

MOD RESOURCES (MOD)

Sandfire offer validates MOD's appeal

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We say

Price

Target

Strategic Target

BUY

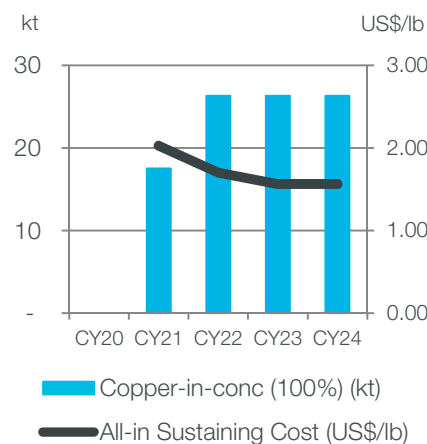
0.34 0.80 1.10

Earlier this week MOD confirmed it had received a highly conditional 38c unsolicited offer from Sandfire (ASX:SFR). The MOD board believes SFR's proposal undervalues the company and elected to raise A\$15m in new equity. The company plans to continue to explore all options including further engagement with SFR. In our view SFR's approach validates the appeal of MOD's T3 project and extensive ground position in Botswana relative to other junior copper plays. Maintain Buy.

SHARE PRICE CHART



T3 PRODUCTION & COSTS (@ 3MTPA)



COMPANY DATA & RATIOS

Enterprise value	\$100m
Diluted market cap*	\$120m
Diluted shares*	352m
Free float	100%
12 month price range	\$0.21-0.62
GICS sector	Materials
Board & Management hold ~10% (FD)	
*Diluted for ~48.6m options	

IMPLIED RETURN

Implied all-in return	135%
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SFR CONDITIONAL OFFER AT 38 CENTS

Earlier this week, MOD confirmed it received a highly conditional offer of 38c from Sandfire (ASX:SFR), valuing the company at A\$113m. The MOD board believes this proposal undervalues the company and while there may be further engagement with SFR, it elected to raise \$15m in new equity this week via a A\$10m placement at 30c and a \$5m underwritten rights issue at 24c.

BFS FOR T3 DUE THIS QUARTER

MOD confirmed this week that its BFS for its 100%-owned T3 copper project in Botswana is due this quarter. We're expect a 3mtpa plant, capex of ~US\$180m, producing ~23ktpa of Cu-in-conc for an initial ~14 years, at an all in sustaining cost of ~US\$1.50/lb. At spot copper, our NPV is ~A\$200m, but our NPV rises to >A\$350m at US\$3.20/lb.

EASE PRICE TARGET TO \$0.80 ON HIGHER DILUTION

We ease our price to \$0.80 (from \$1.30) to reflect the additional dilution of both the recent \$15m raising and the increased likelihood of a major raising to build T3 at materially lower prices than when we last published. We maintain our Buy rating and our revised \$0.80 price target has an implied potential return of ~135%.

SANDFIRE MAKES 38 CENT CONDITIONAL OFFER

On Monday this week, MOD confirmed Sandfire (ASX:SFR) had made an unsolicited, non-binding and conditional proposal to acquire MOD in an all-scrip deal at 38c per share, **valuing the company at A\$113m** on a fully diluted basis.

The MOD board believes this proposal undervalues the company and instead elected to raise ~A\$15m in new equity via a:

- A\$10m institutional placement @ 30c (33.33m shares); and a
- A\$5m fully-underwritten rights issue @ 24c (21.7m shares) based on 1 share for 13 shares owned.

MOD continues to explore all options, including further engagement with Sandfire.

In our view the Sandfire approach does appear opportunistic given:

- MOD was trading at 50c in August
- Our NPV for T3 at spot prices is ~A\$200m (ignoring MOD's substantial ~11,500km² exploration package)
- Our NPV for T3 at US\$3.20/lb copper rises to >A\$350m

In our view, Sandfire's approach validates the appeal of MOD's T3 project and the value of the company's extensive ground position in Botswana, relative to other potential junior copper opportunities.

