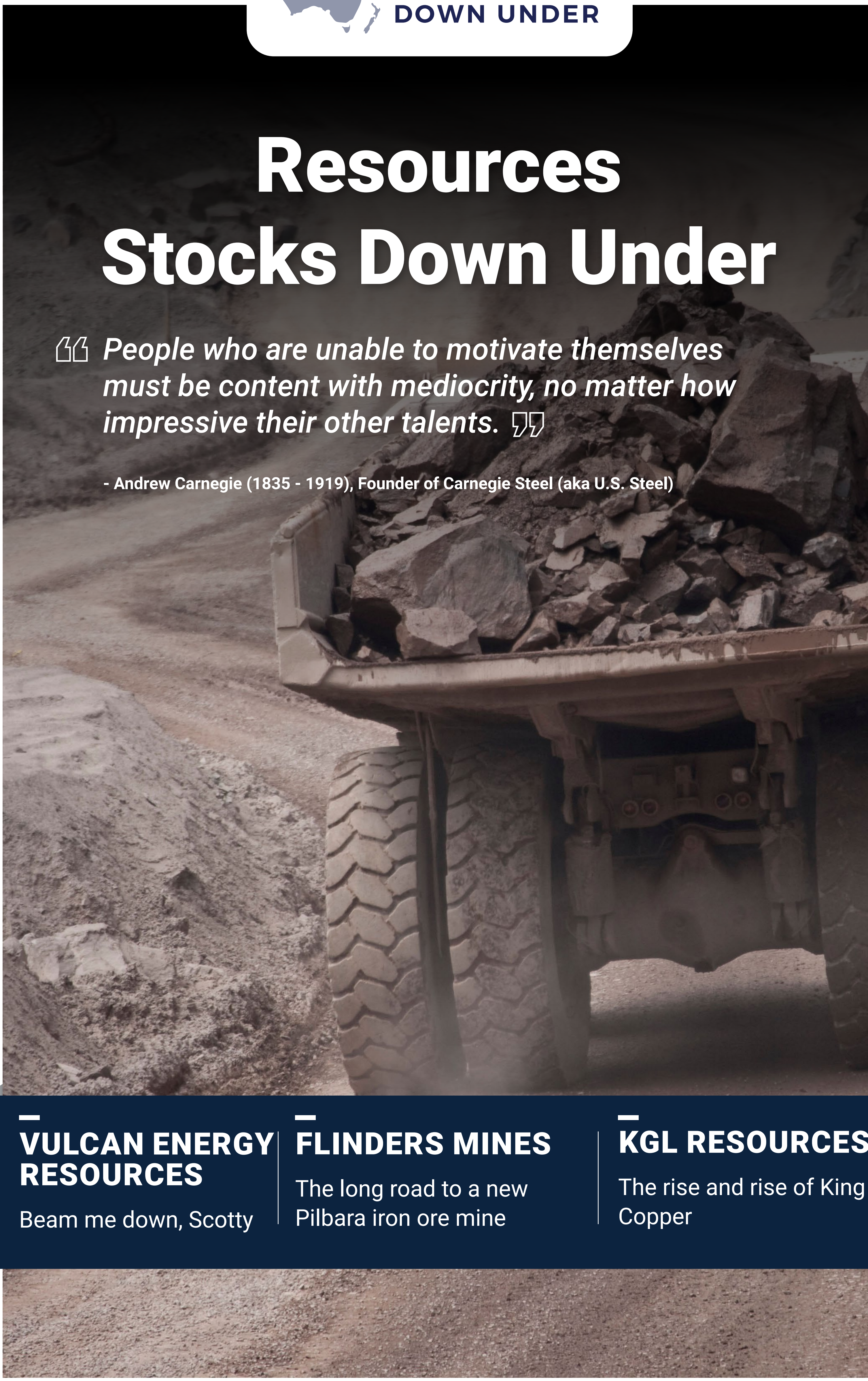
STOCKS DOWN UNDER

21 JANUARY 2021



Resources Stocks Down Under

“People who are unable to motivate themselves must be content with mediocrity, no matter how impressive their other talents.”

