

# PILBARA MINERALS (PLS)

## Funding in place, FID imminent, Time to Buy

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**We say**

# BUY

**Price**

# 0.36

**Target**

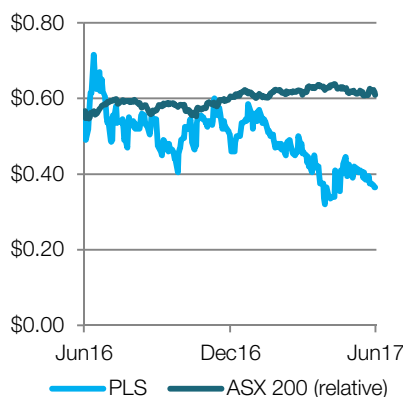
# 1.10

**Strategic Target**

# 1.80

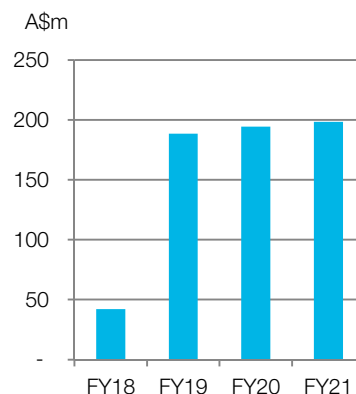
PLS has now secured the balance of funding to build its world-class Pilgangoora lithium project in WA. As the major global technological shift towards the electrification of vehicles becomes clearer, we continue to believe PLS is the go-to ASX lithium name given its superior scale, low-risk jurisdiction and low risk mining and processing. Pilbara remains our top pick in the ASX lithium space and our revised price target of \$1.10 (from \$1.25) has an implied return of over 200%.

### PLS SHARE PRICE (A\$)



Source: IRESS

### EBITDA @ US\$650/T



Source: Blue Ocean estimates

### COMPANY DATA & RATIOS

Enterprise value	\$490m
Diluted market cap*	\$607m
Diluted shares*	1,686m
Free float	100%
12 month price range	0.31-0.74
GICS sector	Materials
Management holds ~5% (fully diluted)	
*Diluted for 102m options	

### IMPLIED RETURN

Implied all-in return	206%
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## FUNDING IN PLACE

PLS recently completed a US\$100m bond with a 5-year term and 12% coupon as well as an A\$80m placement at 35c to institutions (A\$53m) and Ganfeng (A\$27m), one of its Chinese offtakers. With all native title, environmental permits and the Mining Lease in place we expect the PLS board to confirm a positive Final Investment Decision on Pilgangoora shortly, paving the way to commence major construction activities.

## UPSIDE TO BURN

Most lithium industry players expect the lithium supply / demand balance to remain tight until at least 2020. If that proves correct, we believe current elevated prices could persist for several years. That said, our forecasts *don't* assume that. Our forecast assume prices fall 28% to US\$650/t. On page 3 of this report we explore several scenarios where the NPV for Pilgangoora could be as high as ~A\$1.5-2bn.

## EASING PRICE TARGET TO \$1.10. MAINTAIN BUY

We reduce our price target to \$1.10 (from \$1.25) predominately due to the more dilutive final funding package than our previous forecasts. We also use a lithium concentrate price of US\$650/t, ~28% below the most recently agreed prices. Even then, on our forecasts PLS is trading on an undemanding P/NAV of 0.3x. Far too cheap in our view for a company with a clear path to production.

