

16 February 2018

Finders Resources (FND)

BUY

Share Price: A\$0.25

Bid Goes Unconditional

Target Price: A\$0.36

The bid for Finders from Eastern Fields Development Limited (EFDL) has gone unconditional, allowing the group to buy on market at the bid price of 23¢/sh. In EFDL's announcement, two main arguments justifying the bid price are made; 1) there must be little value/interest in Finders because a rival suitor has not emerged and 2) recoveries appear to be lower than the theoretical leach curve. We believe the two claims are overly simplistic, and we reiterate our view that the bid is opportunistic and grossly undervalues the company. We maintain our BUY rating and 36¢/sh target price.

Absence of a Rival Bidder

- Best practice, media leaks and EFDL announcements give us confidence a formal process to solicit other bids is underway. We see Finders and the Wetar Copper Project being very attractive to a range of groups; 28ktpa Cu producers with ~US\$1/lb C1 costs are rare.
- We are therefore puzzled as to why a rival bidder has not yet emerged.
- It is logical that any rival bidder, intent on fully acquiring Finders, would have early discussion with EFDL to divest its 25% blocking stake. It is therefore possible that EFDL find the asset attractive for future cash flows, do not want to sell, prevent other bidders and are intent on acquiring the asset cheaply.

Overall Recoveries

- Finders are targeting a 75% Cu terminal recovery over a 720 day leach curve. We estimate the heap has a weighted average maturity of 1 year and according to the theoretical leach curve should have achieved a recovery of 59%, vs ~41%.
- This shortfall of 8kt Cu is equivalent to 1Q of production after 3 years of operation and, in our view, is immaterial. Discussions with external consultants suggest that this is the ordinary behaviour of a heap and will not affect the terminal recovery of 75%. It is common for the theoretical curve to be shifted during a) overstacking or re-mining, when irrigation has to be halted or b) during the wet season (Nov-Mar) when leached solution is directed to storm water ponds.

Valuation

- Our valuation for Finders of 36¢/sh is based on a 1xP/NPV¹² for the Wetar Copper Project, assuming production of only the current reserve.

Company Data

Shares – ordinary (M)	761.9
Market capitalisation (\$M)	186
12 month low/high (\$)	0.16 / 0.27
Average monthly turnover (\$M)	4.0
GICS Industry	Materials

Financial Summary (fully diluted/normalised)

Year end June	2016A	2017F	2018F	2019F	2020F
Revenue (\$m)	73.6	223.6	228.4	224.1	218.2
Costs (\$m)	72.9	91.0	77.1	81.8	82.9
EBITDA (\$m)	0.7	132.6	151.3	142.3	135.2
NPAT (\$m)	(13.1)	71.2	76.2	70.7	63.0
EPS (cps)	(1.7)	9.3	10.0	9.3	8.3
EPS growth (%)	56%	642%	7%	-7%	-11%
PER (x)	na	2.6	2.4	2.6	3.0
Cashflow (\$m)	(24.4)	70.5	106.2	93.9	104.5
CFPS (cps)	(3.2)	9.3	14.0	12.3	13.7
PCFPS (x)	(7.7)	2.6	1.8	2.0	1.8
Enterprise Value (\$m)	303.2	270.8	192.0	118.9	29.1
EV / EBITDA (x)	440.7	2.0	1.3	0.8	0.2
Payout ratio (%)	0.0	0.0	0.0	0.0	0.0
Dividend (cps)	0.0	0.0	0.0	0.0	0.0
Yield (%)	0%	0%	0%	0%	0%

FND – performance over one year



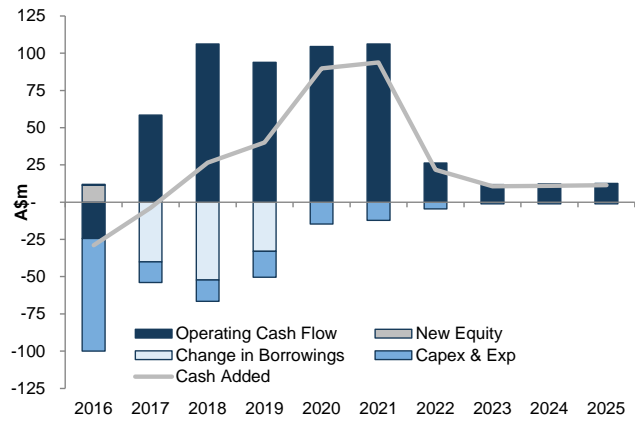
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Analysis

