FOSTER STOCKBROKING

EQUITY RESEARCH

Materials

7th March 2018

Pilbara Minerals Ltd (PLS.ASX)

POSCO downstream opportunity offers an NPV boost

Event:

- **POSCO agreement for offtake and downstream JV. Price target change.**

Investment Highlights:

- **PLS' LOM offtake agreement with POSCO for up to 240kt of Stage 2 offtake means that both Stages 1 and 2 spodumene concentrate sales are fully accounted for**. In return POSCO is subscribing for a $79.6M equity placement in PLS at $0.97/share which will close end March 2018**.**

- **Initially POSCO will purchase 80ktpa of spodumene and increase it to 240ktpa upon PLS participating in a downstream 30kt LCE joint venture (JV) at 30% equity.** POSCO will have 70% and no less than 51% should another party, most likely an end user such as a battery maker, participate in the JV as well. The downstream plant will have capability to produce both lithium carbonate and lithium hydroxide.

- **Stage 2 now fully funded as well.** PLS is targeting Stage 2 DFS mid-CY2018, FID in 3Q, and construction in 4Q2018. With Great Wall and POSCO only eligible for Stage 2 offtake, we expect strong momentum for Stage 2 proceeding sooner rather than later. POSCO's placement, together with previously agreed financing from Great Wall and Ganfeng, means Stage 2 capex of $207M is fully funded.

- **JV downstream interest essentially funded.** While the company has not disclosed capital or operating costs for the downstream JV, we estimate A$400M capex based on average of industry sources for a 30kt LCE plant**.** This equates to $120M for PLS' 30% interest. POSCO will provide a bond to PLS of $80M, meaning shortfall for downstream can be easily fulfilled from mine cash flows.

- **30% interest in JV can add incremental NPV of $141M over and above that of equivalent mine production.** We have built a conceptual model on the downstream plant assuming A$400M capex and operating costs of US$4,400/t of LCE (our estimates not the company's), and show it be NPV-accretive by $141M. We anticipate the refinery and Stage 2 to commence in FY21e vs PLS' target of Stage 2 commissioning in mid-FY20e.

Earnings and Valuation:

- **We have made slight changes to earnings forecasts**: -$15M in FY18e (prior $13M), $201M FY19e (prior $199M) and $173M (prior $172M) mostly due to lower interest expense.

- **We increase our PLS valuation to $1.21.share from $1.13/share.** The derisking of both Stage 2 production and the downstream plant following the offtake and funding agreement with POSCO increases our DCF valuation. This more than offset the dilutive impact of the POSCO equity placement on per share valuation.

Recommendation:

- **We maintain our Buy recommendation and increase our 12-month price target to $1.21/share from $1.13, in-line with our revised valuation.**

- **Catalysts for the share price include:** First DSO sales; Commissioning of process plant; First shipment of spodumene concentrate; DFS results of Stage 2; FID Stage 2; and Upgrade in JORC Reserves.

Recommendation	**Buy**
Previous	Buy
Risk	High
Price Target	**$1.21**
Previous	$1.13
Share Price (A$)	**$ 0.845**
ASX Code	PLS
52 week low - high (A$)	0.3125-1.25
Valuation (A$/share) - risked	**$1.21**
Methodology	DCF
Capital structure	
Shares on Issue (M) pro-forma*	1,728
Market Cap (A$M) pro-forma*	**1,460**
Net Cash/(Debt) Dec 17 (A$M) pro-forma*	152
EV (A$M) pro-forma*	**1,309**
Performance rights	0
Options (M)	72
Fully diluted EV ($M) pro-forma*	**1,369**
***Includes $80M POSCO placement of 82.1M shares**	
12mth Ave Daily Volume ('000)	13,819