NEXT CATALYST: BFS FOR T3 DUE THIS QUARTER

This week, MOD confirmed it is on track to deliver the Bankable Feasibility Study (BFS) for T3 in Q1 CY19 and we outline our expectations in detail on the next page.

The BFS is focused on a 3mtpa plant at T3 and we estimate initial capex of ~US\$180m and a total funding need to US\$200m, however this funding need may vary depending on the type of finance MOD decides to adopt.

We assume the company develops T3 using traditional project finance with 60% debt and 40% equity as set out below.

Funding Uses		US\$m	Funding Sources		US\$m
Initial capex		180	Debt	60%	120
Working capital		20	Equity	40%	80
Total		200	Total		200

Source: Company, Blue Ocean Equities

MOD's ~US\$80m equity needed to build T3 could take a variety of forms, from straight equity to offtake finance and perhaps even selling a stake to a partner, if a suitably attractive offer emerges.

OUR EXPECTATIONS FOR THE T3 BFS

MOD's BFS for T3 is expected later this quarter and we outline our expectations below.

The PFS for T3, released in January 2018, examined two cases:

- A 2.5mtpa Base Case
- A 4.0mtpa Expanded Case

The company has since confirmed it is looking at a 3mtpa plant for its bankable study. We model T3 as a 3mtpa plant producing ~23ktpa of copper-in-conc at a competitive AISC of ~US\$1.50/lb for an initial mine life of ~14 years.

T3 Operating Metrics (100%-basis)		Base Case	Expanded Case	Blue Ocean
Plant size	mtpa	2.5	4.0	3.0
Initial capex	US\$m	155	155	180
Expansion capex (in year 3)	US\$m	-	37	-
Average copper head grade	%	1.02	0.86	0.86
Average copper recovery	%	93.1	92.3	92.3
Copper-in-conc	ktpa	23	28	23
AISC (post Ag credit)	US\$/lb	1.36	1.46	1.54
Average strip ratio (waste:ore)	x	4.76	4.28	4.28
Mining Inventory	mt	21.4	41	41
Mine life	years	8.8	11.7	13.7

T3 Financial Metrics (100%-basis)		Base Case	Expanded Case	Blue Ocean
Copper Price	US\$/lb	3.03	3.02	3.20
AISC Margins	%	55	52	52
Average FCF (pre-tax)	US\$m	77	85	87
Pre-Tax NPV	US\$m	281	402	407
Pre-tax IRR	%	39	38	36
Post-Tax NPV	US\$m	-	-	261
Post-tax IRR	%	-	-	28

Source: Company, Blue Ocean estimates
 Note: NPVs calculated using an 8% real / 10% nominal discount rate

PRICE TARGET & RATING

We ease our price to \$0.80 (from \$1.30) to reflect the additional dilution of both the recent \$15m raising and the increased likelihood of a major raising to build T3 at materially lower prices than when we last published.

Our price target for MOD is predominately based on the NPV of a 3mtpa plant at T3, constructed for initial capex of US\$180m (our unchanged estimate) and based our unchanged copper prices of US\$3.20/lb. Our NPV is discount by 50% to accommodate potential dilution and normal project development risks ahead.

We maintain our Buy rating on MOD and our \$0.80 price target represents an implied potential return of ~135%.

STRATEGIC TARGET

We ease our longer-term Strategic Target to \$1.10 (previously \$1.60) based on the same assumptions above and by removing the discounts applied to our valuation to zero.

It's important to remember that MOD has its foot on a *very* substantial tenement package covering ~11,500km² of the southern end of the Kalahari copper belt in Botswana and the company believes its ground may in time prove to be a copper *district*.

If the company can successfully find another high grade deposit, with thick, flat-lying zones of mineralisation like T3, we believe the market may begin pricing in a much higher probability of further exploration success, and may begin pricing in this copper *district* potential.

