

Chatham Rock Phosphate

Marine consent is final permitting milestone

Chatham Rock Phosphate (CRP) has delivered on its milestones and awaits the set six-month timeframe for marine consent in Q4 CY15 and finalisation of the seabed mining contract. The high margin, low impurity, long-life, wholly owned Chatham Rock Phosphate project does not require any development capital under the build, own and operate mining contract model. The shares are trading at a significant discount to our unrisks DCF valuation of NZ\$1.76/share.

Year end	Revenue (NZ\$m)	PBT* (NZ\$m)	EPS* (c)	DPS (c)	P/E (x)	Yield (%)
03/12	0.0	(0.8)	(1.4)	0.0	N/A	N/A
03/13	0.0	(1.4)	(1.0)	0.0	N/A	N/A
03/14e	0.0	(1.5)	(1.0)	0.0	N/A	N/A
03/15e	0.0	(2.8)	(1.2)	0.0	N/A	N/A

Note: *PBT and EPS are normalised (fully diluted), excluding intangible amortisation, exceptional items and share-based payments.

JORC resource, long mine life, production from 2017

Following the issue of a mining permit in December 2013, CRP's marine consent application was accepted as complete in May 2014. It is expected to be granted in November 2014. It is the only major licence CRP now needs to allow it to begin production. Production is proposed at 1.5Mtpa rock phosphate from 2017 using contract seabed mining. CRP recently announced a JORC resource of 23.4Mt phosphorite, which, with new prospecting licences recently applied for, offer the potential for a long mine life. A point of difference for Chatham rock phosphate is a low cadmium content. Cadmium is an unwanted heavy metal in fertilisers.

Capital-light contract mining model

CRP has embraced a 'capital light' model whereby the seabed mining activities are operated by a mining contractor that owns the equipment. International dredging specialist Boskalis Offshore is CRP's preferred partner to build and operate the dredge on behalf of CRP having undertaken significant work on the project with CRP. However, if Boskalis elects not to proceed with its involvement, CRP has had interest from four other dredging specialists which reduces the risk to its production plans. With increased global exploration activity directed to marine deposits, there is a strong appetite from global dredging companies to be involved in the embryonic seabed mining industry. To reflect expected international interest in the project, CRP is planning an AIM listing.

Valuation: Unrisks NZ\$1.76/share

We have revised our DCF valuation to account for the dilution from the recent 1 for 10 rights issue and the forthcoming secondary AIM listing and capital raising. On our assessment, CRP is virtually fully funded up to the point of production in Q1 CY17, assuming the Subsea NZ\$0.30 options are exercised in 2015. A final equity raising may be needed prior to production for corporate and working capital purposes. On an unrisks basis, we conclude a base valuation of NZ\$1.76/share. Prior to the increase in issued shares, the valuation was NZ\$1.89/share.

Corporate update

Metals & mining

29 May 2014

Price **NZ\$0.22**

Market cap **NZ\$35m**

US\$0.83/NZ\$

Net cash (NZ\$m) (estimated after rights issue) 2.4

Shares in issue (post 1 for 10 rights issue) 158.8m

Free float 46.0%

Code CRP

Primary exchange NZX

Secondary exchange N/A

Share price performance



% 1m 3m 12m

Abs 0.0 (23.2) (34.2)

Rel (local) (1.0) (24.9) (40.7)

52-week high/low NZ\$0.40 NZ\$0.22

Business description

Chatham Rock Phosphate (CRP) is seeking to develop its 100%-owned subsea JORC resource of 23.4Mt phosphorite through seabed mining. Using contracted dredge mining, it expects to be fully permitted by the end of calendar 2014 and in production in 2017.

Next events

Marine permit Q4 CY14

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Progressing towards seabed mine production

The Chatham Rock Project is internationally significant, both as a seabed miner and a new phosphate producer.

