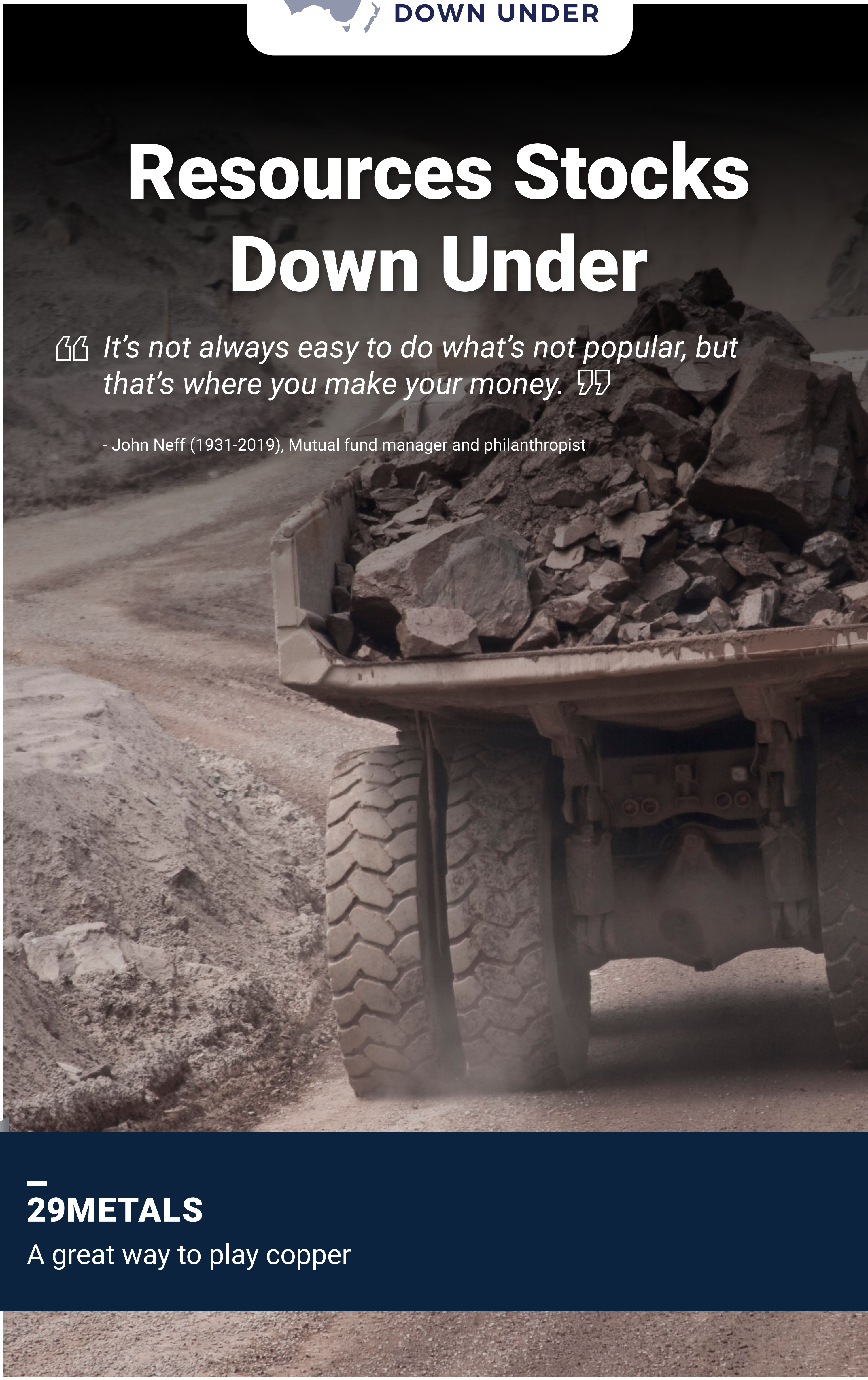
STOCKS
DOWN UNDER



Resources Stocks Down Under

It's not always easy to do what's not popular, but that's where you make your money.

- John Neff (1931-2019), Mutual fund manager and philanthropist

29METALS

A great way to play copper

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Stocks Down Under rating: ★★★★

ASX: 29M
Market cap: A$1.1BN

52-week range: A$1.16 / A$3.35
Share price: A$2.16

When 29Metals first listed on the ASX, back in June 2021, it was the largest base metals IPO in more than a decade. Furthermore, there was arguably no better time for the company to list. Copper prices were at record highs, ensuring positive investor sentiment and a substantial cash flow buffer for the company's projects. It was led by Owen Hegarty and Peter Albert, who in the late 2000s led Oxiana to an $8.7bn merger with Zinifex to form Oz Minerals. The success of Oz Minerals, along with Sandfire Resources, illustrated that copper producers could make it on the ASX. And the fact that 29Metals was already a producer meant there was less risk for investors compared to small cap explorers. The first year of listed life went well for the company, but the second year not so much.

