

25 October 2017

Finders Resources Limited (FND) BUY Share Price: A\$0.24

Our View on the Bidder's Statement

Target Price:

A\$0.38

After numerous press leaks, the official Bidder's Statement by the Eastern Field Development consortium has been released. Eastern Field propose a conditional cash offer of 23¢/sh for Finders and highlight a series of risks to existing shareholders should the offer not be accepted. The company has long traded at a steep discount to our NPV based valuation of 38¢/sh, so a takeover bid was likely and opportunistic, however we believe this offer is too low.

Risks Highlighted in Bidder's Statement

- Indonesian risks – the geopolitical risk of operating in Indonesia is real, but can be partially mitigated by implementing a robust ownership structure and partnering with respected and influential local investors. We believe the ownership structure to be robust (Figure 1) and that the replacement of a local partner on the register is possible.
- Metallurgical risk – the Wetar Copper Project (WCP) is a sulphide, not oxide, heap leach. The leach curve is longer (Figure 2), but with the operation now running at nameplate, we do not consider this an issue. WCP's second deposit, Lerokis, has different metallurgy (Figure 3) but is being extensively tested (Figure 4).
- Reserve position and mine life – our valuation of 38¢/sh is predicated only on the reserve position. We assume mining continues until DQ'20 with copper production declining until SQ'27. The reserve position has not grown since 2012, as the cash sweep facility has prevented any exploration, but this situation has just begun to change with some exploration underway.
- Production risks – WCP has had three quarters of near nameplate production, but like all mining projects, it is subject to operational risk. We saw the interruption announced on 27-June-17 as little more than an unfortunate operator error and not reflective on the quality of the underlying asset ([Petra Note Here](#)).
- Copper price – yes, the copper price is volatile, but is continuing to rally. Copper prices are up 17% since Acorn advised it's on market sale in Feb-17 for 17.7¢/sh and is up 5% since Eastern Field's bid was first announced on 6-Oct-17.

Our View

- Eastern Field are rationale investors aiming to cheaply acquire a quality asset for the benefit of their portfolio or make a return on their original investment. With a NPV of 38¢/sh, we believe the bid of 23¢/sh significantly undervalues Finders and will need to be raised for management to recommend acceptance.

Company Data

Shares – ordinary (M)	761
Market capitalisation (\$M)	179
12 month low/high (\$)	0.13 / 0.26
Average monthly turnover (\$M)	3.2
GICS Industry	Materials / Metals & Mining

Financial Summary (consolidated)

Year end Dec	2016A	2017F	2018F	2019F	2020F
Revenue (\$M)	74	240	257	249	238
Costs (\$M)	73	96	94	97	96
EBITDA (\$M)	1	144	163	152	142
NPAT (\$M)	-13	78	84	78	69
EPS (¢ps)	-2	10	11.0	10.2	9.0
PER (x)	na	2	2	2	3
Cashflow (\$M)	-24	67	128	111	119
CFPS (¢ps)	-3	9	17	15	16
PCFPS (x)	-7	3	1	2	1
Enterprise Value (\$M)	292	252	153	64	-39
EV / EBITDA (x)	424	2	1	0	0
Dividends (¢ps)	0	0	0	0	0
Yield (%)	0	0	0	0	0

FND – performance over one year



Disclosure and Disclaimer

This report must be read with the disclosure and disclaimer on the final page of this document.

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Analysis

Finders Resources (Consolidated Entity)
(FND)
24-Oct-17

Share Price (\$)
A\$0.24
Options / Con. Notes (M)
54.3
Iss. Shares (M)
761.3
Mkt Cap. (\$M)
A\$179M