- Andrew Carnegie (1835 - 1919), Founder of Carnegie Steel (aka U.S. Steel)

VULCAN ENERGY RESOURCES

Beam me down, Scotty

FLINDERS MINES

The long road to a new Pilbara iron ore mine

KGL RESOURCES

The rise and rise of King Copper

VULCAN ENERGY RESOURCES

Beam me down, Scotty

Stocks Down Under rating: ★★

ASX: VUL
Market cap: A$ 846M

52-week range: A$0.15 / A$14.20
Share price: A$ 9.65

Back on 30 March 2020, Vulcan Energy Resources, the Perth-based developer of a lithium project in Germany, was changing hands at just 15.5 cents per share. This one gradually increased in popularity through the remainder of 2020, so that by November it was over $2.00. Then on 15 January 2021, the stock went, to use the vernacular, 'nuts'. We think that maybe that's a little too enthusiastic.

READ MORE

FLINDERS MINES

The long road to a new Pilbara iron ore mine

Stocks Down Under rating: ★★★★

ASX: FMS
Market cap: A$ 165M

52-week range: A$0.018 / A$1.55
Share price: A$ 0.995

The Perth-based Flinders Mines is an iron ore project developer, this one focused on the Pilbara region. In what has been a long journey for Flinders, the Pilbara Iron Ore Project is now one step closer to going ahead with its New Zealand partner, the BBI Group, indicating last month that it would like to combine its infrastructure plans with Flinders' iron ore resource in one company. This could be the edge that the project needs.

READ MORE

KGL RESOURCES

The rise and rise of King Copper

Stocks Down Under rating: ★★★★

ASX: KGL
Market cap: A$ 114M

52-week range: A$0.094 / A$0.45
Share price: A$ 0.45

KGL Resources is bullish on copper's future. The company has just finished its updated Mineral Resource Estimate for its flagship Jervois Base Metal Project in the Northern Territory, providing greater confidence in this project's ultimate success. Jervois, which was only a series of small grade open-pit mines a century ago, is now another potential solution to the growing demand for the reddish metal.

READ MORE

VULCAN ENERGY RESOURCES

Beam me down, Scotty

Stocks Down Under rating: ★★

ASX: VUL
Market cap: A$ 846M

52-week range: A$0.15 / A$14.20
Share price: A$ 9.65

Back on 30 March 2020, Vulcan Energy Resources, the Perth-based developer of a lithium project in Germany, was changing hands at just 15.5 cents per share. This one gradually increased in popularity through the remainder of 2020, so that by November it was over $2.00. Then on 15 January 2021, the stock went, to use the vernacular, 'nuts'. We think that maybe that's a little too enthusiastic.

Share price chart

Source: Tradingview

There was a time when Vulcan Energy Resources, then called Koppar Resources, was just another junior explorer on the ASX with a number of copper and zinc projects in Norway. Then in July 2019, the company made a major change. It announced that it was going into the lithium industry with the acquisition of a lithium project in Germany. But not just any project. The Vulcan Lithium Project covered a lithium brine resource in the Upper Rhine Valley near Stuttgart, the capital of the German state of Baden-Württemberg. What made this project special was that its developers had worked out a way to produce lithium from these brines in a way that lowered the project's carbon footprint compared to other competing projects. They even had a catchy name for this approach: Zero-Carbon Lithium. Koppar Resources changed its name to Vulcan Energy Resources in November 2019 to reflect this new focus.

Hot rocks, hot stock

The way Vulcan expects to produce Zero Carbon Lithium is, firstly, power the process using geothermal energy and secondly, extract the lithium from the brines using a 'direct lithium extraction' approach. The Upper Rhine Valley is one of Europe's most geothermally active regions, so those brines are hosted in hot rocks. The geothermal energy in situ can be harnessed to produce electricity without a carbon footprint. Direct lithium extraction is where, instead of leaving the brines out to dry, the lithium is precipitated out of the brine before it is sent back underground. That saves on various carbon-rich reagents, most notably soda ash, that would normally be used in evaporative approaches.