Share price chart

Source: Tradingview

Dancing until the music stops

29Metals' vision is 'to be a leading ASX-listed copper producer, developer and explorer, offering investors exposure to attractive copper market dynamics'. It has 100% ownership of three copper assets. Two of these are Australian mines that have entered production - Golden Grove in Western Australia and Capricorn in Queensland. It also owns the Red Hill project in Chile that is at the exploration phase. Golden Grove is the most diverse asset, producing silver, zinc, lead and gold in addition to copper. Golden Grove has been in production since 1989 and produces over 1.4Mt per annum. It lies 450km north-east of Perth and 250km east of Geraldton. 29Metals picked it up in 2017 and has grown Ore Reserves and Mine Life by over 200%, thanks to further exploration work.

Capricorn began production in the 1920s on a small scale, before large-scale mining began in 1970. It is prospective for copper and silver and lies 120km north of Mount Isa. Similar to Golden Grove, 29Metals and its preceding entities have expanded the project since its acquisition, and it promises more could be to come. The project has a mining rate of 1.8Mtpa. As for Red Hill, it is an exploration asset and therefore won't be too important any time soon. Nevertheless, one particular prospect at Red Hill (Cutters Cove) has an Inferred Mineral Resource Estimate of 4.3Mt at 1.7% copper, 33g/t silver and 0.3g/t gold, and exploration work continues.

A good first year, a poor second year (so far)

In FY21, which is the calendar year for this company, it generated $709.6m in revenue, $254.1m in EBITDA and $34.3m NPAT. Revenue and EBITDA were up 14% and 7%, due to higher copper production and realised commodity prices, but NPAT was down 6% due to foreign exchange movements and unfavorable commodity price movements on derivative financial instruments. The company produced 68.2kt of copper equivalent during the year.

After hitting a $3.35 all-time high in mid-April 2022, shares plunged over the following 3 months. The company was impacted by labour market conditions and adverse weather. Copper equivalent production for 1Q22 was 15.8kt, up from 11.6kt in 1Q21, but down from 20.3kt in 4Q21. It was a similar story with the company's costs, the AISC of US$3.62 per US$/lb of copper sold was up 20% from the last quarter (when it was US$3.03) and even though the AISC was lower than 12 months ago (when it was US$5.03), investors took little consolation from that fact. Considering the average copper price throughout FY21 of US$4.22/lb, this was a significant margin compression, before one accounts for the fact that FY21 was a bull market for copper.

Short-term pain is set to continue, but longer-term gain awaits

For FY22, 29Metals has not issued revenue or earnings guidance – understandably so given copper price volatility. It has issued production guidance, however. It is expecting copper production to be flat, while zinc production will be 5-10% higher and gold and silver production will be 0-15% lower.

Consensus estimates for FY22 expect $706.6m and $166.6m in EBITDA, down 0.5% and 35% respectively. FY23 is expected to see flat revenue and lower earnings, $707.8m in revenue and $145.9m in EBITDA (down 13%), but a recovery in FY24 to $817.4m in revenue and $246.9m in EBITDA (up 15% and 69% respectively).

The mean target price among the 11 analysts covering the stock is $1.92. We think analysts are pricing in a recession in FY23 and a big hit to China (the world's largest copper producer) from the pandemic, both leading to lower copper prices. But from FY24, analysts seem to anticipate any impacts to have subsided, and copper to be in hot demand as the world decarbonises.

There is a lot to like, the short-term might be volatile

There is a lot to like about 29Metals. The company's shares are well ahead of their 12-month low and back above their IPO price. The long-term fundamentals for copper look strong, with demand set to grow to over 30Mt by 2025, which is 20% higher than in 2020. And with a significant supply deficit on the market, due to a lack of new mines coming onto the market, we believe 29Metals is in the right place at the right time. It has a proven track record of growing project reserves, having done so at both Capricorn and Golden Grove, and could continue to do so at both projects.

Notwithstanding all the things going for it, the short-term uncertainty in the copper market, along with the lower consensus estimates for FY23 are dissuading. Ultimately, we have decided to give 29Metals four stars assuming that copper has a strong year in CY23. This may also help it outperform consensus estimates.

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