Year End December

PROFIT & LOSS	2016A	2017F	2018F	2019F	2020F	2021F
Revenue	A\$M 73.6	239.8	256.7	249.4	237.8	197.5
Operating Costs	A\$M 86.3	103.2	94.7	98.4	98.1	61.7
Exploration	A\$M 0.0	0.8	2.5	2.5	2.5	2.5
Other	A\$M (13.3)	(8.2)	(3.3)	(3.5)	(4.9)	29.5
EBITDA	A\$M 0.7	144.0	162.8	152.0	142.0	103.8
Depreciation & Amort.	A\$M 13.8	42.9	45.8	50.2	54.3	48.8
EBIT	A\$M (13.1)	101.1	117.0	101.8	87.7	55.0
Net Interest	A\$M 4.8	19.7	5.2	(1.8)	(4.1)	(7.4)
Pre-Tax Profit	A\$M (17.8)	81.4	111.8	103.6	91.8	62.4
Tax	A\$M (4.7)	3.8	27.9	25.9	23.0	15.6
Net Profit	A\$M (13.1)	77.6	83.8	77.7	68.9	46.8
Abnormal	A\$M 0.0	9.1	0.0	0.0	0.0	0.0
Reported Profit	A\$M (13.1)	86.7	83.8	77.7	68.9	46.8
Dividends Paid	A\$M 0.0	0.0	0.0	0.0	0.0	0.0
Adjustments	A\$M 0.0	0.0	0.0	0.0	0.0	0.0

CASHFLOW

Net Op Cash Flow	A\$M (16.4)	76.0	133.0	135.5	137.6	133.8
Net Interest	A\$M (8.0)	(9.5)	(5.2)	1.8	4.1	7.4
Tax Paid	A\$M 0.0	0.0	0.0	(25.9)	(23.0)	(15.6)
Gross Op Cash Flow	A\$M (24.4)	66.6	127.8	111.4	118.8	125.6
Net Capex	A\$M (75.7)	(13.7)	(10.6)	(13.5)	(10.6)	(8.5)
Exploration	A\$M 0.0	(1.5)	(5.0)	(5.0)	(5.0)	(5.0)
Investing Cash Flow	A\$M (75.7)	(15.2)	(15.6)	(18.5)	(15.6)	(13.5)
Free cash flow	A\$M (100.0)	51.3	112.3	92.9	103.3	112.1
Net Borrowings	A\$M 0.7	(40.0)	(52.3)	(33.0)	0.0	0.0
Dividends	A\$M 0.0	0.0	0.0	0.0	0.0	0.0
Equity Issues	A\$M 11.3	0.0	0.0	0.0	0.0	0.0
Other	A\$M 59.2	(8.2)	(13.2)	(3.4)	0.0	0.0
Financing Cash Flow	A\$M 71.2	(48.2)	(65.5)	(36.4)	0.0	0.0
Net Increase/Cash	A\$M (28.8)	3.1	46.8	56.5	103.3	112.1