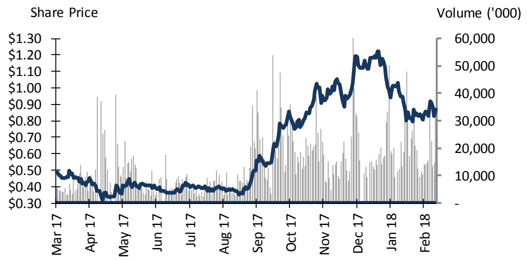
Y/e Jun (A$M)	**2017a**	**2018e**	**2019e**	**2020e**
Sales	0	26	402	431
Adj EBITDA	-28	-1	276	278
Adj NPAT underlying	**-26**	**-15**	**201**	**173**
Adj EPS diluted $	**-0.02**	**-0.01**	**0.11**	**0.10**
PER x diluted	**nm**	**nm**	**7.6**	**8.8**
EV/EBITDA x	nm	nm	3.7	3.7

*Adj = underlying FSB estimate

Board	
Tony Kiernan	Non-Executive Chairman
Ken Brinsden	Managing Director
Nick Cernotta	Non-Executive Director
Steve Scudamore	Non-Executive Director
John Young	Non-Executive Director

Substantial shareholders	
Mineral Resources Ltd	8.2%

Share Price Graph



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The analyst owns 254,462 PLS shares.
Foster Stockbroking and associated entities (excluding Cranport Pty Ltd) own 604,462 PLS shares.
Cranport Pty Ltd owns 600,000 PLS shares.

Pilbara Minerals (PLS)
Full Year Ended 30 June

Profit and Loss A$M	2017a	2018e	2019e	2020e
Sales	0	26	402	431
Other revenue	2	1	0	0
Operating Costs	30	28	125	153
Underlying EBITDA	**-28**	**-1**	**276**	**278**
D&A	0	0	16	21
Underlying EBIT	**-28**	**-1**	**261**	**256**
Net Interest exp / (income)	-2	14	13	9
Profit before tax	**-26**	**-15**	**248**	**247**
Tax exp / (benefit)	0	0	47	74
Underlying NPAT	**-26**	**-15**	**201**	**173**
Non-recurring exp/(benefit)	0	0	0	0
Reported NPAT	**-26**	**-15**	**201**	**173**
Underlying EPS diluted ($)	**-0.02**	**-0.01**	**0.11**	**0.10**

Cashflow A$M	2017a	2018e	2019e	2020e
Underlying EBITDA	-28	-1	276	278
Change in WC	0	-19	-18	10
Tax paid	0	0	-47	-74
Other	-3	5	0	0
Net interest	2	-14	-13	-9
Share based payments	12	3	0	0
Operating Cashflow	**-16**	**-25**	**199**	**204**
Purchase of PP&E	-47	-236	-11	-211
Acquisitions	-8	0	0	0
Investments	0	0	0	0
Other	0	0	0	0
Investing Cashflow	**-54**	**-236**	**-11**	**-211**
Equity issue	68	149	0	0
Debt proceeds	132	0	0	0
Debt repayments	0	0	0	0
Other	-8	-3	0	0
Financing Cashflow	**193**	**146**	**0**	**0**
Net Cashflow	**122**	**-115**	**188**	**-7**

Balance Sheet A$M	2017a	2018e	2019e	2020e
Cash	222	107	295	288
Receivables	4	16	33	34
Inventories	0	0	0	0
PPE	104	340	335	525
Capitalised exploration	6	6	6	6
Intangibles	0	0	0	0
Other	0	0	12	5
Total Assets	**336**	**469**	**682**	**859**
Accounts payable	11	3	9	11
Provisions	0	2	10	13
Debt	124	124	124	124
Other	0	6	3	3
Total Liabilities	**136**	**135**	**146**	**150**
Reserves and capital	294	444	444	444
Retained earnings	-94	-109	92	265
Total Equity	**200**	**334**	**535**	**709**

Capital structure	M
Ordinary shares	1,728
Performance rights	0
Options	72
Fully diluted equity pro-forma	**1,800**