Finders Resources (Consolidated Entity)

(FND)							Share Price													
15-Feb-18							(\$)		A\$0.25											
Year End December							Options / Con. Notes													
							(M)		54.3											
							Iss. Shares		(M)											
							Mkt Cap.		(S\$M)											
							AS\$187M													
									2016A		2017F		2018F		2019F		2020F		2021F	
PROFIT & LOSS									Resource		Reserve									
Revenue	A\$M	73.6	223.6	228.4	224.1	218.2	169.3	Wetar (Dec-17)												
Operating Costs	A\$M	86.3	108.1	87.6	92.1	93.4	55.0	Tonnes	Mt	5.3			5.0							
Exploration	A\$M	0.0	0.8	2.5	2.5	2.5	2.5	Copper grade	%	2.75%			2.72%							
Other	A\$M	(13.3)	(17.9)	(13.0)	(12.7)	(12.9)	25.6	Contained copper	t	146,000			136,000							
EBITDA	A\$M	0.7	132.6	151.3	142.3	135.2	86.2													
Depreciation & Amort.	A\$M	13.8	40.1	44.1	48.9	53.9	44.7													
EBIT	A\$M	(13.1)	92.5	107.2	93.4	81.3	41.5													
Net Interest	A\$M	4.8	19.7	5.6	(0.9)	(2.7)	(5.7)													
Pre-Tax Profit	A\$M	(17.8)	72.8	101.6	94.3	84.0	47.2													
Tax	A\$M	(4.7)	1.6	25.4	23.6	21.0	11.8													
Net Profit	A\$M	(13.1)	71.2	76.2	70.7	63.0	35.4													
Abnormal	A\$M	0.0	9.1	0.0	0.0	0.0	0.0													
Reported Profit	A\$M	(13.1)	80.2	76.2	70.7	63.0	35.4													
Dividends Paid	A\$M	0.0	0.0	0.0	0.0	0.0	0.0	Copper stripped	t	11.87	23.16	24.55	25.00	25.00	18.75					
Adjustments	A\$M	0.0	0.0	0.0	0.0	0.0	0.0	C1	US\$/lb	0.92	1.12	1.05	1.06	1.07	0.73					
CASHFLOW																				
Net Op Cash Flow	A\$M	(16.4)	80.0	111.8	116.6	122.8	112.2													
Net Interest	A\$M	(8.0)	(9.5)	(5.6)	0.9	2.7	5.7													
Tax Paid	A\$M	0.0	0.0	0.0	(23.6)	(21.0)	(11.8)													
Gross Op Cash Flow	A\$M	(24.4)	70.5	106.2	93.9	104.5	106.1													
Net Capex	A\$M	(75.7)	(12.4)	(9.3)	(12.4)	(9.7)	(7.3)													
Exploration	A\$M	0.0	(1.5)	(5.0)	(5.0)	(5.0)	(5.0)													
Investing Cash Flow	A\$M	(75.7)	(13.9)	(14.3)	(14.7)	(14.7)	(12.3)													
Free cash flow	A\$M	(100.0)	56.6	92.0	76.5	89.8	93.9													
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	(8.4)	(13.2)	(3.4)	0.0	0.0													
Financing Cash Flow	A\$M	71.2	(48.4)	(65.5)	(36.4)	0.0	0.0													
Net Increase/Cash	A\$M	(28.8)	8.2	26.5	40.1	89.8	93.9													
BALANCE SHEET																				
Cash	A\$M	4.9	1.1	27.6	67.7	157.4	251.3													
Other Current	A\$M	46.8	76.9	76.9	76.9	76.9	76.9													
Current Assets	A\$M	51.6	77.9	104.5	144.5	234.3	328.2													
Fixed Assets	A\$M	229.1	186.9	152.1	115.6	71.4	33.9													
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	214.6	179.7	143.2	99.0	61.6													
Total Assets	A\$M	308.0	292.5	284.2	287.7	333.3	389.8													
Borrowings	A\$M	42.7	52.3	33.0	0.0	0.0	0.0													
Payables	A\$M	41.7	46.5	46.5	46.5	46.5	46.5													
Other	A\$M	9.1	13.2	13.2	13.2	13.2	13.2													
Current Liab	A\$M	93.5	112.1	92.8	59.7	59.7	59.7													
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	163.2	110.9	77.8	77.8	77.8													
Total Equity	A\$M	114.1	129.4	173.3	209.9	255.5	311.9													
RATIO ANALYSIS																				
EPS	¢	(1.7)	9.3	10.0	9.3	8.3	4.6													
PER	x	na	2.6	2.4	2.6	3.0	5.3													
EPS Growth	%	56%	642%	7%	-7%	-11%	-44%													
CFPS	¢	(3.2)	9.3	14.0	12.3	13.7	13.9													
PCFR	x	na	2.6	1.8	2.0	1.8	1.8													
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%	65%	3%	-32%	-62%	-81%													
Interest Cover	x	na	4.7	19.2	na	na	na													
EBITDA Margin	%	0.9	59.3	66.2	63.5	62.0	50.9													
EBIT Margin	%	(17.8)	41.4	46.9	41.7	37.3	24.5													
Return On Assets	%	(4.2)	31.6	37.7	32.5	24.4	10.6													
Eff Tax rate	%	25	25	25	25	25	25													
REVENUE																				
Wetar	US\$M	44	154	153	156	161	125													
Total	US\$M	44	154	153	156	161	125													
COSTS																				
Wetar	US\$M	19	89	67	68	69	41													
Total	US\$M	19	89	67	68	69	41													
CAPEX																				
Wetar	US\$M	0.0	9.0	7.0	9.2	7.2	5.4													
Total	US\$M	0.0	9.0	7.0	9.2	7.2	5.4													
ASSUMPTIONS																				
Exchange Rate	A\$/US\$	0.74	0.77	0.76	0.74	0.74	0.74													
Copper price	US\$/lb	2.21	2.74	2.80	2.80	2.90	2.90													
Copper price	US\$/t	4868	6032	6173	6173	6393	6393													
NPV (+1Yr)																				
Wetar	(74.1%)						213	\$	0.28											
Exploration							50	\$	0.07											
Corporate costs							(10)	\$	(0.01)											
Net Cash (Debt)	(74.1%)						19	\$	0.03											
Total							271	\$	0.36											