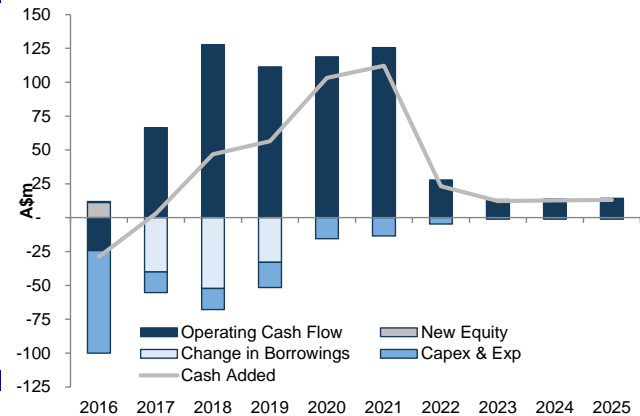
BALANCE SHEET

Cash	A\$M 4.9	8.0	54.8	111.2	214.5	326.6
Other Current	A\$M 46.8	64.9	64.9	64.9	64.9	64.9
Current Assets	A\$M 51.6	72.9	119.7	176.1	279.4	391.5
Fixed Assets	A\$M 229.1	185.5	150.3	113.6	69.8	29.4
Exploration	A\$M 0.0	0.0	0.0	0.0	0.0	0.0
Other	A\$M 27.3	27.7	27.7	27.7	27.7	27.7
Non Current Assets	A\$M 256.4	213.2	177.9	141.2	97.4	57.1
Total Assets	A\$M 308.0	286.1	297.6	317.3	376.8	448.6
Borrowings	A\$M 42.7	52.3	33.0	0.0	0.0	0.0
Payables	A\$M 41.7	21.5	21.5	21.5	21.5	21.5
Other	A\$M 9.1	13.2	13.2	13.2	13.2	13.2
Current Liab	A\$M 93.5	87.1	67.8	34.7	34.7	34.7
Borrowings	A\$M 78.9	33.0	0.0	0.0	0.0	0.0
Provisions	A\$M 13.0	10.6	10.6	10.6	10.6	10.6
Other	A\$M 8.5	7.5	7.5	7.5	7.5	7.5
Non Current Liab	A\$M 100.5	51.1	18.1	18.1	18.1	18.1
Total Liabilities	A\$M 194.0	138.2	85.9	52.8	52.8	52.8
Total Equity	A\$M 114.1	147.9	211.7	264.5	324.0	395.8

RATIO ANALYSIS

	A\$	A\$	A\$	A\$	A\$	A\$
EPS	¢ (1.7)	10.2	11.0	10.2	9.0	6.1
PER	x na	2.3	2.1	2.3	2.6	3.8
EPS Growth	% (55.5)	(691.0)	8.0	(7.4)	(11.3)	(32.1)
CFPS	¢ (3.2)	8.7	16.8	14.6	15.6	16.5
PCFR	x na	2.7	1.4	1.6	1.5	1.4
DPS	¢ 0.0	0.0	0.0	0.0	0.0	0.0
Yield	% 0%	0%	0%	0%	0%	0%
Payout Ratio	% 0%	0%	0%	0%	0%	0%
Gearing ND/E	% 166%	52%	-10%	-42%	-66%	-83%
Interest Cover	x na	5.1	22.5	na	na	na
EBITDA Margin	% 0.9	60.0	63.4	60.9	59.7	52.6
EBIT Margin	% (17.8)	42.2	45.6	40.8	36.9	27.8
Return On Assets	% (4.2)	35.3	39.3	32.1	23.3	12.3
Eff Tax rate	% 25	25	25	25	25	25

	2016A	2017F	2018F	2019F	2020F	2021F
Resource						
Wetar (Dec-16)						
Tonnes	Mt	7.3				
Copper grade	%	2.39%		2.41%		
Contained copper	t	174,180		168,180		
Reserve						
Production						
Ore stacked	Mt	2.15	1.78	1.60	1.60	1.60
Grade - copper	%	2.20%	2.00%	2.53%	2.53%	2.53%
Metal in ore stacked	Mt	47	37	40	40	40
Copper stripped	t	11.87	26.03	28.00	28.00	27.25
C1	US\$/lb	0.92	1.03	1.01	1.02	1.04



REVENUE

Wetar	US\$M	44	167	175	175	176	146
Total	US\$M	44	167	175	175	176	146

COSTS

Wetar	US\$M	19	85	72	73	73	46
Total	US\$M	19	85	72	73	73	46

CAPEX

Wetar	US\$M	0.0	10.1	8.0	10.0	7.8	6.3
Total	US\$M	0.0	10.1	8.0	10.0	7.8	6.3

ASSUMPTIONS

Exchange Rate	A\$/US\$	0.74	0.77	0.76	0.74	0.74	0.74
Copper price	US\$/lb	2.21	2.73	2.80	2.80	2.90	2.90
Copper price	US\$/t	4868	6014	6173	6173	6393	6393

NPV (+1Yr)

	ASM	A\$/sh.
Wetar	(74.1%)	278 \$ 0.36
Exploration		50 \$ 0.07
Corporate costs		-11 \$ (0.01)
Net Cash (Debt)	(74.1%)	-29 \$ (0.04)
Total		288 \$ 0.38

Source: Petra Capital

What Do Provident and Saratoga Want?

We ultimately believe that Eastern Field Development consortium are looking for either a return on their investment, or acquire an asset on the cheap as a mechanism to help fund Merdeka's Tujuh Bukit, high capex, porphyry project.