KEY RISKS

MOD Resources is exposed to all the normal risks associated with developing and operating mining projects, including funding and construction risk.

Assuming the company makes the transition into production, the company's revenues will be derived from the sale of copper and silver. Fluctuations in the copper and silver price as well as the Australian dollar could impact the company's reported cash flow (in A\$), profitability and share price.

As MOD's T3 copper project is based in Botswana, an investment in MOD Resources also carries Botswana sovereign risk. An overview of Botswana sovereign risk is outlined on the next page.

BOTSWANA: A PREFERRED JURISDICTION IN AFRICA

Botswana is a landlocked country in southern Africa, with a strong stable democracy and a consistent record of uninterrupted democratic elections dating back to 1966.

Botswana is topographically flat with the Kalahari Desert stretching across ~70% of the country. With a population of just over 2 million, it is also one of the most sparsely populated nations in the world.

Botswana has an internationally respected mining industry, Mining Act and English language based commerce.



Source: Company Reports

SOVEREIGN RISK

The chart below show a comparison of country risk according to Credendo, Belgium’s state-owned credit insurer and the world’s second largest credit insurer. Credendo provides cover for companies and banks against political and commercial risks relating to international transactions. According to Credendo:

- **Botswana is considered lower risk than Indonesia**, being **lower risk on 7 of the 8 measures below**. Indonesia is home to Finders (FNX) Wetar copper project, which was bid for by Eastern Field on 6 October 2017.
- **Botswana is considered much lower sovereign risk than Brazil**, being **lower risk on all 8 measures below**. One of MOD’s ASX-listed copper peers is the Brazil-based Avanco Resources (AVB) which was bid for by OZ Minerals (OZL) on 27 March 2018.

Comparing Sovereign Risk



Risk Score*: **Botswana: 13/52**

Indonesia: 22/52

Brazil: 28/52

Source: Credendo May 2018. *Our estimate which assumes A=1,B=2,C=3 for Commercial Risk

MODEL SUMMARY: FINANCIALS & VALUATION (A\$M)
Stock Details

Recommendation:	BUY					Enterprise Value	\$100m
Target	\$0.80	Share Price	\$0.34	Strategic Target (ST)	\$1.10	Diluted MCap	\$120m
NAV	\$0.83	52 Week High	\$0.62	Implied Return to ST	224%	Diluted Shares	352m
Implied Return	135%	52 Week Low	\$0.21			Free Float	100%
						Avg Daily Value	\$0.2m

Macro Assumptions	CY17E	CY18E	CY19E	CY20E	CY21E
Copper Price (US\$/lb)	2.80	3.00	3.00	3.20	3.20
Silver Price (US\$/oz)	17.05	15.94	15.50	16.00	18.00
Exchange Rate (A\$/US\$)	0.77	0.75	0.72	0.71	0.70

Profit & Loss (A\$m)	CY17E	CY18E	CY19E	CY20E	CY21E
Revenue	-	-	-	-	182
Operating Costs	-	-	-	-	(112)
Operating Profit	-	-	-	-	70
Corporate & Other	(3)	(4)	(4)	(4)	(6)
Exploration Expense	(0)	(3)	(3)	(1)	(1)
EBITDA	(3)	(7)	(7)	(5)	63
D&A	(0)	(0)	(0)	(0)	(14)
EBIT	(4)	(7)	(7)	(5)	49
Net Interest Expense	0	0	-	(4)	(16)
Pre-Tax Profit	(3)	(7)	(7)	(9)	33
Tax Expense	-	-	-	-	(10)
Minorities (5% Govt)	-	-	-	-	-
Underlying Profit	(3)	(7)	(7)	(9)	23
Significant Items (post tax)	(0)	-	-	-	-
Reported Profit	(3)	(7)	(7)	(9)	23