Neither geothermal electricity nor direct lithium extraction is new. Geothermal power plants have been producing electricity since the early 20th century. As for direct lithium extraction, the first such process was used on the Salar del Hombre Muerto in the Argentine part of South America's Lithium Triangle way back in 1997.

The reason why the term 'Zero-Carbon Lithium' has everyone paying attention to Vulcan is because there's a school of thought out there that Electric Vehicles really aren't all that green once you factor in all the carbon emissions from the car's manufacture, not to mention the electricity generation to power the factories. Those concerns have battery makers and Electric Vehicle companies working hard to reduce their own carbon emissions. Lithium made with minimal emissions would be an ideal input into the EV supply chain. And if the lithium could be sourced closed to all those gigafactories and EV assembly plans in Europe, so much the better. Basically, Vulcan appears to have found itself with the right project at the right time.

An exciting Pre-Feasibility Study

This brings us to the reason why Vulcan stock went nuts. On 15 January the company published the results of a Pre-Feasibility Study on the Vulcan Lithium Project and the numbers were good. On the smallest version of the project, called Phase 1, the post-tax NPV was €700m, which translates into A$1.1bn at the current exchange rate. A slightly larger Phase 2 increases the NPV to €1.4bn, or A$2.2bn, while the NPV for the full project without phasing comes in at €2.25bn, or A$3.53bn.

Why so valuable? Well, this is a lithium brine project, so costs are low to begin with and there's plenty of electricity left over after the lithium operation has been powered to create a second source of revenue. Additionally, the lithium end-product is the higher-value lithium hydroxide that battery makers will need more of in the years ahead. Throw in the fact that this project had such a low carbon footprint and the realisation of those billions in shareholder value seemed a laydown misère, and what's not to like? Particularly since Stuttgart, home of Porsche and Mercedes-Benz, is only 60 km away,

This stock is too hot

Sure, Vulcan's market capitalisation is still below the level of the Phase 1 NPV, so Vulcan stock could go higher. We think, however, that after such a violent upswing a reaction will almost surely follow. For one thing, a capital raising to take advantage of the high share price might slow the stock. Profit-taking will surely kick in regardless of how good the Vulcan story is. And then there's the fact that this story is still immature. Remember, 15 January was a Pre-Feasibility Study. That means there's still the Definitive Feasibility Study to come. Moreover, Vulcan will have to raise a lot of capital to develop its project – €700m for Phase 1, €1.14bn for Phase 2 and €1.74bn for the full project. And then there's the timing – this project won't get going until 2024 or 2025.

Here at Stocks Down Under we're bullish on lithium, and we're excited about the prospects of the metal's recovery in 2021. However, we think this stock has run too hard, too fast. That's why we're calling it two stars, for now, because we fear the reaction is coming sooner rather than later. If you want to good lithium story with a European angle, take a look at Infinity Lithium, ASX: INF, which we wrote about in the 24 December 2020 edition of Stocks Down Under.

FLINDERS MINES

The long road to a new Pilbara iron ore mine

Stocks Down Under rating: ★★★★

ASX: FMS
Market cap: A$ 165M

52-week range: A$0.018 / A$1.55
Share price: A$ 0.995

The Perth-based Flinders Mines is an iron ore project developer, this one focused on the Pilbara region. In what has been a long journey for Flinders, the Pilbara Iron Ore Project is now one step closer to going ahead with its New Zealand partner, the BBI Group, indicating last month that it would like to combine its infrastructure plans with Flinders' iron ore resource in one company. This could be the edge that the project needs.