## PILGANGOORA FUNDING IN PLACE

In the last month, Pilbara Minerals has confirmed the balance of the funding to build Pilgangoora:

- A\$133m bond (US\$100m), with a 5-year term and 12% coupon
- A\$80m placement @ 35c comprising:
  - A\$53m to institutional investors (increased by A\$3m from A\$50m)
  - A\$27m (US\$20m) to Ganfeng (one of PLS's Chinese offtake partners)
- A\$15m SPP @ 35c assuming full uptake (opens 27 June, closes 17 July)

The recent A\$80m placement was undertaken in two tranches:

- Tranche 1: A\$66.5m settles on 26 June 2017 (PLS's 15% placement capacity)
- Tranche 2: A\$13.5m subject to shareholder approval on 26 July, settles on 2 August 2017

The table below summarises the funding sources and uses for the 2mtpa Pilgangoora project:

Sources		Uses	
Cash Balance (30 April 2017)	A\$51 million	Remaining Pilgangoora Project Capex	A\$207 million
General Lithium Equity (previously approved by shareholders)	A\$18 million	Corporate and Exploration	A\$16 million
Ganfeng New Equity <sup>2</sup>	A\$27 million	Interest Costs	A\$16 million
Other New Equity <sup>2</sup>	A\$50 million	Funding Costs and General Working Capital	A\$19 million
SPP Proceeds (assuming full uptake)	A\$15 million	Management and Liquidity Reserves <sup>3</sup>	A\$35 million
Bond Issue Proceeds <sup>1</sup>	A\$133 million	<b>Total Uses</b>	<b>A\$293 million</b>
<b>Total Sources</b>	<b>A\$293 million</b>		

<sup>1</sup> Total of USD 100 million and a USD:AUD exchange rate of 0.75

<sup>2</sup> Total placement of A\$77 million.

<sup>3</sup> Liquidity reserve of A\$15M and Cost Overrun Account of A\$10M required as per the Bond Terms

Source: Company

It is worth noting that we still see funding risk on some elements of the financing package, namely the funds from the Chinese counterparties (Ganfeng and General Lithium) and the SPP, but once these funds settle, PLS should be in a strong position. We also believe there is a sufficient funding buffer in funding "Uses" within Corporate and Exploration (A\$16m), Funding costs and General Working Capital (A\$19m) and Management and Liquidity Reserves (A\$35m).

### Final Investment Decision Imminent

As per this extract from the company's latest investor presentation, PLS has now secured the necessary native title and environmental permits as well as the Mining Lease at Pilgangoora.

The company has also secured offtake for over 95% of forecast production from Pilgangoora (300ktpa out of 315ktpa) with its two key Chinese offtakers – General Lithium and Ganfeng.

We expect the board of PLS to confirm the Final Investment Decision (FID) to commence major construction works at Pilgangoora shortly.

▶ Updated Resource of 156Mt 1.25% Li <sub>2</sub> O	✓
▶ Native Title Agreement	✓
▶ Mining Leases granted	✓
▶ Construction commenced	✓
▶ Plant EPC Contract Tender/Award	✓
▶ Native Vegetation Clearing Permit	✓
▶ Mining Proposal Approval	✓
▶ Secure offtake	✓
▶ Financing / FID	
▶ Other construction and operating contracts	
▶ Major Works Construction	
▶ Commissioning on track for March 2018	

## COMPELLING VALUE IN OUR VIEW

In our view PLS is compelling value and **on our estimates PLS is trading on just 0.3x P/NAV using a spodumene price of US\$650/t (compared to recent prices closer to ~US\$900/t)**. We continue to believe the stock should re-rate materially higher as the company makes the transition into production, due in Q2 CY18.

### Recent Lithium Prices

There is no spot price for lithium concentrates, so the best guide in our view is recently offtake agreements:

- **April 2017:** Tawana (TAW): **US\$880/t** FOB Esperance for all 6% Li<sub>2</sub>O conc production between March 2018 and December 2019. Offtaker: Burwill Holdings (HK: 0024)
- **December 2016:** Galaxy (GXY): **US\$905/t** FOB Esperance for 6% Li<sub>2</sub>O conc production in CY17 from Mt Cattlin. Offtakers: Chinese customers but identities not disclosed, but settled through Mitsubishi Corp.

PLS includes ocean freight to China of ~US\$20/t in its costs, so on a like for like basis, on our estimates, the most recent price agreed by Tawana would be closer to ~US\$900/t CFR China.

