

Precious Metals Australia Limited PMA (\$2.00)

Recommendation: BUY

Noble deal underpins margins

Analyst: Alex Passmore

OUR VIEW

PMA has completed a bankable feasibility study on the re-opening of the Windimurra vanadium project, which shows the operation to be economically robust. In addition, the company recently reached an agreement with Noble Group Ltd for the off take of vanadium production for the life of the project (under the current mine plan) at market prices. The off take includes a 'floor price' equivalent to the cash costs of the operation for the first seven years of production. Patersons view the agreement as highly positive for PMA as it underpins the price received for vanadium product from the Windimurra mine without capping upside participation in price strength. The Noble Group off take deal significantly de-risks the Windimurra project as we had previously seen the early stages of development as high-risk with operating cash costs likely to exceed vanadium price. The next major driver for PMA will be the finalisation of bank financing for \$150m, which we anticipate in coming weeks. With PMA trading at a discount to our DCF valuation of 3.67/sh and construction of the plant set to commence in November 06 (first production in March 08) we rate the stock a BUY.

Investment Highlights

- ▲ *The Windimurra Feasibility Study has been completed concluding that Windimurra Vanadium Project is robust, viable and can be economically developed. Total capital expenditure requirements including working capital were assessed at \$161.1m plus \$14.3m contingency in line with Patersons' estimates of A\$170m. The project shows highly competitive operating costs in the lowest quartile of world costs. On our estimates these will be circa US\$9.3/kg FeV80 and US\$2.8/lb V2O5 produced once the project reaches 'steady state'.*
- ▲ *In late July PMA announced the conclusion of a vanadium sales and marketing agreement with Noble Resources Ltd (Subsidiary of Hong Kong-based commodities trading house Noble Group Ltd). This entailed Noble Resources agreeing to purchase the total vanadium output of the Windimurra Mine at prevailing market prices (currently US\$7.80/lb for V2O5 and US\$37.5/kg for FeV80). Additionally, for the first seven years of production, Noble will pay a minimum price for vanadium equal to the cash costs of production at Windimurra (in the event that prevailing market prices fall below these levels).*
- ▲ *Noble will exclusively market and handle all distribution logistics for Windimurra vanadium worldwide and will be paid a commercial fee (we estimate 0.75 - 1.0% NSR) for this service. In return for the agreement PMA has agreed to pay Noble a once-off fee of A\$10m which will be satisfied by the issue of 3.728m PMA shares and has given Noble the option to subscribe for 9.99% of PMA's operating subsidiary, PMA (Windimurra) Pty Ltd, the owner of the Windimurra project for A\$13.5m. In addition Noble will also subscribe to an unlisted, unsecured convertible note with a 3-year term and face value of \$8.2m. Interest coupons on the note are Libor +2%. The note is convertible into 3.728m PMA ordinary shares, equivalent to an issue price of A\$2.20/share*
- ▲ *Our valuation for PMA is \$3.69/share based on a DCF methodology using a 10% discount rate. We have reduced our discount rate for PMA from 12% following the off take agreement with noble as we believe this significantly de-risks the project.*

Investment Summary

Year End June 30	2006F	2007F	2008F	2009F
Reported Earnings				
Net Profit (\$m)	6.0	(2.6)	(3.4)	33.6
EPS (cents)	8.0	(3.4)	(4.5)	44.5
EPS growth (%)	nm	nm	nm	nm
PER (x)	25.1	(58.5)	(44.5)	4.5
EBITDA				
EBITDA (\$m)	10.0	(1.0)	10.9	70.9
EV/EBITDA (x)	10.6	(185.8)	22.2	2.9
Cashflow Multiples				
Gross Cashflow (\$m)	7.3	(3.4)	(2.8)	41.9
GCFPS (cents)	9.7	(4.5)	(3.6)	55.6
PGCF (x)	20.7	(44.5)	(54.8)	3.6
Free Cashflow (\$m)	6.3	(80.6)	(56.2)	38.1
FCFPS (cents)	8.3	(106.8)	(74.5)	50.6
PFCF (x)	24.1	(1.9)	(2.7)	4.0
Dividend				
Dividend (cents)	0.0	0.0	0.0	0.0
Yield (%)	0.0	0.0	0.0	0.0
Franking (%)	100	100	100	100

