12-month price target on Pilbara of $1.06, up from 80c previously. However it did sound a note of caution.

"We have no doubt that eventually lithium will be oversupplied. But whether that happens in 2018 or 2025 is not clear given the range of outcomes possible for demand."

But it added that as Pilbara will generate significant cash flow at current prices (when it is in production), prices only need to stay strong for a relatively short period to generate significant free cash.