### Supply / Demand Outlook

While the full lithium picture remains relatively opaque, most of the lithium industry players we have spoken to continue to believe **the supply / demand balance for lithium is likely to remain tight until at least 2020**. If this forecast proves correct, we believe it's possible the current elevated prices could potentially persist for a few years.

If current lithium concentrate prices hold up, for PLS this would mean:

- Price ~US\$900/t
- Cost to China ~US\$260/t (based on the DFS)
- **Margins >70% or US\$640/t on 315ktpa of production**
- EBITDA ~US\$200m p.a. or ~A\$267m p.a.

While we regard this as a possible upside scenario... our current forecasts assume lithium concentrate prices pull back ~28% from ~US\$900/t to US\$650/t. At US\$650/t, PLS would still generate EBITDA of ~A\$200m p.a.

### Some food for thought

At 36c PLS has a fully-diluted market cap of A\$607m, but running the scenarios below, the NPV<sub>10</sub> for Pilgangoora would be:

- A\$1.06bn at US\$650/t, a 2mtpa rate and a flat A\$/US\$ of 0.75
- A\$1.21bn at US\$650/t, a 2mtpa rate and **A\$/US\$ falling to 0.70**
- A\$1.30bn at **US\$550/t**, a **4mtpa** rate and a flat A\$/US\$ of 0.75
- A\$1.48bn at US\$550/t, a 4mtpa rate and **A\$/US\$ falling to 0.70**
- A\$1.72bn at **US\$650/t**, a 4mtpa rate and a flat A\$/US\$ of 0.75
- A\$1.93bn at US\$650/t, a 4mtpa rate and **A\$/US\$ falling to 0.70**

Many would argue a 10% discount rate is too high... providing scope to lift the NPV even further!

## PRICE TARGET & RATING

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We reduce our price target to \$1.10 (from \$1.25) based on our risk-adjusted NAV representing an implied return of over 200%.

The key changes since our last published note are:

- Updating our forecasts to reflect the final funding package, including considerably more dilution than our previous assumptions. The bulk of the recent A\$53m placement @ 35c was to cover the upfront costs of the US\$100m bond. i.e. A\$25m in liquidity reserves and overrun facilities required under the bond and A\$16m in upfront interest costs.
- Reducing the discount applied to our NPV on the Pilgangoora 2mtpa scenario from 10% to 0% now all environmental permits and the mining licence is in place and the project is fully funded

## STRATEGIC TARGET

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Our \$1.80 Strategic Target for Pilbara minerals is primarily based on:

- Running the 4mtpa case as our base case (instead of the 2mtpa case)
- Removing the discounts applied to each element of our valuation
- Using US\$800/t spodumene instead of US\$650/t

## KEY RISKS

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Pilbara Minerals is exposed to all the normal risks associated with developing and operating mining projects, including construction, commissioning and ramp-up risks.

Assuming the company successfully makes the transition into production, the company's revenues will be derived from the sale of lithium concentrate (spodumene) and tantalum. Fluctuations in the lithium concentrate and tantalum price as well as the Australian dollar could impact the company's cash flow, profitability and share price.

Pilbara Minerals' shares also carry embedded Australian sovereign risk as the company's projects are based in Western Australia.

## MODEL SUMMARY – FINANCIALS & VALUATION

Stock Details				Enterprise Value	
Recommendation:	<b>BUY</b>			Diluted MCap	\$607m
Target	\$1.10	Share Price	\$0.36	Diluted Shares	1,686m
NAV	\$1.10	52 Week High	\$0.74	Free Float	100%
Implied Return	206%	52 Week Low	\$0.31	Avg Daily Value	\$5.0m
		Strategic Target (ST)	\$1.70		
		Implied Return to ST	372%		