Mining permit awarded, final marine licensing stage underway

A 20-year mining permit for phosphate extraction was issued in December 2013 for an area of 820sq km. The next and only major licence CRP still needs is marine consent. This was submitted to the Environmental Protection Authority (EPA) on 31 March 2014. On 28 May 2014, the EPA accepted CRP's formal marine consent application as being complete. There will be a fixed timeframe for full public process with the EPA's decision expected on 17 November 2014.

Maiden JORC resource defined

A maiden inferred resource (see Exhibit 1) was reported in April 2014 in accordance with the JORC code, 2012 edition. The resource is located about 450km offshore of the east coast of New Zealand at a water depth of approximately 350-450m. CRP has recently applied for new prospecting licences both east and west of its existing licence areas. It has indicated there is potential for an additional 40,000,000m³ containing 8-12Mt phosphorite (Ph) at a grade range of 200-300kg/m³.

Exhibit 1: Chatham Rise Phosphate Project maiden inferred mineral resource

Calculated at a cut-off grade of 100kg Ph/m ³	Volume	Thickness	Ph	Contained Ph
Classification	(m ³)	(cm)	(kg/m ³)	(Mt)
Inferred	80,000,000	20	290	23.4

Source: Chatham Rock Phosphate

Market position

A key point of difference for the CRP rock phosphate is its low cadmium content. Many rock phosphates have high cadmium levels. Cadmium can cause health problems because it is a heavy metal.

In its raw unprocessed form, Chatham rock phosphate has a grade of 21-22% P₂O₅, which is comparable to other rock phosphate sources. Export grade phosphate, which trades at benchmark prices, is rock that has been upgraded to 30-32% P₂O₅. This is often accomplished in a froth flotation process.

The company does not intend to upgrade the rock in New Zealand. In the domestic New Zealand market, the rock phosphate can be directly applied (DA) to pasture. New Zealand is a key target market for DA, which is expected to grow due to its low environmental impact and sells at a premium. The phosphate rock can also be used to make medium- or high-grade super phosphate (SSP) or di-calcic phosphate (DCP). These are made with blended imported rock to reduce cadmium.

CRP also plans to export its rock phosphate. It has so far identified multiple customers in seven countries (Australia, India, Pakistan, Indonesia, Malaysia, Brazil and Argentina) buying for SSP or DA. CRP is also having ongoing discussions with potential buyers in Japan, China and Korea.