Cash Flow (A\$m)	CY17E	CY18E	CY19E	CY20E	CY21E
Operating Cashflow	(2)	(4)	(4)	(4)	64
Tax	-	-	-	-	(10)
Net Interest	0	0	-	(4)	(16)
Net Operating Cash Flow	(2)	(4)	(4)	(8)	39
Exploration	(8)	(14)	(6)	(1)	(3)
Capex	(1)	(2)	(83)	(169)	(8)
Acquisitions / Disposals	-	-	-	-	-
Other	-	-	-	-	-
Net Investing Cash Flow	(9)	(15)	(89)	(170)	(11)
Equity Issue	14	17	127	-	-
Borrowing / Repayments	(1)	(1)	-	168	-
Dividends	-	-	-	-	-
Other	2	2	-	-	-
Net Financing Cash Flow	16	19	127	168	-
Change in Cash Position	5	0	34	(11)	28
FX Adjustments	(0)	(0)	-	-	-
Cash Balance	26	28	175	76	110

Balance Sheet (A\$m)	CY17E	CY18E	CY19E	CY20E	CY21E
Cash	10	10	45	34	62
Other Current Assets	4	4	4	4	4
PP&E	1	2	85	254	248
Exploration & Development	21	32	35	36	37
Other Non Current Assets	0	0	0	0	0
Total Assets	36	49	170	328	352
Debt	1	-	-	168	168
Other Liabilities	5	8	8	8	8
Net Assets	31	41	162	153	176

Ratio Analysis		CY17E	CY18E	CY19E	CY20E	CY21E
Diluted Shares	m	238	297	730	730	730
EPS - Diluted	Ac	(1.4)	(2.5)	(1.2)	(1.2)	3.2
P/E	x	n.m.	n.m.	n.m.	n.m.	10.7x
CFPS - Diluted	Ac	(0.9)	(1.4)	(0.7)	(1.1)	5.3
P/CF	x	n.m.	n.m.	n.m.	n.m.	6.4x
FCF - Diluted	Ac	(1.2)	(1.8)	(12.0)	(23.7)	6.4
P/FCF	x	n.m.	n.m.	n.m.	n.m.	5.3x
Dividends	Ac	-	-	-	-	-
Dividend yield	%	-	-	-	-	-
Payout Ratio	%	-	-	-	-	-
Franking	%	-	-	-	-	-
Enterprise Value	A\$m	110	109	75	253	225
EV/EBITDA	x	n.m.	(15.8x)	(11.1x)	(55.5x)	3.6x
ROE	%	(11%)	(17%)	(4%)	(6%)	13%
ROA	%	(9%)	(14%)	(4%)	(3%)	7%
Net Debt or (Cash)	A\$m	(10)	(10)	(45)	134	106
Gearing (ND/(ND+E))	%	(45%)	(33%)	(38%)	47%	38%
Gearing (ND/E)	%	(31%)	(25%)	(28%)	88%	60%

Reserves & Resources

Resources		mt	% Cu	g/t Ag	% CuEq*	kt Cu	kt CuEq*
T3	M+I	36.6	1.14%	16.0	1.27%	417	464
	Inferred	23.5	0.74%	11.0	0.83%	173	195
	M+I+I	60.2	0.98%	14.0	1.09%	590	657
T1 (Mahumo)	M+I	2.2	1.88%	48.2	2.27%	42	51
	Inferred	0.4	2.52%	57.4	2.98%	11	13
	M+I+I	2.7	2.00%	50.0	2.40%	53	64
		mt	% Cu	g/t Ag	% CuEq*	kt Cu	kt CuEq*
Total	M+I+I	62.8	1.02%	15.5	1.15%	644	721
Reserves		mt	% Cu	g/t Ag	% CuEq*	kt Cu	kt CuEq*
T3	P+P	21.4	1.02%	10.3	1.10%	218	235