Financial Metrics	2017a	2018e	2019e	2020e
Sales growth %	nm	nm	nm	7%
EPS growth %	nm	nm	nm	-14%
EBITDA margin	nm	nm	69%	64%
EBIT margin	nm	nm	65%	59%
Gearing (ND/ND+E)	-94%	5%	-47%	-30%
Interest Cover (EBIT/net int)	nm	nm	20x	28x
Average ROE %	nm	nm	46%	28%
Average ROA %	nm	nm	45%	33%
Wtd ave shares (M)	1,230	1,632	1,728	1,728
Wtd ave share diluted (M)	1,334	1,704	1,800	1,800

Sales and earnings multiples	2017a	2018e	2019e	2020e
P/E x	**nm**	**nm**	**7.6**	**8.8**
EV/EBITDA x	nm	nm	3.7	3.7
EV/EBIT x	nm	nm	4.0	4.0

Company Valuation	A$M	A$/sh	A$M	A$/sh
DCF, WACC 10% nominal	**Unrisked**	**Unrisked**	**Risked**	**Risked**
Segment	**A$M**	**A$/sh**	**A$M**	**A$/sh**
Pilgangoora 2Mtpa - using Reserves	1251	$0.70	1,126	$0.63
5Mtpa - incremental value using Reserves	669	$0.37	535	$0.30
DSO	113	$0.06	102	$0.06
Sub-total 5Mtpa	2032	$1.13	1,762	$0.98
Resources ex-Reserves at 2Mtpa	58	$0.03	26	$0.01
Resources ex-Reserves - incremental at 5Mtpa	493	$0.27	197	$0.11
Refinery option - incremental	141	$0.08	58	$0.03
Unallocated corporate	-76	-$0.04	-59	-$0.03
Cash - options-in-money	34	$0.02	30	$0.02
Net cash - end Dec 17 pro-forma (incl POSCO placement)	152	$0.08	152	$0.08
Company Valuation	**2833**	**$1.58**	**2,166**	**$1.21**
Ordinary shares proform (incl POSCO placement)	1728		1,728	
Shares - exercise of options M	70		63	
Performance rights	0		0	
Pro-forma diluted shares M	1798		1,791	

Commodity Assumptions	2017a	2018e	2019e	2020e
Prices				
Spodumene 6% Li_2O CFR (US$/t)	707	859	835	747
DSO 1.5% Li_2O, mine gate (US$/t)	55	55	55	55
Tantalite (US$/lb)	51	52	52	51
A$ (US$)	0.75	0.77	0.76	0.75
Production				
Spodumene 6.0% kt	0.0	0.0	223.6	351.6
DSO Mt	0.0	0.2	1.1	0.1
Tantalite t	0.0	0.0	91.1	145.8
Costs				
Costs - AISC US$/t, CFR 6% spodumene	nm	nm	256	250
Costs - AISC DSO 1.5% Li_2O, US$/t	nm	19	19	19

JORC Resources & Reserves				
Pilgangoora	**Ore Mt**	**Li_2O %**	**Li_2O kt**	**LCE Mt**
Measured	17.6	1.39%	244	0.60
Indicated	77.7	1.31%	1,017	2.52
Inferred	61.1	1.13%	691	1.71
Total Resources	**156.3**	**1.25%**	**1,952**	**4.83**
Total Reserves	**80.3**	**1.27%**	**1,020**	**2.52**

Source: Company; Foster Stockbroking estimates

POSCO AGREEMENT WRAPS UP STAGE 2

Offtake secured in return for equity placement

- POSCO last week signed a binding life-of-mine (LOM) agreement with PLS for up to 240kt of Pilgangoora Stage 2 spodumene offtake. In return POSCO will subscribe for a placement of 82.1M PLS shares at $0.97/share for $79.6M, and invite PLS in a proposed downstream lithium processing facility to be located in South Korea. The placement will result in POSCO owning 4.75% of PLS. The placement is targeted to close end March 2018.
- Initially, POSCO will agree for 80ktpa of Stage 2 offtake in return for the equity placement. This will then increase to 240ktpa upon PLS participating in a downstream 30kt LCE conversion plant joint venture with POSCO, that can produce both lithium carbonate and lithium hydroxide.
- Pricing of offtake will be based on battery grade carbonate and hydroxide prices in South Korea.