Source: Petra Capital

Investment Thesis

Finders is a mid-sized, low cost, copper cathode producer that has constructed and commissioned the 28ktpa Wetar Copper Project. The company generated strong EBITDA of US\$72.2m in CY17. Strong free cash flow and closure of the hedge book has allowed the company to pay down US\$93.5m of debt since 30th Jun 2016, net project debt was reduced to US\$51.5m at 31-Dec-17.

In late 2017 the project experienced unexpected operational difficulties in the form of a crud run through event and a crusher breakdown. We believe this was the catalyst for its Indonesian partners to form EFDL and on 6th Oct 2017 launch an opportunistic takeover bid at 23¢/sh, which in our view grossly undervalues the company versus our target price of 36¢/sh. On 15th February the takeover bid was declared unconditional and allows EFDL to acquire share on market at the 23¢/sh bid price.

If the bid is unsuccessful we expect the company to generate strong free cash flow of A\$92m in CY'18, be in a net cash position in 2H'18 and repatriate cash to shareholders.

Discrepancy in Recoveries?

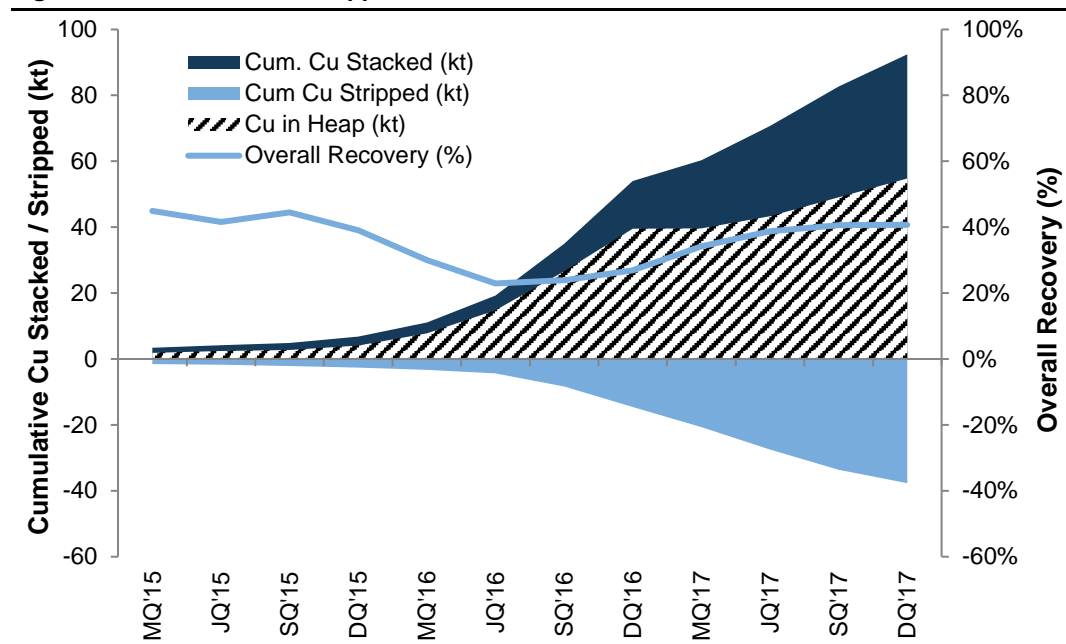
EFDL's Argument

EFDL claim Finders are overestimating the heap copper recoveries to date. Finders disclose, indirectly and directly, the number of tonnes of contained copper that has cumulatively been stacked upon the heaps, excluding copper leached. The two data sources show a discrepancy;

- **Indirectly – 92.5kt Cu** – The quarterly production reports detail the tonnes of ore and its grade that has been incrementally stacked on the heap pads. We calculate this cumulative total of stacked ore to be 4.3Mt at 2.1% Cu for 92.5kt Cu as of 31st Dec 2017 (Figure 1).