Share price chart

Source: Tradingview

If you want to develop a decent iron ore resource, then the Pilbara region of Western Australia is where it's to be. Flinders Mines, with its unimaginatively named Pilbara Iron Ore Project (PIOP), has about 1.5 billion tonnes of iron ore in a JORC resource with a 52% iron content located only 60 km northwest of Tom Price. Flinders has been working on PIOP for a long time and for a long time investors more or less took no notice on the assumption that the Blacksmith and Anvil deposits that made up the PIOP were just another stranded iron ore resource that would wither on the vine for want of access to rail and port infrastructure. Then the Todd's arrived on the scene in a serious way about 2015. Since then things have been looking up for PIOP.

If you're a Kiwi, you will doubtless have heard of Wellington's Todd family, which is one of New Zealand's wealthiest, with a combined net worth of around NZ$4bn. The family's wealth was built on the automotive sector and then on energy, although there are numerous other interests within the unlisted Todd Corp. One of the family's newer ventures is BBI Group, involving the development of infrastructure relevant to new Pilbara iron ore projects. If it works out, BBIG, which is 94% owned by Todd Corp., will create a 162 km railway connected up to a historic Pilbara port called Balla Balla that will be turned into a modern iron ore export port shipping 50 million tonnes a year.

Straw hats in winter

Todd Corp. first offered to buy PIOP in 2015 and then in 2016 made a takeover offer for Flinders Mines at the equivalent of 32.5 cents per share in which it ended up with a majority stake. It currently holds 59%. That tells you why the Todd's have such a high net worth – they were buying or looking to buy, straw hats in winter when that winter was particularly cold. In the meantime, Todd Corp. has had time to formulate plans for developing PIOP in conjunction with BBIG.

In 2020 those plans started to move off the drawing board. Under a March 2020 farm-in agreement, for which all conditions precedent were satisfied by September, BBIG agreed to fund the next stage of feasibility work on PIOP, spending $15m. Should a Final Investment Decision get made, BBIG would own 10% of PIOP directly, and Flinders' stake would fall to 40%. 'Equity funding parties' would have the other 50%.

Would you like some infrastructure with that?

The fly in the ointment was the 'Equity funding parties.' Previously, Flinders and BBIG had talked to potential Chinese partners, including State-Owned Enterprises. As we all know, China's investment environment in Australia became trickier in 2020 after the government tightened the rules, which means that the equity funding may have to come from BBIG itself.

On 14 December 2020, perhaps in light of the China situation, BBIG decided to go one step further and suggested to Flinders that it simply combine the BBIG project and the PIOP into just one company. The offer was non-binding and indicative only, but if it transitions into something definite, then Flinders Mines and the Pilbara opportunity, under the aegis of the Todd's, will be on track for a potentially big payday. Stay tuned for this one.

It's time to get mining

It's a plan of action the Flinders Mines board can't really say no to, although the Independent Experts and the shareholders need to acquiesce. As an inspiring iron ore miner, this company has been trying to get PIOP off the ground since 2009. That made the 2020 farm-in agreement such a significant step. Right on time: China's recovery from the Pandemic came earlier than expected, with steel production forecast to reach 1 billion tonnes in 2021. As part of its economic plan spanning 2021-2025, the country has big infrastructure spending plans. These plans will need a lot of steel and therefore iron ore, which, as well all know, has been running hard.

Flinders is probably going to need more cash soon. At the end of the September 2020 quarter, Flinders had only $3.4m in cash, with a lot of money going towards progressing the transaction with BBIG. However, now that the farm-in agreement with BBIG is finally satisfied, the big money lies with BBIG. The next hurdle for Flinders will depend on BBIG's ability to complete feasibility studies during until the Decision to Mine is made.

In the wake of the share price run-up just prior to the 14 December proposal, Flinders stock has cooled off. We think the stock bodes watching given the good times for iron ore. Both BBIG and Flinders have a lot of work to do in the near term, but the $5bn PIOP development journey has resumed. As the company says in its March plea to its shareholders, 'It's time to get mining.' We're sure followers of the 10-year saga couldn't agree more. Four stars.