Macro Assumptions	FY16	FY17E	FY18E	FY19E	FY20E
Exchange Rate (A\$/US\$)	0.73	0.75	0.74	0.73	0.71
Avg Li Conc Price (US\$/t)	650	650	650	650	650
Tantalum Price (US\$/lb)	60	60	60	60	60
Avg Li Conc Price (A\$/t)	892	862	884	897	915
Tantalum Price (A\$/lb)	82	80	82	83	85

Profit & Loss (A\$m)	FY16	FY17E	FY18E	FY19E	FY20E
Revenue	-	-	81	325	332
Operating Costs	-	-	(32)	(128)	(129)
<b>Operating Profit</b>	-	-	<b>49</b>	<b>197</b>	<b>203</b>
Corporate & Other	(31)	(14)	(6)	(6)	(6)
Exploration Expense	(11)	(7)	(1)	(3)	(3)
<b>EBITDA</b>	<b>(42)</b>	<b>(22)</b>	<b>42</b>	<b>189</b>	<b>194</b>
D&A	(0)	(0)	(2)	(7)	(7)
<b>EBIT</b>	<b>(42)</b>	<b>(22)</b>	<b>40</b>	<b>182</b>	<b>188</b>
Net Interest Expense	(2)	2	(6)	(5)	(0)
<b>Pre-Tax Profit</b>	<b>(44)</b>	<b>(19)</b>	<b>34</b>	<b>177</b>	<b>188</b>
Tax Expense	(0)	-	(11)	(53)	(56)
<b>Underlying Profit</b>	<b>(44)</b>	<b>(19)</b>	<b>23</b>	<b>124</b>	<b>131</b>
Significant Items (post tax)	(11)	-	-	-	-
<b>Reported Profit</b>	<b>(56)</b>	<b>(19)</b>	<b>23</b>	<b>124</b>	<b>131</b>

Cash Flow (A\$m)	FY16	FY17E	FY18E	FY19E	FY20E
Operating Cashflow	(5)	(4)	43	191	197
Tax	(1)	-	-	-	(55)
Net Interest	(0)	2	(6)	(5)	(0)
<b>Net Operating Cash Flow</b>	<b>(6)</b>	<b>(2)</b>	<b>37</b>	<b>186</b>	<b>142</b>
Exploration	(10)	(8)	(1)	(3)	(3)
Capex	(5)	(54)	(180)	(8)	(8)
Acquisitions / Disposals	(2)	0	-	-	-
Other	(1)	(5)	-	-	-
<b>Net Investing Cash Flow</b>	<b>(17)</b>	<b>(66)</b>	<b>(180)</b>	<b>(11)</b>	<b>(11)</b>
Equity Issue	116	72	47	13	15
Borrowing / Repayments	4	(0)	80	(80)	-
Dividends	-	-	-	-	(17)
Other	-	-	-	-	-
<b>Net Financing Cash Flow</b>	<b>120</b>	<b>71</b>	<b>127</b>	<b>(67)</b>	<b>(2)</b>
Change in Cash Position	97	3	(17)	108	129
FX Adjustments	-	-	-	-	-
<b>Cash Balance</b>	<b>100</b>	<b>103</b>	<b>86</b>	<b>194</b>	<b>323</b>

Balance Sheet (A\$m)	FY16	FY17E	FY18E	FY19E	FY20E
Cash	100	103	86	194	323
Other Current Assets	2	2	2	2	2
PP&E	1	107	285	286	287
Exploration & Development	0	5	5	6	6
Other Non Current Assets	0	0	0	0	0
<b>Total Assets</b>	<b>103</b>	<b>217</b>	<b>378</b>	<b>487</b>	<b>618</b>
Debt	0	0	80	0	0
Other Liabilities	4	6	17	70	71
<b>Net Assets</b>	<b>98</b>	<b>210</b>	<b>281</b>	<b>417</b>	<b>547</b>