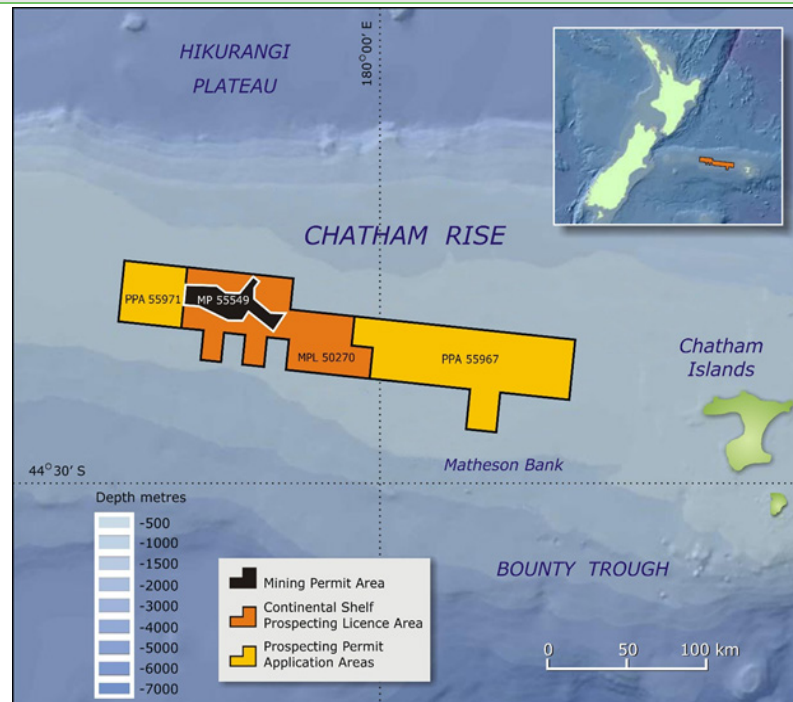
Mining method

Mining will be carried out using a trailing suction dredge, which sucks the nodule bearing sediment from the seabed with pumps. The nodules will be lifted to a specially modified vessel where they will be separated from the other material and stored on the vessel. Tailings will be returned to the seabed close to their original location. The vessel will transport the rock phosphate to the port for unloading. There could be a cycle of, say, three days mining and nine days in transit/port.

Contract mining

Seabed mining at depth is a very specialised activity. CRP has engaged with four international subsea and dredging firms to separately undertake jointly-funded mining concept studies. Each of the studies concluded that extraction was technically viable using extensions of existing technology.

Exhibit 2: Chatham Rock Phosphate licences and permits



Source: Chatham Rock Phosphate

CRP intends to adopt a contract mining model whereby the dredge operator is fully responsible for the capital costs of the dredging venture. The dredge operator also carries out the mining activities and is responsible for all mining costs including maintenance. To cover the dredge operator's capital and operating costs and provide a profit margin, the dredge operator will charge CRP a tonnage-related fee.

In this way, CRP's funding needs for the project are confined to corporate head office and related costs such as licence fees, exploration and rock phosphate testwork.

International dredging specialist Boskalis Offshore is CRP's preferred partner to build and operate the dredge on behalf of CRP having undertaken significant work on the project with CRP. However, if Boskalis elects not to proceed with its involvement, CRP has had interest from four other dredging specialists which reduces the risk to its production plans. With increased global exploration activity directed to marine deposits, there is a strong appetite from global dredging companies to be involved in the embryonic seabed mining industry. To reflect expected international interest in the project, CRP is planning an AIM listing.

Funding

We estimate a funding requirement for FY15 (March year end) of approximately NZ\$8-9m. Expenditure over this period includes corporate costs and costs associated with the marine consent, secondary AIM listing and testwork and field trials.

This expenditure will be funded by the recent 1 for 10 rights issue and the proposed capital raising and secondary listing on London's AIM market. The underwritten 1 for 10 rights issue at NZ\$0.15/share raised just over NZ\$2.16m before costs, including oversubscriptions, for the issue of an additional 14.4m shares. The capital raising on AIM is intended to raise approximately £4m or NZ\$8m. Pricing for this raising has not yet been determined. It is intended the offering will begin in June 2014.

We anticipate total corporate, mine appraisal and licence work programme costs of approximately NZ\$11.0m in FY16 and FY17. This leads up to seabed mine production, which is planned to begin in Q117.

Funding for FY16 and FY17 will be generated by the exercise of unlisted options, which is expected to raise a further NZ\$10.9m. In total, there are 36.4m issued options which are all exercisable at NZ\$0.30 by 31 March 2015.

These options were issued to a cornerstone investor, Subsea Investments II, LLC, as part of a broader funding package. The exercise of the options is dependent on the CRP share price being above the NZ\$0.30 options exercise price. As the CRP rock phosphate project will, by this time, be further de-risked with the expected granting of the marine consent in November 2014, there is a reasonable expectation that this will be the case.

However, if the options exercise does not occur, additional funding, most likely from another equity raising, will be required. Funding is only required for corporate-related costs, as capital costs for the seabed rock phosphate project itself, including the dredge and related infrastructure, will be funded by the mining contractor under the build, own and operate arrangement.

Valuation

We have revised our success-case NPV valuation to take into account dilution from the 1 for 10 rights issue, secondary AIM listing and, as before, the full impact of the exercise of the Subsea unlisted options (where the last tranche will be exercised in August 2015). On our base case assumptions, our unrisks valuation is now NZ\$1.76/share (previously NZ\$1.89/share).