- **Directly – 101kt Cu** – The resource/reserve reports detail additions of contained copper to the heaps. The reports show 98kt Cu had been added to the heaps by 1st Dec 2018. If we assume 3.2kt Cu was added in the Dec calendar month, the cumulative total of stacked ore contained 101kt Cu as of 31st Dec 2017.

EFDL claim that this discrepancy of ~10kt Cu has allowed Finders to underestimate the total number of tonnes of copper on the heaps, and therefore overestimated the recoveries to date. It is our view that the discrepancy in the underlying data is unhelpful, it is immaterial and insufficient to reach such a conclusion.

Figure 1: Cu stacked and stripped to date



Source: Petra Capital, Company Reports

Expected Recoveries

The Wetar Copper Project is a sulphide heap leach copper operation, similar to that of Barrick's Zaldivar, and consequently has much longer leach curves than a traditional oxide heap leach. Finders expect total copper recoveries, over a 720 day leach cycle, of 75% at Kali Kuning and 62.9% at Lerokis (Figure 2).

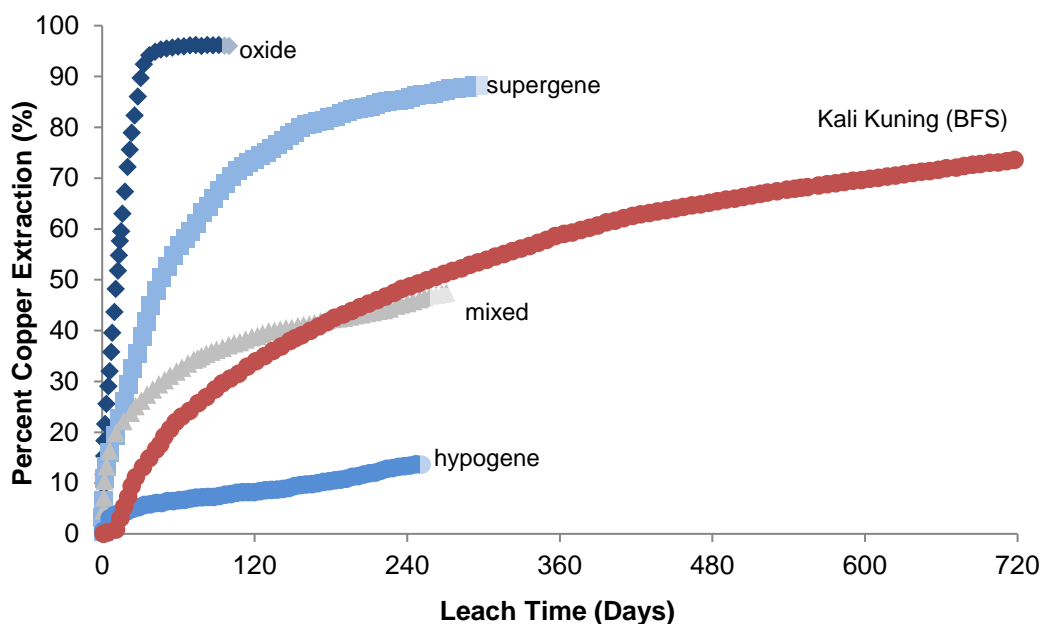
It is our view that the long leach times, and the relatively short period of operation prevent any meaningful or accurate conclusions from the analysis of publicly available production data on the operation. The weighted average length of time copper has been on the heap is ~1 year, theoretically this should have achieved a weighted average copper recovery of ~59%, it is currently 41%.