Company Statistics & Performance

Shares on Issue	75.4m	Daily Vol.	84,754
Market Cap	\$150.8m	Debt	\$0.0m
52 Week Range	\$0.08 - \$2.25	Cash	\$51.3m



Precious Metals Australia Limited

\$2.00

Year End June 30

Profit & Loss (\$m)	1HY06E	2HY06E	1HY07E	2HY07E
Sales Revenue	11.4	0.0	0.0	0.0
Other Income	0.0	1.9	2.1	1.8
Operating Costs	0.7	0.0	0.0	0.0
Depn & Amort	0.6	0.0	0.0	0.0
Exploration Exp.	0.2	0.4	0.4	0.4
Corporate/Admin	0.0	2.0	2.0	2.0
EBIT	9.9	(0.5)	(0.3)	(0.6)
Interest	0.0	0.0	0.2	1.4
Operating Profit	9.9	(0.5)	(0.5)	(2.1)
Tax expense	3.4	0.0	0.0	0.0
Minorities	0.0	0.0	0.0	0.0
NPAT	6.6	(0.5)	(0.5)	(2.1)
Significant Items	0.0	0.0	0.0	0.0
Reported NPAT	6.9	(0.4)	(0.4)	(1.5)

Cash Flow (\$m)	1HY06E	2HY06E	1HY07E	2HY07E
Adjusted Net Profit	6.6	(0.5)	(0.5)	(2.1)
+ Interest/Tax/Expl Exp	3.6	0.4	0.6	1.9
- Interest/Tax/Expl Inc	2.5	0.8	1.0	2.3
+ Depn/Amort	0.6	0.0	0.0	0.0
+/- Other	0.0	0.0	0.0	0.0
Operating Cashflow	8.3	(0.9)	(0.9)	(2.5)
- Capex (+asset sales)	0.7	0.0	31.6	45.6
- Working Capital Increase	0.4	0.0	0.0	0.0
Free Cashflow	7.2	(0.9)	(32.5)	(48.0)
- Dividends (ords & pref)	0.0	0.0	0.0	0.0
+ Equity raised	27.0	0.0	0.0	0.0
+ Debt drawdown (repaid)	0.0	0.0	16.4	100.0
Net Change in Cash	34.2	(0.9)	(16.1)	52.0
Cash at End Period	45.2	44.3	28.2	80.1
Net Cash/(Debt)	45.2	44.3	20.0	(28.1)

Production Summary	1HY06E	2HY06E	1HY07E	2HY07E
Ferrovandium (t)	0	0	0	0
Price Received (US\$/kg)	0.00	14.01	14.15	14.29
Cash Cost (US\$/kg)	na	na	na	na
Cash Margin (US\$/kg)	na	na	na	na
FX Received	0.75	0.74	0.75	0.75
Cash Margin (A\$/lb)	na	na	na	na
Vanadium Pentoxide (klbs)	0	0	0	0
Price Received (US\$/lb)	0.00	2.82	2.85	2.87
Cash Cost (US\$/lb)	na	na	na	na
Cash Margin (US\$/lb)	na	na	na	na
FX Received	0.75	0.74	0.75	0.75
Cash Margin (A\$/lb)	na	na	na	na

Balance Sheet (\$m)	2005A	2006F	2007F	2008F
Cash	11.0	44.3	80.1	73.9
Total Assets	11.2	44.2	158.0	204.6
Total Debt	0.0	0.0	116.4	166.4
Total Liabilities	1.1	1.1	117.5	167.5
Shareholders Funds	10.1	43.6	41.8	39.5
Ratios				
Net Debt/Equity (%)	na	na	87	234
Interest Cover (x)	na	na	0.0	0.1
Return on Equity (%)	68%	-6%	-8%	85%