The three parties making the bid are; Provident, Saratoga and Merdeka.

- **Procap Partners Limited (Provident)** – entered the register in Dec-2012 through a placement, with the original intention of developing the Wetar Copper Project into an Indonesian mining house. The group now own 106m shares (13.7% of Finders) with an average entry price of 17¢/sh. Provident are an Indonesian investment group, led by Gavin Caudle an Indonesian-Australian, who is also a director of Finders.
- **PT Saratoga Investama Sedaya Tbk (Saratoga)** – entered the register in Jan-2013, the group now own 47m shares (6.1% of Finders) with an average entry price of 16¢/sh. Saratoga are an Indonesian investment group, led by Indonesian Edwin Soeryadjaya.
- **PT Merdeka Copper Gold Tbk (Merdeka)** – Merdeka own and operate the Indonesian Tujuh Bukit copper and gold mine in East Java. Provident and Saratoga are both major shareholders of Merdeka. Merdeka has a Melbourne office, and Colin Moorhead, an Australian national is the VP Director and CEO.
 - **Tujuh Bukit** – consists of two stages; 1) a low capex, oxide heap leach project and; 2) a higher capex copper gold porphyry project. The oxide heap leach is currently operating, whilst the porphyry project is not yet being developed. We understand that Merdeka may be exploring an ASX listing to assist in funding the high capex porphyry project. If successful, the inclusion of Finders' free cash flow would also contribute significantly to the capital requirements. We also believe that the inclusion of an additional, fully operational asset, which is familiar to the ASX would add operational diversification and increase the appeal of this portfolio to investors.

The language initially used by the consortium has softened significantly. David Fowler a director of Eastern Field has been quoted by the AFR as saying “[Provident and Saratoga] are professional investors they are not going to do anything which destroys a lot of value”. We believe that the consortium are looking for a return on their investment, and whilst they would prefer to cheaply acquire Finders as a mechanism to help fund Merdeka's Tujuh Bukit porphyry project, they will not exit their position, currently worth A\$35m, for a loss.

Possible Outcomes

- **Eastern Field exit Finders** – We believe the combined average entry price for Provident and Saratoga is ~17¢/sh which has been held for over 5 years. If the consortium does decide to exit their position, it represents around 3.5 months of average volume in Finders. We believe there are two possibilities if Eastern Field exit;
 - **Rival bid appears** – assuming this is greater than 23¢/sh, this would give the consortium a minimum 35% ROI for a 5 year investment, and give other shareholders upside from the current share price.
 - **No rival bid appears** – acting as rationale, sophisticated investors, we don't believe the consortium would exit at a loss, we therefore believe the downside is capped at 17¢/sh.
- **Eastern Field are successful in their bid** – We believe Eastern Field has to increase their bid to give management the opportunity to support the offer. In our view, 23¢/sh significantly undervalue Finders, our fundamental valuation is 38¢/sh and based on 1xNPV₁₂.

Indonesian Risk

The geopolitical risk in Indonesia is real, but can be mitigated with a robust ownership structure, partnering with respected and influential local investors, and being a good corporate citizen.

Ownership Structure

We believe the ownership structure to be robust (Figure 1). Finders have a 74.1% economic ownership of the Wetar Copper Project which is made up by a 78% interest in PT Batutua Tembaga Raya (BTR) and a 54.6% effective interest PT Batutua Kharisma Permai (BKP). BTR is the processing entity which comprises 95% of the economic benefit of the overall project, giving Finders a 74.1% economic interest in the project (78% x 95%). This allows local equity ownership of BKP, the mining entity, without significantly affecting Finders and Daewoo's economic interest in the overall project.