In Figure 3 we analyse the tonnes of ore stacked and the length of time it has been on the heap. We then apply an expected leach rate, based on that length of time on the heap, and multiply that leach rate by the tonnes of contained copper of that age. We conclude that by 31-Dec-2017, there should theoretically have been 46kt Cu stripped, instead, 38kt Cu has been stripped. This shortfall of 8kt is equivalent to one quarter of production.

We understand from discussions with a third party consultant that the shortfall of 8kt or 18% is a typical short term deviation for a project of this type and can be explained by;

- **Materiality** – 8ktpa is equivalent to the curve being shifted by one quarter of production, consequently it is likely to be immaterial with no implication for the terminal recovery value of 75%.
- **Seasonality** – the wet season (November to March) dilutes the leach solution and can result in the build of dilute inventory in storm water ponds which will be recovered as raffinate in the dry season.
- **Overstacking/Remining** – it is likely this is the primary cause for the shift from theoretical, to the actual leach curve. Whenever the heap is over stacked, or re-mined, the leach process is halted. The Wetar Copper Project employs over stacking, where fresh ore is placed on top of existing heaps, and the project has also recently been forced to re-mine part of the heap for geotechnical reasons. In both these instances the leach process would have been halted. To recommence the leach process all the over stacked ore, plus all of the pre-existing ore needs to be re-saturated with leach solution.

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

Figure 3: Stacking, heap maturity and leaching forecasts/actuals

		JQ14	SQ14	DQ14	MQ15	JQ15	SQ15	DQ15	MQ16	JQ16	SQ16	DQ16	MQ17	JQ17	SQ17	DQ17
Stacking																
Ore stacked	kt	113	0	0	0	45	43	97	179	347	678	950	430	554	514	368
Cu Grade	%	2.7%				1.7%	1.6%	2.0%	2.4%	2.3%	2.3%	2.0%	1.5%	1.7%	2.3%	2.7%
Contained Cu	kt	3.0				0.8	0.7	1.9	4.3	8.1	15.8	19.1	6.3	10.5	11.9	9.8
Maturity																
Time on heap	yrs	3.5	3.25	3.0	2.75	2.5	2.25	2.0	1.75	1.5	1.25	1.0	0.75	0.5	0.25	0.0
Leaching Forecasts/Actuals																
% expected to leached by 31Dec17	%	75%	75%	75%	75%	75%	75%	75%	71%	67%	64%	59%	51%	42%	29%	0%
Cu expected to be leached by 31Dec17	kt	2.3	0.0	0.0	0.0	0.6	0.5	1.5	3.1	5.4	10.1	11.2	3.2	4.4	3.5	0.0
Expected cumulative Cu leach by 31Dec17	kt	2.3	2.3	2.3	2.3	2.9	3.4	4.8	7.9	13.3	23.4	34.6	37.9	42.3	45.7	45.7
Actual cumulative stripping	kt															37.7
Difference	kt															8.0
Difference	%															-18%

Source: Petra Capital, Company Reports

Conclusions

- It is our view that the bid of 23¢/sh by EFDL for Finders significantly undervalues the company. The unconditional nature of the bid now allows EFDL to acquire stock on market at the bid price of 23¢/sh and is opportunistic.
- We believe the two main arguments presented by EFDL justifying the bid price of 23¢/sh are overly simplistic;
 - Lack of rival bidder – It is our view that a 28ktpa Cu producer with ~US\$1/lb C1 cash costs would be attractive to a wide range of groups, but there is a possibility EFDL and their 25% blocking stake is preventing a rival bid emerging.
 - Variance to the theoretical leach curve – It is common for the leach curve to vary on site from the theoretical curve, but this variance does not prevent the terminal recovery being achieved.
- In our view there a number of near term catalysts for the company as we expect Finders to;
 - return to nameplate capacity by the end of the MQ'18 and;
 - be in a net cash position by the end of CY'18 and;
 - begin to repatriate cash by the end of CY'18.

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