*CuEq based on US\$3.20/lb Cu & US\$18/oz Ag

Earnings Sensitivity		CY21E	CY22E	CY21E	CY22E
		A\$m	A\$m	%	%
Copper Price	US\$/lb +10%	5.5	9.8	91%	34%
Silver Price	US\$/oz +10%	0.4	0.7	6%	2%
FX translation to A\$ accts	A\$/US\$ -10%	1.2	3.8	21%	13%

Valuation	Discount	Stake	A\$m	A\$/sh
T3 (unrisked)	-	100%	367	1.04
T3 (risk-adjusted)	50%	100%	184	0.52
T1 (risk-adjusted)	50%	100%	37	0.10
Exploration & Other Projects			100	0.28
Corporate & Other			(47)	(0.13)
Debt			-	-
Cash			20	0.06
Option Strikes			0	0.00
Risk adjusted NAV			294	0.83
				0.41

Source: Company data, Blue Ocean Equities

MODEL SUMMARY: OPERATIONAL INPUTS & FREE CASH FLOW (US\$m)

						Macro Assumptions						
						CY18E	CY19E	CY20E	CY21E	CY22E		
						Copper Price	US\$/lb	3.00	3.00	3.20	3.20	3.20
						Silver Price	US\$/oz	15.94	15.50	16.00	18.00	18.00
Operational Summary						FCF Contribution						
						US\$m	CY18E	CY19E	CY20E	CY21E	CY22E	
T3 (100% basis)						T3 (MOD's 100% share)						
Ore Milled	mt	-	-	-	2.0	3.0						
Head Grade	%	-	-	-	0.95%	0.95%						
Recovery	%	-	-	-	92%	92%						
Copper in Conc	kt	-	-	-	18	26						
Mining	US\$/lb	-	-	-	1.12	0.84						
Power	US\$/lb	-	-	-	0.27	0.27						
Processing	US\$/lb	-	-	-	0.20	0.20						
G&A	US\$/lb	-	-	-	0.09	0.09						
Transport & Marketing	US\$/lb	-	-	-	0.17	0.17						
TC/RCS	US\$/lb	-	-	-	0.17	0.17						
Silver Credit	US\$/lb	-	-	-	(0.22)	(0.22)						
C1 Cash Costs	US\$/lb	-	-	-	1.78	1.50						
Royalties	US\$/lb	-	-	-	0.11	0.11						
Operating Cost	US\$/lb	-	-	-	1.88	1.61						
Sustaining Capex	US\$/lb	-	-	-	0.14	0.10						
All-in Sustaining Cost	US\$/lb	-	-	-	2.03	1.70						
% AISC Margin	%	-	-	-	37%	47%						
						Revenue	US\$m	-	-	-	128	192
						Operating Costs	US\$m	-	-	-	79	102
						Sustaining Capex	US\$m	-	-	-	5	5
						All-in Sustaining Cost	US\$m	-	-	-	84	108
						AISC Margin	US\$m	-	-	-	44	84
						Initial Capex	US\$m	-	60	120	-	-
						Exploration	US\$m	8	4	1	2	2
						Corporate						
						US\$m	CY18E	CY19E	CY20E	CY21E	CY22E	
						Cash Tax	-	-	-	7	18	
						Corporate Overheads	3	3	3	4	4	
						Other Items	1	0	0	-	-	
						FCF pre Debt Service	(13)	(67)	(124)	31	60	
						Net Interest	(0)	-	3	11	11	
						Debt Drawdown / (Repayment)	(0)	-	119	-	(23)	
						FCF post Debt Service	(13)	(67)	(7)	20	26	
						New Equity/Dividends						
						US\$m	CY18E	CY19E	CY20E	CY21E	CY22E	
						Proceeds from Shares/Options	13	92	-	-	-	
						Dividends Paid	-	-	-	-	-	
						Change in Cash	0	25	(7)	20	26	
						Cash Balance	21	126	54	77	138	

Source: Company data, Blue Ocean Equities

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