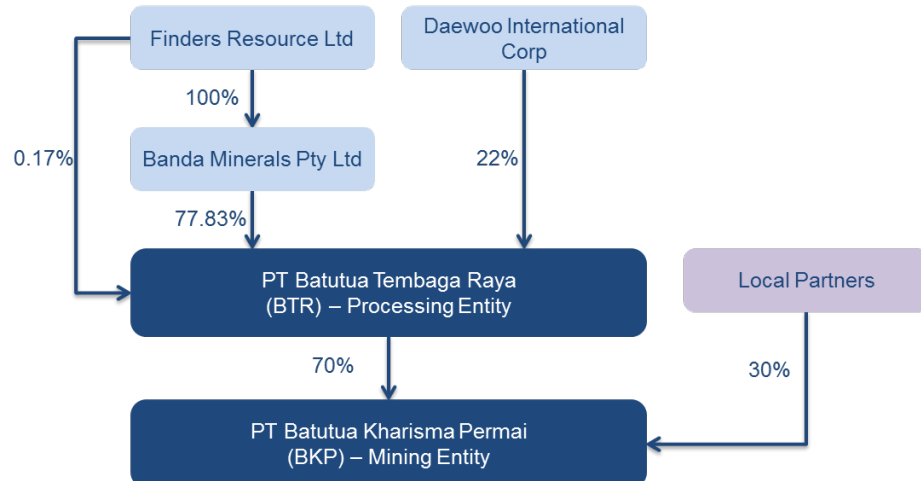
Local Sell Down

Legislation introduced in 2010 (GR/ 23/2010) requires that BKP is progressively divested after first production. After 10 years, the project must have a minimum local ownership of 51%.

- 20% local ownership in the sixth year
- 30% local ownership in the seventh year
- 37% local ownership in the eighth year
- 44% local ownership in the ninth year
- 51% local ownership in the tenth year

Production commenced on 8th March 2014, so the obligation to complete the divestment of 51% of BKP does not start until the year commencing 8th March 2023. Even with the integration of Lerokis, we expect mining to cease in DQ'20, and we therefore do not see a situation arising where local partners have a majority ownership of the mining entity. Local partners currently own 30% of BKP and therefore no further sell down is required until the year commencing 8th March 2021.

Figure 1: Ownership structure of the Wetar Copper Project. BTR consists of 95% of the economic interest of the project, whilst BKP consists of 5% of the economic interest.



Source: Petra Capital, Company Reports

Respected and Influential Local Investors

There is little denial that Provident (Procap Partners Limited) has been an active supporter of Finders since joining the register in 2012. Provident provided assistance in the successful Indonesian regulatory approval process and introduced Saratoga (PT Saratoga Investama Sedaya Tbk), another supportive, high quality Indonesian shareholder to Finders in 2013.

There are however other high quality Indonesian investors that would find an operating copper asset with a 46% CY'18 FCF yield attractive. We cite Herald Resources as an example where Indonesian led entities bid against one another to control an Indonesian located, Australian listed asset, and the Martabe Gold Mine where EMR Capital led a consortium, including high net worth Indonesians to control an Indonesian asset.