KGL RESOURCES

The rise and rise of King Copper

Stocks Down Under rating: ★★★★

ASX: KGL
Market cap: A$ 114M

52-week range: A$0.094 / A$0.45
Share price: A$ 0.45

KGL Resources is bullish on copper's future. The company has just finished its updated Mineral Resource Estimate for its flagship Jervois Base Metal Project in the Northern Territory, providing greater confidence in this project's ultimate success. Jervois, which was only a series of small grade open-pit mines a century ago, is now another potential solution to the growing demand for the reddish metal.

Share price chart

Source: Tradingview

A much-needed upgrade

First things first… How do you pronounce Jervois? KGL pronounces it 'jer voice'. We Australians prefer to Anglicise names of French origin.

You'll find KGL's Jervois Base Metal Project driving along the Plenty Highway about 380 km north-east of Alice Springs. KGL's flagship project just had a major update to its Mineral Resource Estimate (MRE). Thanks to that update, Jervois now has 30% more contained copper, at 426,200 tonnes, with grades almost doubling from 1.07% to 2.03%. This upgrade comes with a reduction in tonnage (31 million to 21 million tonnes), but increased confidence in the resource with 68% now in the indicated resource category. This success at Jervois led to a surge in the company's share price from 16 cents at the start of September to 32 cents by mid-November.

KGL's resource-building strategy has been ongoing since 2016 and, apart from the upgrade, the company has also broadened its understanding of the geological structures of the Jervois and surrounding Unca Creek tenement (acquired in 2017), which offers the potential to target extensions and find new lead/zinc and silver/gold leads. KGL's December 2020 Prefeasibility Study revealed an economically solid 30,000 tonne per annum project with a Net Present Value of A$177m at an 8% discount rate and a pre-tax Internal Rate of Return of

23% for a 7.5-year mine life. Jervois' economics are greatly helped by the gold and silver by-products. With the PFS complete and the authority to mine recently granted by the NT government, the company can now move towards a Definitive Feasibility Study.

Use and reuse again

We all know that copper is set to have a renaissance thanks to Electric Vehicles, but some analysts think we might be underestimating how big the copper boom will get. Copper is tipped to rocket in 2021 and there's some speculation that it could go over US$8,000 per tonne by 2024. Judging by copper's rise during the second half of calendar 2020, this might have a lot to do with China's rapid recovery and urbanisation plans. KGL is set on taking advantage of the lack of copper discoveries back home and the continued mine closures overseas. Interestingly, one of the world's largest producing copper mines in Chile, Escondida, has suffered setbacks during the pandemic.

With at least 4.2 million tonnes of copper needed from new projects by 2028 to meet the demand, the disruption to many copper producers in South America and elsewhere has spurred some of the biggest copper producers to look at ways of sustainably meeting the expected demand. Copper is highly recyclable, meaning that, in essence, it doesn't lose quality when reused. Big miners like Glencore source and recycle copper scrap, while BHP has its 'green copper' initiative in reducing water and energy consumption. While that might be unavailable to juniors like KGL, the company is still developing its concept for a hybrid diesel/solar process plant to negate the more harmful environmental effects of diesel only.

The big picture

KGL had $6.3m in cash at the end of the September quarter, but ahead of the December PFS, it raised $3.8m, which should come in handy as the DFS process gets underway. We're excited by the potential of this DFS because the PFS didn't use all that much of the existing resource whereas the DFS will and that could reasonably extend the mine life out to 12-15 years. We understand KGL is already talking project finance options for Jervois.

All up, 2020 was a year of encouraging signs of life for a junior that sees the big picture for the future of copper: with the world's demand for copper continuing to increase, its forecast that over the next 26 years more copper will be mined than what has been mined in all of history. If that's not a reason to get excited, we don't know what is. Four stars.

Pitt Street Research Pty Ltd

95 Pitt Street, Sydney, NSW 2000, Australia

Pitt Street Research Pty Ltd is founded on more than 40 years of combined experience researching companies in a range of different sectors.

You are receiving this email because you subscribed to our Stocks Down Under newsletter.