Final piece of Stage 2 jigsaw puzzle completed

- The POSCO offtake agreement means that both Stage 1 and 2 spodumene concentrate is now effectively all sold across four customers – General Lithium, Ganfeng, Great Wall and now POSCO – while the company still retains 100% of Pilgangoora.

Figure 1: Pilgangoora Lithium Offtake Breakdown

Customer	Origin	Offtake secured (kt)	Stage	%
General Lithium	China	150	1	17%
Ganfeng	China	up to 310	1 and 2	36%
Great Wall	China	up to 150	2	17%
POSCO	South Korea	up to 240	2	28%
Total		**Up to 850**		**100%**

Source: Company; Foster Stockbroking estimates.

Stage 2 moving with impetus as funding now all in place

- For the 5Mtpa Stage 2 project, the company is targeting DFS mid-CY2018, FID in 3Q, and construction in 4Q and commissioning from 4QCY2019. We are more conservative, factoring in commissioning from FY21e.
- We note that Great Wall and POSCO are only eligible for Stage 2 offtake, and believe both customers will be keen for Stage 2 to proceed sooner rather than later, and provide impetus for the project momentum to be maintained.
- The $79.6M POSCO equity placement, together with existing funding agreements in place with Great Wall and Ganfeng means that PLS is now fully funded for Stage 2, even after not accounting for any inclusion of cash flows from DSO or Stage 1. This further fuels momentum for Stage 2 by eliminating the requirement for any further financing to be negotiated.

Figure 2: Funding of Stage 2 Capex

	A$M
Stage 2 Capex	**207**
Funding source:	
Great Wall: US$50M	64*
Ganfeng: US$50M	64*
POSCO placement	80
Total	**208**
Surplus (shortfall)	**1**

**Assumes A$ = US$0.78*

Source: Company; Foster Stockbroking estimates.

JV opportunity to participate downstream

- Key conditions of the proposed JV will be PLS agreeing to be a 30% participant (at its election) for the development and operation of a downstream plant from 2019. Production from the plant would be targeted from 1H CY2020. POSCO will initially hold 70% of the JV and PLS 30%. POSCO will maintain a minimum of 51%, should another partner, likely an end user such as battery manufacturer, participate in the JV.
- The plant will be located in South Korea and use POSCO's PosLX conversion technology. POSCO is the first company in South Korea to produce battery grade lithium carbonate and hydroxide and PosLX can reduce cost of spodumene conversion by recycling reagents. PosLX can make lithium hydroxide for high nickel cathode materials and produce battery grade or ultra-purity grade carbonate. POSCO opened its first PosLX plant in February 2017 to produce 2,500tpa of carbonate.
- PLS has the right to participate in the JV at any time up to November 2018. The JV is subject to stage 2 FID, license agreement re use of PosLX, regulatory, construction approvals for plant, and completion of due diligence and documentation by no later than March 2019.

Favourable bond financing for JV offered

- Additionally, POSCO will provide an unsecured convertible bond for a further $79.6M available to PLS to fund its downstream development. The bond is conditional upon the JV participation finalised by March 2019. We view the bond terms as mostly favourable including:
  - Interest at 1.5% premium to RBA cash rate, currently equivalent to circa 3% p.a;
  - Convertible to PLS shares at 7.5% discount at any time with power to convert residing only with PLS;
  - Five year term repayable on maturity;
  - Redeemable at company's election at any time.
- While no capex has been disclosed by PLS for the downstream development, we derive our own estimate of $400M (US$300M) for 100% of the plant. Our figure is based on average of industry estimates we have observed. For PLS' 30% interest, this would imply its share of funding to be A$120M. This equates to a shortfall of only $40M after the bond, which could easily be funded from the mine's cash flows.