Ratio Analysis		FY16	FY17E	FY18E	FY19E	FY20E
Diluted Shares	m	1,150	1,588	1,686	1,686	1,686
EPS - Diluted	Ac	(4.8)	(1.6)	1.4	7.4	7.8
<b>P/E</b>	<b>x</b>	<b>n.m.</b>	<b>n.m.</b>	<b>25.6x</b>	<b>4.9x</b>	<b>4.6x</b>
CFPS - Diluted	Ac	(0.7)	(0.2)	2.2	11.1	8.5
<b>P/CF</b>	<b>x</b>	<b>n.m.</b>	<b>n.m.</b>	<b>16.3x</b>	<b>3.2x</b>	<b>4.3x</b>
FCF - Diluted	Ac	(0.9)	(3.7)	(8.1)	10.9	7.9
<b>P/FCF</b>	<b>x</b>	<b>n.m.</b>	<b>n.m.</b>	<b>n.m.</b>	<b>3.3x</b>	<b>4.5x</b>
Dividends	Ac	-	-	-	-	2.0
Dividend yield	%	-	-	-	-	5.6%
Payout Ratio	%	-	-	-	-	25%
Franking	%	-	-	-	-	100%
Enterprise Value	A\$m	507	504	601	413	284
<b>EV/EBITDA</b>	<b>x</b>	<b>n.m.</b>	<b>n.m.</b>	<b>n.m.</b>	<b>2.2x</b>	<b>1.5x</b>
ROE	%	(45%)	(9%)	8%	30%	24%
ROA	%	(43%)	(9%)	6%	25%	21%
Net Debt or (Cash)	A\$m	(100)	(103)	(6)	(194)	(323)
Gearing (ND/(ND+E))	%	n.m.	n.m.	(2%)	(87%)	(144%)
Gearing (ND/E)	%	n.m.	n.m.	(2%)	(46%)	(59%)

Lithium (Li <sub>2</sub> O)	P&P Reserves		M&I Resources		Inferred		
	mt	%	cont(kt)	mt	%	cont(kt)	cont(kt)
Pilgangoora	69.8	1.26%	883	95.3	1.32%	1,261	691
						<b>Total</b>	<b>1,952</b>

Tantalum (Ta <sub>2</sub> O <sub>5</sub> )	P&P Reserves		M&I Resources		Inferred		
	mt	ppm	cont(mlb)	mt	ppm	cont(mlb)	cont(mlb)
Pilgangoora	29.5	134	8.7	95.3	130	27.37	16.84
Tabba Tabba	0.13	1,290	0.38	0.22	1,077	0.53	0.14

Earnings Sensitivity		FY19E	FY20E	FY19E	FY20E
		A\$m	A\$m	%	%
Lithium conc price	US\$/t +10%	20	20	16%	16%
Tantalum price	US\$/lb +10%	2	2	1%	1%
Exchange Rate	A\$/US\$ -10%	22	22	18%	17%

Valuation	Discount	Stake	A\$m	A\$/sh
Pilgangoora 2mtpa	-	100%	1,295	0.77
Expansion to 4mtpa	40%	100%	436	0.26
Downstream processing	60%	50%	58	0.03
Corporate & Other			(60)	(0.04)
Debt			-	-
Cash			118	0.07 P/NAV
<b>Risk adjusted NAV</b>			<b>1,847</b>	<b>1.10</b> 0.33x