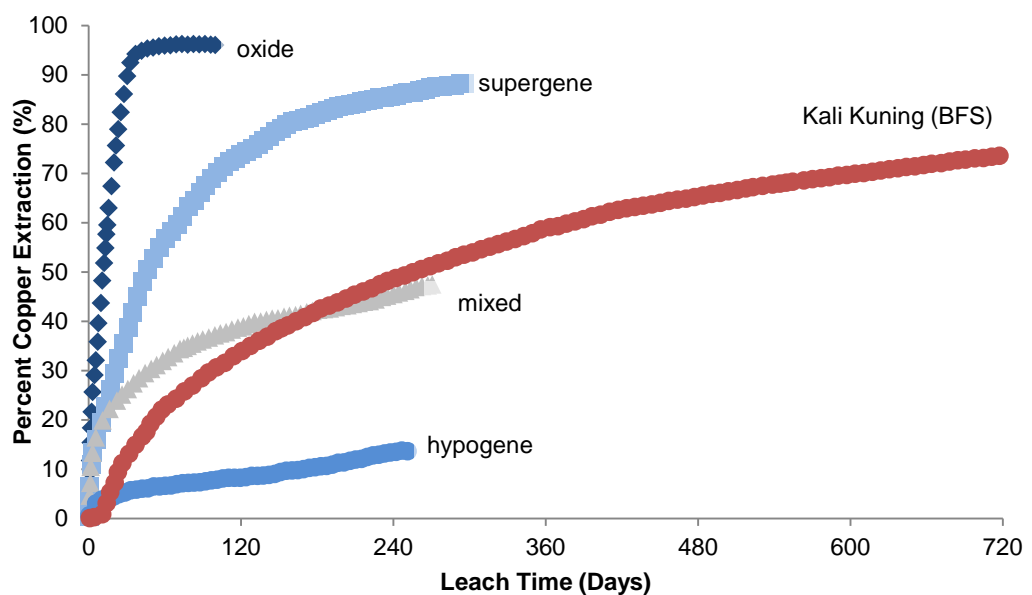
- **Herald Resources** – Indonesian listed miner, PT Bumi Resources Tbk made an all cash offer of A\$2.25/sh or A\$455m for Australian listed Herald Resources (HER.ASX) in Dec-2007. A bidding war followed between Pt Bumi Resources and a consortium led by PT Antam Tbk, a state-controlled Indonesian miner and Shenzhen Zhongjin Lignan Nonfermet Co, a Chinese miner/smelter. Ultimately Pt Bumi Resources paid A\$2.85/sh or A\$576m, or 27% more than the initial bid for Herald Resources.
- **Martabe Gold Mine** – A consortium of investors led by EMR Capital from Australia acquired the Martabe Gold Mine along with Farallon Capital and Indonesian/Chinese investors Martua Sitorus, Robert Budi Hartono and Michael Bambang Hartono.

Metallurgical Risk

Sulphide versus Oxide Heap Leach Operation

The Wetar Copper Project is a sulphide heap leach operation, similar to that of Barrick's Zaldivar mine. Consequently the leach curves are much longer than an oxide heap leach (Figure 2), but it is important to recognise the metallurgy has been well tested by Finders and the operation is running at near nameplate. In our Finders Resources initiation ([Heaps of Copper](#)) we explore the chemistry of the sulphide heap leach operation, in detail, and are confident that the company cannot only meet, but exceed the initial recovery assumptions of 75%.

Figure 2: Kali Kuning leach time compared to other copper species categories



Source: Petra Capital, Company Reports, Studies on the Curing and Leaching Kinetics of Mixed Copper Ores

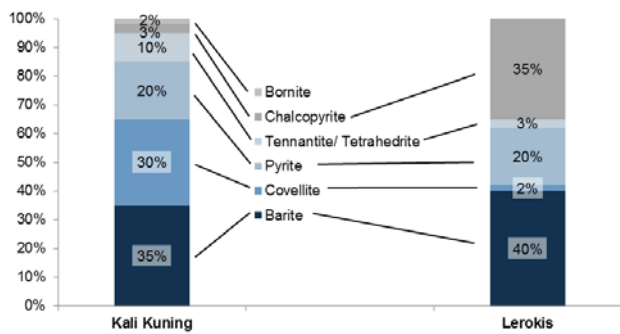
Kali Kuning versus Lerokis

We forecast the Kali Kuning reserve to be depleted in JQ'19, and replaced with ore feed from Lerokis. The mineralisation at Lerokis is similar to Kali Kuning with pyrite levels of ~20%, although Lerokis has much lower levels of faster leaching covellite (2% vs 30%). Instead, Lerokis has more chalcocopyrite (35% vs 3%) (Figure 3). These differences in mineralogy are likely to increase the time needed to leach the copper into solution.

Importantly the equivalent levels of pyrite between the two orebodies will ensure that the Wetar Copper Project continues to generate excess sulphuric acid. Typically sulphuric acid would account for 20-30% of the C1 cash costs at a heap leach operation. At Wetar Copper Project, this is avoided due to the high pyrite content of its ore, which generates sulphuric acid when irrigated with water. The heaps generate 1.2kg acid per 1kg of Cu produced.