DOWNSTREAM PLANT NPV ACCRETIVE ABOVE MINE

Conceptual model yields incremental unrisked $141M NPV for 30% interest

- While PLS has not disclosed any financial metrics of the proposed downstream JV, we have made a rudimentary stab at approximating what the valuation and cash flows of refinery could be. To do this, we have used capital and operating costs assumptions which we have based on an average of various estimates disclosed by industry sources. We assume:
  - Capital cost of US$300M for a 30kt LCE plant and operating costs (inclusive spodumene feed and conversion cost) of circa US$4,400/t;
  - Current long-term prices for spodumene 6% concentrate of US$651/t and US$11,558/t for BG lithium carbonate.
  - We also assume Stage 2 and the refinery to begin in FY21e (vs PLS target of FY20e).
- Figure 3 shows a comparison of cash flows with 240ktpa of spodumene fed to a conversion plant versus being sold externally. It can be seen that downstream yields higher cash flows. While on EBIT margin there is not much difference between the two operations, the higher value product of the refinery means cash flow is greater in quantum.

Figure 3: Conceptual Comparison of Cash Flow Between Conversion Plant & Mine

	Unit	FY20e	FY21e	FY22e	FY23e	FY24e
Assumptions:						
Li_2CO_3 BG 99.5% China US$/t	US$/t	13,844	12,199	11,331	11,558	11,789
Spodumene price US$/t	US$/t	747	682	651	664	677
A$	US$	0.75	0.74	0.74	0.74	0.74
30kt LCE conv plant:						
Spodumene feed kt	kt		151	203	252	240
Recovery %	%		87%	87%	87%	87%
LCE kt	kt		20	26	32	31
LCE sales	US$M		238	296	376	366
Operating costs	US$M		86	115	145	144
Unit cost	US$/t		4,377	4,388	4,454	4,655
EBITDA	US$M		153	182	231	221
D&A	US$M		20	24	24	24
EBIT	US$M		144	158	207	198
Tax	US$M		37	43	57	54
Capex	US$M	300	5	5	5	5
Chng in WC	US$M		-13	-4	-6	1
Cash flow (A)	**US$M**	**-300**	**98**	**129**	**163**	**163**
Spodumene only mined 240kt:						
Spodumene produced	kt		151	203	252	240
Spodumene sales	US$M		103	132	167	163
Costs	US$M		50	50	51	55
EBITDA	US$M		53	82	116	108
D&A	US$M		8	8	8	8
EBIT	US$M		46	74	109	100
Tax	US$M		14	22	33	30
Chng in WC	US$M		-4	-2	-3	1
Capex	US$M		2	2	2	2
Cash flow (B)	**US$M**		**33**	**55**	**79**	**76**
Cash flow delta btw LCE & spod (A-B)	**US$M**	**-300**	**65**	**74**	**84**	**86**

Source: Foster Stockbroking estimates.

- The greater cash flow is reflected in Figure 4 which shows the refinery yields a higher NPV, making it compelling on this basis to pursue. We show unrisked NPV which is based on life-of-mine modelled on all current Resources.

Figure 4: NPV Delta Between LCE Plant and Spodumene Mine (A$M)

Operation	100%	30% interest
NPV_{10} 30kt LCE unrisked	1,415	425
NPV_{10} 240kt mine unrisked	945	284
NPV_{10} delta	**470**	**141**

Source: Foster Stockbroking estimates

TIMELINE

DSO sales next quarter, spodumene production late 2Q CY2018.

- PLS is targeting wet commissioning of the plant to start 2Q 2018 and first concentrate later in the quarter. DSO sales should start sooner, PLS expecting these to commence 2Q 2018 - we expect April 2018. Atlas Iron (AGO) recently signed an agreement with end user Sinosteel for export of Pilgangoora DSO, which AGO will process, transport, and ship. Mining by the contractor MACA is underway for both Stage 1 and DSO.

EARNINGS FORECASTS

- We have made only slight changes to earnings our forecasts mostly based on lower net interest expense from the placement, with NPAT for FY18e now -$15M (prior -$13M), $201M for FY19e (prior $199M) and $173M for FY20e (prior $172M).