Source: IRESS, Company data, Blue Ocean estimates

## MODEL SUMMARY – INPUTS & FREE CASH FLOW

<b>Operational Summary</b>						<b>Macro Assumptions</b>							
		FY16	FY17E	FY18E	FY19E	FY20E			FY16	FY17E	FY18E	FY19E	FY20E
<b>Pilgangoora</b>						<b>Pilgangoora</b>							
Ore Milled	mt	-	-	0.5	2.0	2.0	Exchange Rate	A\$/US\$	0.73	0.75	0.74	0.73	0.71
Lithium Head Grade	%	-	-	1.33%	1.33%	1.33%	Chem Spodume Price	US\$/t	650	650	650	650	650
Recovery	%	-	-	75%	75%	75%	Tech Spodume Price	US\$/t	-	-	-	-	-
<b>Li Conc Produced</b>	<b>kt</b>	-	-	<b>84</b>	<b>334</b>	<b>334</b>	Avg Li Conc Price	US\$/t	650	650	650	650	650
Tantalum Head Grade	ppm	-	-	134	134	134	Tantalum Price	US\$/lb	60	60	60	60	60
Recovery	%	-	-	55%	55%	55%	Realised Li Conc Price	A\$/t	892	862	884	897	915
<b>Tantalum Production</b>	<b>kib</b>	-	-	<b>81</b>	<b>322</b>	<b>322</b>	Realised Ta Price	A\$/lb	82	80	82	83	85
Net Cash Cost (post credit)	A\$/t conc	-	-	306	306	307	<b>FCF Contribution</b>						
<b>All-in Sustaining Cost</b>	<b>A\$/t conc</b>	-	-	<b>351</b>	<b>352</b>	<b>353</b>	<b>A\$m</b>	<b>FY16</b>	<b>FY17E</b>	<b>FY18E</b>	<b>FY19E</b>	<b>FY20E</b>	
<b>% AISC Margin</b>	<b>%</b>	-	-	<b>60%</b>	<b>61%</b>	<b>61%</b>	Lithium Revenue	-	-	74	300	306	
							Tantalum Revenue	-	-	6	26	26	
							Operating Costs (ex credit)	-	-	32	128	129	
							<b>Operating Margin</b>	-	-	<b>49</b>	<b>197</b>	<b>203</b>	
							Sustaining Capex	-	-	2	8	8	
							Sustaining Exploration	-	-	0	1	1	
							Corp Overheads	-	-	-	6	6	
							<b>All-in Sustaining Margin</b>	-	-	-	<b>182</b>	<b>188</b>	
							Growth Capex	4	57	178	-	-	
							<b>Group Operations</b>						
							<b>A\$m</b>	<b>FY16</b>	<b>FY17E</b>	<b>FY18E</b>	<b>FY19E</b>	<b>FY20E</b>	
							Revenue	-	-	81	325	332	
							All-in Sustaining Cost	1	1	40	143	144	
							<b>All-in Sustaining Margin</b>	<b>(1)</b>	<b>(1)</b>	<b>41</b>	<b>182</b>	<b>188</b>	
							Growth Capex	4	57	178	-	-	
							Growth Exploration	4	3	1	2	2	
							<b>All-in Margin</b>	<b>(9)</b>	<b>(61)</b>	<b>(138)</b>	<b>180</b>	<b>186</b>	
							<b>Corporate</b>						
							<b>A\$m</b>	<b>FY16</b>	<b>FY17E</b>	<b>FY18E</b>	<b>FY19E</b>	<b>FY20E</b>	
							Cash Tax	1	-	-	-	55	
							Other Items	13	10	-	-	-	
							<b>FCF pre Debt Service</b>	<b>(23)</b>	<b>(70)</b>	<b>(138)</b>	<b>180</b>	<b>131</b>	
							Net Interest	0	(2)	6	5	0	
							Debt Drawdown / (Repayment)	4	(0)	80	(80)	-	
							<b>FCF post Debt Service</b>	<b>(19)</b>	<b>(69)</b>	<b>(63)</b>	<b>95</b>	<b>131</b>	
							<b>New Equity/Dividends</b>						
							<b>A\$m</b>	<b>FY16</b>	<b>FY17E</b>	<b>FY17E</b>	<b>FY18E</b>	<b>FY20E</b>	
							Proceeds from Shares/Options	116	72	47	13	15	
							Dividends Paid	-	-	-	-	17	
							<b>Change in Cash</b>	<b>97</b>	<b>3</b>	<b>(17)</b>	<b>108</b>	<b>129</b>	
							<b>Cash Balance</b>	<b>100</b>	<b>103</b>	<b>86</b>	<b>194</b>	<b>323</b>	

Source: IRESS, Company data, Blue Ocean estimates

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