Reserves & Resources	Mt	% V2O5	Mlbs V2O5
Ore Reserves			
Windimurra	50.4	0.49	544.4
Mineral Resources			
Windimurra	95.5	0.47	989.8

Profit & Loss (\$m)	2006F	2007F	2008F	2009F
Sales Revenue	11.4	0.0	47.8	150.4
Other Income	1.9	3.9	7.4	7.4
Operating Costs	0.7	0.0	39.4	81.8
Depn & Amort	0.6	0.0	1.5	9.2
Exploration Exp.	0.6	0.8	0.8	0.8
Corporate/Admin	2.0	4.0	4.1	4.2
EBIT	9.4	(1.0)	9.4	61.8
Interest	0.0	1.6	12.7	13.8
Operating Profit	9.4	(2.6)	(3.3)	48.0
Tax expense	3.4	0.0	0.1	14.4
Significant Items (gain)/loss	0.0	0.0	0.0	0.0
NPAT	6.0	(2.6)	(3.4)	33.6
Significant Items	0.0	0.0	0.0	0.0
Reported NPAT	6.6	(1.8)	(2.3)	33.6

Cash Flow (\$m)	2006F	2007F	2008F	2009F
Adjusted Net Profit	6.0	(2.6)	(3.4)	33.6
+ Interest/Tax/Expl Exp	4.0	2.4	13.6	29.0
- Interest/Tax/Expl Inc	3.3	3.2	14.4	29.9
+ Depn/Amort	0.6	0.0	1.5	9.2
+/- Other	0.0	0.0	0.0	0.0
Operating Cashflow	7.3	(3.4)	(2.8)	41.9
- Capex (+asset sales)	0.7	77.2	53.4	3.8
- Working Capital Increase	0.4	0.0	0.0	0.0
Free Cashflow	6.3	(80.6)	(56.2)	38.1
- Dividends (ords & pref)	0.0	0.0	0.0	0.0
+ Equity raised	27.0	0.0	0.0	0.0
+ Debt drawdown (repaid)	0.0	116.4	50.0	0.0
Net Change in Cash	33.3	35.8	(6.2)	38.1
Cash at End Period	44.3	80.1	73.9	112.1
Net Cash/(LT Debt)	44.3	(28.1)	(84.3)	(46.1)

Production Summary	2006F	2007F	2008F	2009F
Ferrovandium (t)	0	0	1,151	6,777
Price Received (US\$/kg)	7.01	14.22	31.106	14.80
Cash Cost (US\$/kg)	na	na	25.37	11.39
Cash Margin (US\$/kg)	na	na	5.7	3.4
FX Received	0.75	0.75	0.74	0.73
Cash Margin (A\$/lb)	na	na	7.7	4.7
Vanadium Pentoxide (klbs)	0	0	517	2,699
Price Received (US\$/lb)	1.4	2.9	2.9	3.0
Cash Cost (US\$/lb)	na	na	10.3	3.6
Cash Margin (US\$/lb)	na	na	(7.4)	(0.7)
FX Received	0.7	0.8	0.7	0.7
Cash Margin (A\$/lb)	na	na	(9.9)	(0.9)

Valuation	A\$m	A\$/sh
Windimurra	264	3.34
FX and Commodity Hedging	0	0.00
Unpaid Capital	1	0.01
Corporate	(16)	(0.20)
Exploration	0	0.00
Cash	51	0.65
Debt	(8)	(0.10)
Total @ 10% Disc Rate	292	3.69

Directors	Position
Name	
Tony Grey	Chairman
Roderick Smith	Managing Director
Earl of Warwick	Non-Executive Director
Michael Fry	Non-Executive Director
Michael Kiernan	Non-Executive Director
Substantial Shareholders	Shares (m) %
R J H Smith	11.81 15.66
Earl of Warwick	6.31 8.36
JP Morgan Chase and Co	6.46 8.56

Patersons Securities Limited acted as Underwriter to the 1 for 5 Renounceable Rights Issue that raised \$0.5m at \$0.07 per share for Precious Metals Australia Limited in January 2005. It received a fee for this service.

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