VALUATION – INCREASES TO $1.21/SHARE (PRIOR $1.13)

Derisking Stage 2 and refinery increases NPV

- We have increased our risked NPV_{10} valuation of PLS to $1.21/share from $1.13/share. The increase is mostly due to derisking both Stage 2 and refinery option, following the agreement with POSCO which gives us more confidence on both offtake and funding for the projects. This has more than offset the dilutive per share impact of the POSCO placement.

Figure 7: PLS Valuation

Segment	Unrisked A$M	Unrisked A$/sh	Risked A$M	Risked A$/sh	1- Risk factor
Pilgangoora 2Mtpa – using Reserves	1,238	$0.69	1,114	$0.62	90%
5Mtpa - incremental value using Reserves	682	$0.38	545	$0.30	80%
DSO	113	$0.06	102	$0.06	90%
Sub-total 5Mtpa Stage 2	2,032	$1.13	1,761	$0.98	87%
Resources ex-Reserves at 2Mtpa	58	$0.03	26	$0.01	45%
Resources ex-Reserves – incremental at 5Mtpa	493	$0.27	197	$0.11	40%
Refinery option - incremental	141	$0.08	58	$0.03	41%
Unallocated corporate/tax losses	-76	-$0.04	-59	-$0.03	77%
Cash – Exercise of options	34	$0.02	30	$0.02	90%
Net cash Dec 2017 pro-forma incl POSCO placement	152	$0.08	152	$0.08	100%
Company Valuation	**2,833**	**$1.58**	**2,165**	**$1.21**	**76%**
Ord shares pro-forma incl POSCO placement M	1,728		1,728		100%
Shares - exercise of options M	70		63		90%
Performance rights	0		0		90%
Pro-forma diluted shares M	1,798		1,791		100%

Source: Foster Stockbroking estimates.

RECOMMENDATION – MAINTAIN BUY, PT INCREASED TO $1.21/SHARE

- We maintain our Buy recommendation on PLS, and increase our 12-month price target to $1.21/share, in-line with our revised valuation. We envisage a number of milestones for PLS over the remainder of CY2018. These include:
    - Updated JORC Mineral Resource - Early CY2018
    - Receipt of AGO pre-payment – March 2018
    - Commissioning of concentrator – April 2018
    - First DSO sales – April 2018
    - Revised JORC Reserve – mid CY2018
    - DFS on 5Mtpa Stage 2 - Mid CY2018
    - First production of concentrate – July 2018
    - First shipment of concentrate – August 2018
    - FID Stage 2 – 3Q CY2018
    - JV progress.

APPENDIX A-1:

Pilgangoora Cash Flows FY18e – FY20e

Y/e June	Unit	2018e	2019e	2020e
Commodity assumptions:				
Spodumene concentrate 6% Li_2O	US$/t	859	835	747
DSO 1.5% Li_2O, mine gate	US$/t	55	55	55
Tantalite	US$/lb	52	52	51
A$	US$	0.77	0.76	0.75
Production:				
Ore mined incl. DSO	Mt	0.2	2.5	2.1
Spodumene 6% Li_2O concentrate	kt	0	224	352
DSO 1.5% Li_2O	kt	0.2	1.2	0.1
LCE	Mt	6	78	56
Cashflow:				
Spodumene 6% Li_2O sales	A$M	0	201	391
DSO sales	A$M	26	189	16
Totals sales (A)	**A$M**	**26**	**390**	**407**
Total cash costs	A$M	4	98	113
EBITDA	**A$M**	**22**	**292**	**294**
All-in-sustaining costs (conc)	US$/t	0	251	257
All-in-sustaining costs (DSO)	US$/t	19	19	19
All-in-sustaining costs (B)	**A$M**	**4**	**104**	**123**
Project capex (C)	A$M	231	6	202
Chng In Working Capital (D)	A$M	8	17	-1
Tax (E)	A$M	6	83	82
Net Free Cashflow (A-B-C-D-E)	**A$M**	**-228**	**182**	**2**

Source: Foster Stockbroking estimates.

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