The company has installed a best in class column leach test facility (Figure 4) on site to determine a strategy for managing this difference in mineralogy. Potential strategies could include; higher levels of aeration to increase the temperature of the heap, or incorporating a longer leach cycle into the schedule.

Figure 3: Mineral composition of Kali Kuning and Lerokis ore



Source: Petra Capital, Company Reports

Figure 4: Wetar Copper Project column test work facility



Source: Petra Capital Site Visit to Wetar Copper Project

Mine Life, Reserve Position and Exploration

Mine Life and Reserves

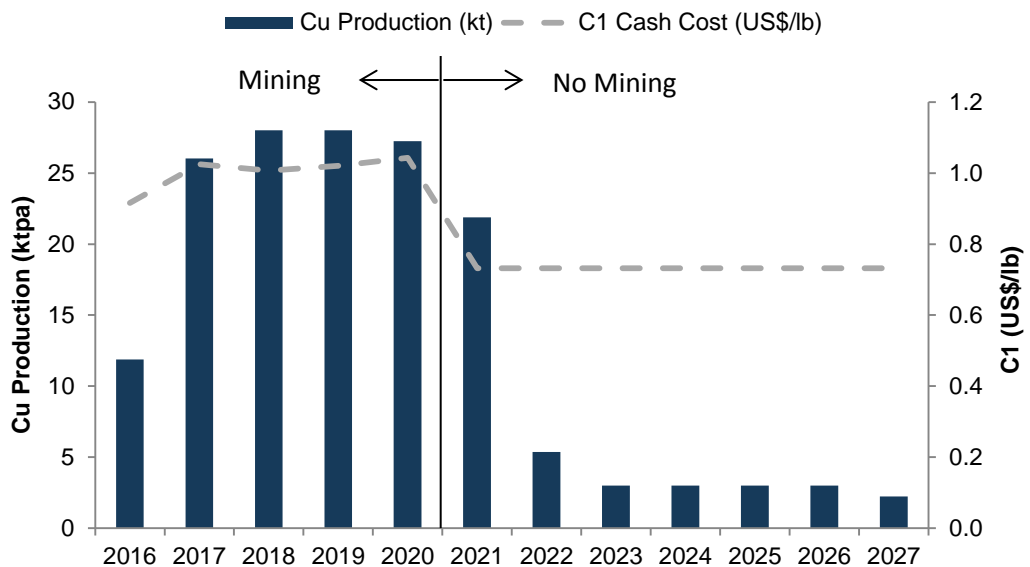
We value Finders at 38¢/sh, including only the reserves of the WCP, which were last updated in June-16 (8.6Mt @ 2.3% for 202kt Cu). We assume mining continues until DQ'20 and the heaps continue to produce copper until SQ'27 (Figure 5).

Exploration Potential

Despite strong brownfield exploration potential, the resource and reserve position, excluding depletion, has not changed for 5+ years. Finders has been unable to allocate expenditure whilst the debt facilities include a cash sweep facility, although this situation is now changing.

- **Lerokis** – On 3-Oct-17 Finders released the results of a recent exploration campaign at Lerokis, which discovered new areas of mineralisation. We would expect these new exploration results to be incorporated into an updated resource and announced to the market in the coming months.
- **Meron** – Finders has a 42 hole, 4,600m campaign planned at Meron, a nearby prospect. Management believe this program would be sufficient to define an inferred resource. Conceptually we believe Meron could host up to 5Mt of Cu Ore, significantly expanding the mine life at the WCP.
- **Greenfield exploration** – was last undertaken on Wetar Island in the 1990's. We understand new tenements on Wetar Island are expected to be released by the Government in CY'17/18 via a tender process. We consider the island to be highly prospective for similar mineralisation and see Finders to be in a strong position given it is the only operator on the island and has expertise operating in the rugged terrain.