Key assumptions for our base case include:

- **Schedule:** First production is now expected to be in Q117 (previously Q4 CY16). We assume a production rate of 1.5Mtpa in years 1-10 and thereafter on a 7.5% decline curve.
- **Sales:** Export and domestic sales split 75/25. We assume a long-term 32% P₂O₅ benchmark price of US\$125/t for local and export sales, but with a US\$25/t weighted average sales price (WASP) premium over 22% P₂O₅ peer product. Domestic prices are adjusted for shipping-related import parity pricing and export prices are adjusted for freight differentials.
- **Operating costs:** Mining operations are carried out by the contractor using contractor-owned equipment. Mining costs, which are still subject to negotiation, include a capital recovery charge so there is no equipment-related depreciation and capital expenditure to CRP's account. Royalties apply at the higher of 2% of revenue or 10% of pre-tax profit.

Exhibit 3: Financial summary

	NZ\$000s	2012	2013	2014e	2015e
Year end 31 March		IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS					
Revenue		0	0	0	0
Cost of Sales		0	0	0	0
Gross Profit		0	0	0	0
EBITDA		(761)	(1,427)	(1,497)	(2,754)
Operating Profit (before amort. and except.)		(761)	(1,427)	(1,497)	(2,754)
Intangible Amortisation		0	0	0	0
Exceptionals		8	0	0	0
Other		0	0	0	0
Operating Profit		(754)	(1,427)	(1,497)	(2,754)
Net Interest		0	0	0	0
Profit Before Tax (norm)		(761)	(1,427)	(1,497)	(2,754)
Profit Before Tax (FRS 3)		(754)	(1,427)	(1,497)	(2,754)
Tax		0	0	0	0
Profit After Tax (norm)		(761)	(1,427)	(1,497)	(2,754)
Profit After Tax (FRS 3)		(754)	(1,427)	(1,497)	(2,754)
Average Number of Shares Outstanding (m)		48.1	106.0	144.2	227.0
EPS - normalised (c)		(1.6)	(1.3)	(1.0)	(1.2)
EPS - normalised and fully diluted (c)		(1.4)	(1.0)	(1.0)	(1.2)
EPS - (IFRS) (c)		(1.6)	(1.3)	(1.0)	(1.2)
Dividend per share (c)		0.0	0.0	0.0	0.0
Gross Margin (%)		N/A	N/A	N/A	N/A
EBITDA Margin (%)		N/A	N/A	N/A	N/A
Operating Margin (before GW and except.) (%)		N/A	N/A	N/A	N/A
BALANCE SHEET					
Fixed Assets		11,389	17,677	20,444	29,690
Intangible Assets		11,374	17,434	20,444	29,690
Tangible Assets		0	0	0	0
Investments/other financial assets		15	243	0	0
Current Assets		478	1,293	351	9,524
Stocks		0	0	0	0
Debtors		196	142	0	0
Cash		270	1,152	351	9,524
Other		12	0	0	0
Current Liabilities		(3,621)	(355)	(126)	(227)
Creditors		(3,621)	(355)	(126)	(227)
Short term borrowings		0	0	0	0
Long Term Liabilities		0	0	0	0
Long term borrowings		0	0	0	0
Other long term liabilities		0	0	0	0
Net Assets		8,245	18,615	20,669	38,986
CASH FLOW					
Operating Cash Flow		(666)	(1,372)	(1,625)	(2,666)
Net Interest		10	0	40	12
Tax		3	5	0	0
Capex		(3,839)	(5,237)	(2,768)	(9,246)
Acquisitions/disposals		0	0	0	0
Financing		4,539	7,486	3,551	21,072
Dividends		0	0	0	0
Net Cash Flow		48	882	(801)	9,173
Opening net debt/(cash)		(231)	(270)	(1,152)	(351)
HP finance leases initiated		0	0	0	0
Other		(9)	0	0	0
Closing net debt/(cash)		(270)	(1,152)	(351)	(9,524)

Source: Chatham Rock Phosphate accounts, Edison Investment Research

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