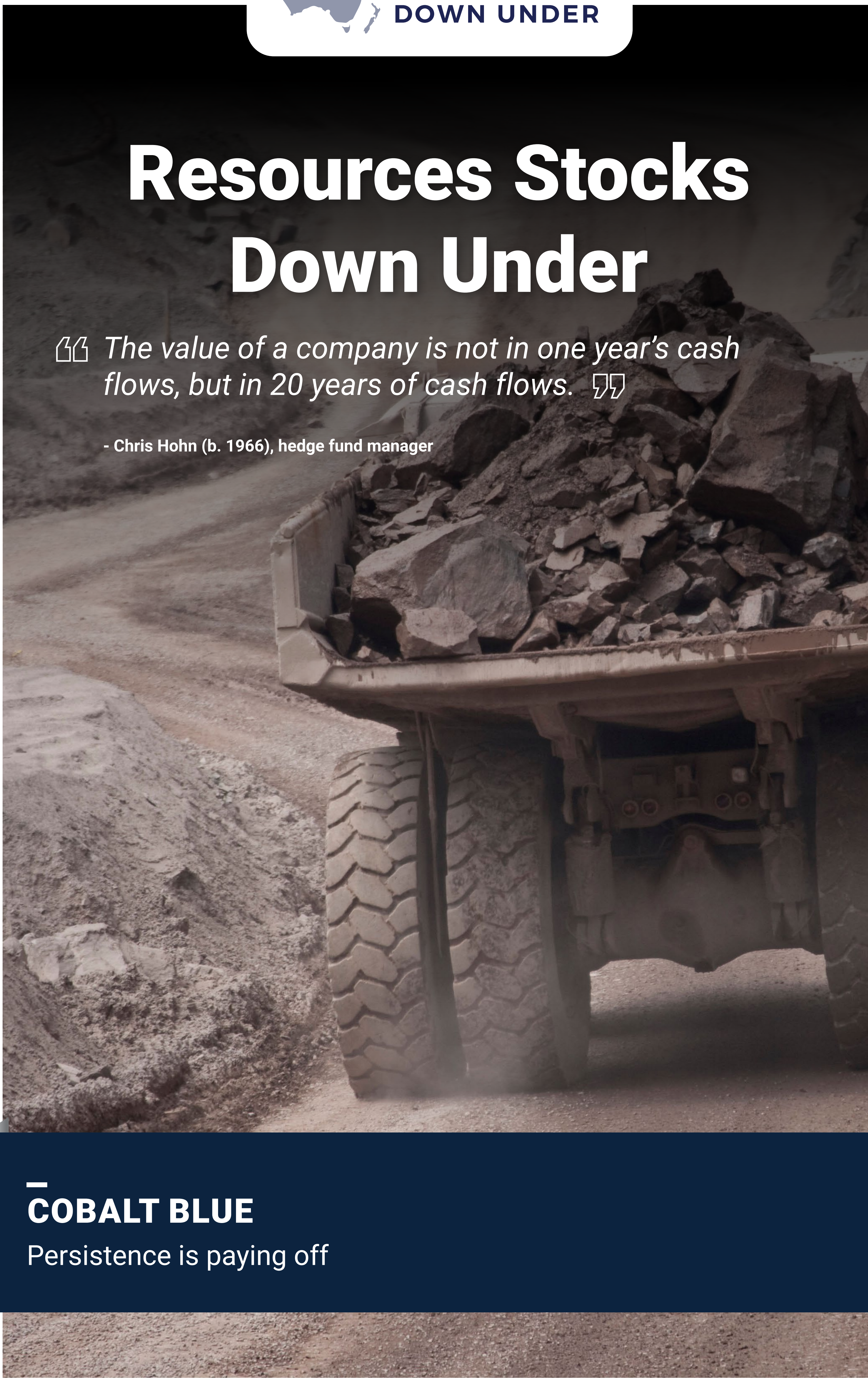

Resources Stocks Down Under

"The value of a company is not in one year's cash flows, but in 20 years of cash flows."

- Chris Hohn (b. 1966), hedge fund manager

COBALT BLUE

Persistence is paying off

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Stocks Down Under rating: ★★★★

ASX: COB
Market cap: A$199.6M

52-week range: A$0.23 / A$1.07
Share price: A$0.62

We last covered Cobalt Blue (ASX: COB), the owner of the Broken Hill cobalt project, in August last year. The Cobalt Crash of 2018-19 resulted in many ASX companies jumping ship, but Cobalt Blue stuck with it and is reaping the rewards. Since 2016, it has completed substantial drilling and an optimised Pre-feasibility Study. And earlier this year, the federal government gave it Major Project Status, resulting in a substantial re-rate. Shareholders will have to wait until mid to late 2025 for production, but we think the wait will be worth it.