Figure 5: Forecast WCP Production



Source: Company Reports, Petra Capital

Production Risk

Production Performance

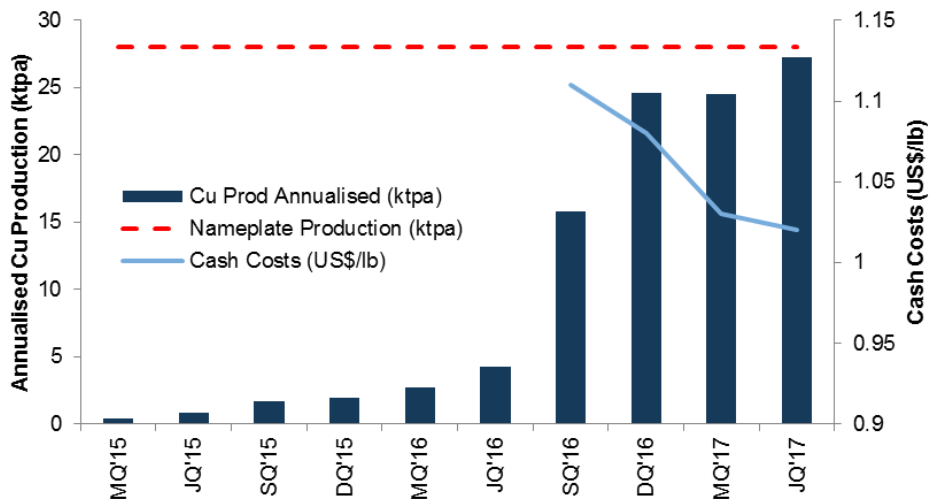
The Wetar Copper Project has had 3 quarters of near nameplate production and cash costs have fallen to US\$1.02/lb in the JQ'17 (Figure 2). The bidder's statement claims Finders guided to CY'17 production of 28kt Cu, and consequently, production of less than 8.8kt Cu in DQ'17 will result in missed guidance (Figure 7). We dispute the fact Finders has released official guidance, so find this assertion particularly misleading.

Production since SQ'16 has been impressive, and importantly demonstrates the ability of the WCP to operate at, or near, nameplate capacity. This gives us confidence that the project is on track to produce 28kt Cu in CY'18 and generate A\$112m of free cash flow (100% basis).

Minor Interruption to Production

The interruption to production announced on 27-Sep-17 was, in our view, an unfortunate error, by an inexperienced nightshift operator and does not reflect the quality of the underlying asset. Our note discussing this, in detail, is [here](#).

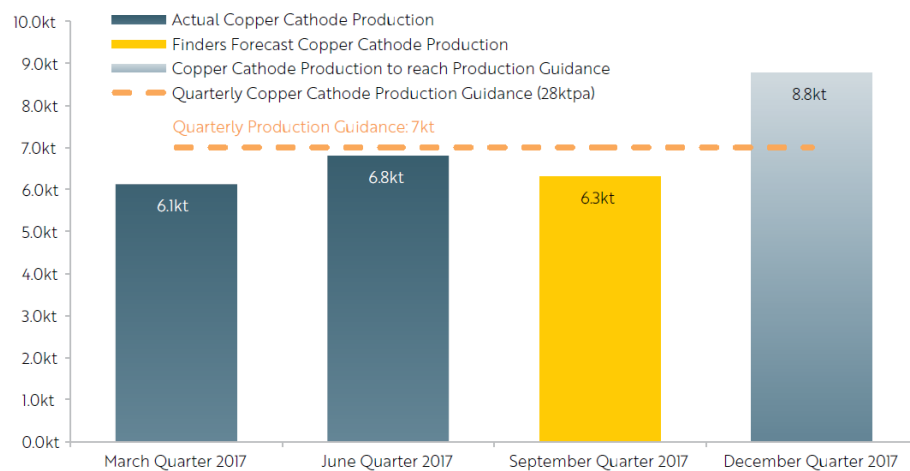
Figure 6: Forecast WCP Production



Source: Source: Company Reports, Petra Capital

Figure 7: Misleading reference to DQ'17 production

Figure 2: 2017 Finders Historical Copper Cathode Production² & Production Guidance



Source: Bidder's Statement

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