Share price chart

Source: Tradingview

Cobalt coming out of its shadow

Cobalt has lived in the shadows of more popular battery metals, such as lithium, being rarer and typically found unintentionally as a by-product - Chalice's Julimar discover is one such project with a modest cobalt by-product. But cobalt is an important battery metal and has other uses too, including as magnetic elements in MRI machines and gas turbines for gas engines. As with other battery metals, cobalt prices plunged by over two thirds in the back end of the 2010s due to a market oversupply and a slow uptake of electric vehicles. The increasing adoption of EVs has turned things around although the cobalt price, at US$36/lb, is still below the pre-pandemic peak.

More than three quarters of the world's cobalt comes from the copper belt in Congo, Central African Republic and Zambia. Cobalt Blue's Broken Hill project is currently the only greenfield cobalt-only project outside of Africa. It hosts a global Mineral Resource estimate of 118Mt at 859ppm (parts per million) cobalt-equivalent (CoEq) for 81.1kt contained cobalt, equating to 3.5kt per annum over the mine's 17 year life. It has set a production target of 98Mt at 690ppm cobalt and 7.4% sulphur for 67kt of contained cobalt. When in production, it will use an open pit mining scenario, extracting ore using conventional techniques, but it can also produce a mixed hydroxide product of cobalt sulphate. It has a Net Present Value of $792m at a 7.5% discount and an Internal Rate of Return of 22% based on current production targets.

The operation is low-cost with a production process that separates over 80% of the waste from the ore at the first step. This means it will refine less than 20% of the material brought out of the ground. The operation will have a direct connection to rail transport, power and water and has an all-in sustaining cost of US$12/lb, which is just over a third of current cobalt prices and makes Broken Hill appear a very profitable operation. And it will make a significant contribution to the transition to electric vehicles. The company told analysts last month that it has enough cobalt to enable ~300,000 EVs annually and 5 million over the total mine life.

Federal government support

Currently, the company is occupying time with three things: project approvals, a Definitive Feasibility Study and winning offtake partners. For the latter, it is planning to operate a demonstration plant to show potential offtake partners large scale samples. While those three remain a work in progress, its shares are up 132% in the last year and they went on a particularly strong run in March.

This was a result of the project winning Major Project Status from the Australian government back in March. Then energy minister Angus Taylor said it was based on the opportunity the project offers to advance Australia's downstream critical minerals processing capability and its close alignment with the mineral strategies of the federal and state government. The government is keen to secure its own supply chains for critical minerals and evidently saw Cobalt Blue's project as important for it. Of course, this isn't the final go ahead, but will likely result in a fast-tracked approval process. A few weeks later, it was thrown another bone with a grant $15m from the government's critical minerals accelerator.

De-risked, but not without risk

As with all companies at the stage Cobalt Blue is at – namely, at pre-DFS - there are two major risks. The first is commodity prices. We observe that current prices make the operation very profitable. But remember, it has only been 3 years since cobalt prices were below the project's AISC (US$12/lb). The last fall in cobalt prices below that level caused many ASX companies to put their cobalt projects on the backburner and this will inevitably be the case with Cobalt Blue should the worst come to worst. Naturally, the share price would follow suit.

Second, the Definitive Feasibility Study may not live up to shareholder expectations. The company's current reserves and pre-feasibility studies have been impressive. But remember, none of the parameters have been as comprehensive as at later stages – just sufficient to deduce the most appealing possible scenario for the DFS. Now, if it does pass the test, the DFS will depict that the project is viable. That is, assuming it obtains finance. The DFS will depict just how much is needed and these operations can run into the hundreds of millions, if not billions. Shareholders shouldn't fear a hefty dilution, as companies typically seek debt finance. But of course, the project will be difficult to get off the ground if it cannot secure funding. And the company is yet to make a Final Investment Decision, although if the DFS is positive, this funding will be a fait accompli. The DFS is expected by the end of 1QCY23.

Ultimately, the aforementioned risks are applicable to any company at the pre-DFS stage. But we think Cobalt Blue is de-risked because of the federal government's support, it's reserves to date and current cobalt prices. We expect it to further de-risk itself through its activities at its demonstration plant – ore extraction and staged commission has just gotten underway. For all those reasons, and notwithstanding the risks, we think Cobalt Blue deserves four stars.

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