



Prospect Resources Ltd (PSC.ASX)

More lithium exploration to come - for free

Event:

- Sale of Arcadia; PT change.

Investment Highlights:

- **US\$378M sale of Arcadia a positive outcome.** On 23 December, PSC executed a binding agreement with Zhejiang Huayou Cobalt Co (Huayou) for sale of its 87% interest in the Arcadia lithium project. Consideration is approximately US\$378M (\$528M), 9% below our \$582M risked valuation of Arcadia, a positive outcome given the project was pre-FID, pre-construction, and pre-financing. Cash consideration is equivalent to \$1.23/share.
- **We estimate PSC to have \$500M after tax, transaction costs, offtake damages, and options exercise.** We estimate PSC will pay Zimbabwe tax of US\$30M (\$42M), and approximately \$15M across transaction costs (legal, advisor fees etc.) and offtake damages. Sale is expected to complete in late 1Q/early 2Q 2022, with PSC spending on corporate, exploration and new projects development until then. We estimate PSC will have net cash of \$500M, including \$23M cash held prior to transaction and \$11M from options exercise.
- **Most cash to return to shareholders, we estimate minimum \$0.92/share.** Following sale, PSC intends to retain a cash balance of up to US\$50M (\$70M), with the balance distributed to shareholders. We expect it to be between \$0.92 and \$1.05/share, assuming in-the-money options exercised, and depending on whether the maximum or adequate minimum amount of cash is retained.
- **PSC 2.0: Other battery metal projects in Zimbabwe and globally.** Post transaction close and armed with requisite cash, we anticipate initial focus in Zimbabwe, where PSC enjoys key advantages, including the country being underexplored for battery metals vs other jurisdictions, inherent experience of Board in the country. Scouring of global assets will also be undertaken.
- **Existing assets give company a ready-start.** PSC currently has at least two early stage projects in Zimbabwe: rare earths; and one encompassing an area within 20km of Arcadia excised from the transaction, likely prospective for lithium.

Earnings and Valuation:

- **We assume sale of Arcadia and removing it from our earnings forecasts.** We assume \$35M cash retained (mid-range of expressed intention) post deal close and \$1.00/diluted share returned.
- **Risked PSC valuation rises to \$1.09 from \$1.06,** with removal of future equity dilution and increase in our valuation of the remnant lithium assets more than offsetting proceeds being lower than prior DCF. We value PSC's existing near-Arcadia assets using average EV for nearology lithium plays of \$28M.

Recommendation:

- **We maintain our Buy and raise our 12-month price target to \$1.09 (prior \$1.06)** based on risked valuation. We estimate the current share price offers PSC's existing exploration assets in Zimbabwe for free, plus management experience that can add value to new projects within Zimbabwe and globally.
- **Share price catalysts** are: 1) Progress of regulatory approvals; 2) Exploration from existing lithium and rare earths projects in Zimbabwe; 3) Completion of Arcadia sale; and 4) New battery metal projects M&A.

Disclosures

The analyst owns 71,000 PSC shares.
Foster Stockbroking and associated entities (excluding Cranport Pty Ltd), own 1,132,027 PSC shares.
Cranport Pty Ltd owns 3,050,000 PSC shares.
Refer details end of report.

Foster Stocking acted as Joint Lead Manager to the \$18M placement of 45M PSC shares at \$0.40 in October 2021, for which it received fees.

Recommendation	Buy
Previous	Buy
Risk	High
Price Target	\$1.09
Previous	\$1.06
Share price (A\$)	\$0.840
ASX code	PSC
52 week low-high	1.19048
Valuation - risked (A\$/share)	\$ 1.09
Methodology	risked NPV

Capital structure

Shares on Issue (M)	429
Market cap (A\$M)	360
Net cash (debt) (A\$M)	23
Options (M)	41
Diluted EV (A\$M)	372
Ave daily volume ('000)	2,832

Earnings

	FY21a	FY22e	FY23e	FY24e
Sales	0	0	0	0
EBITDA adj	-3	-6	-6	-6
NPAT pre minorities	-3	-5	-5	-5
NPAT attrib. adj.	-3	-5	-5	-6
NPAT reported	-3	443	-5	-6
EPS adj. \$	-0.01	-0.01	-0.01	-0.01
Dividend \$	0.00	1.00	0.00	0.00
PE x	nm	nm	nm	nm
Yield %	nm	119%	nm	nm

Adj =underlying

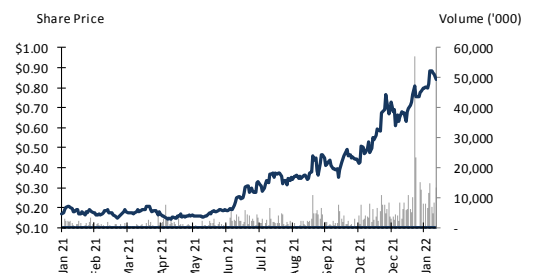
Substantial shareholders

	%
Eagle Eye Asset Holdings Pte Ltd	11.4%

Board

Mark Wheatley	Non-Executive Chairman
Sam Hosack	Managing Director
Duncan (Harry) Greaves	Executive Director
Gerry Fahey	Non-Executive Director
Zivanayi (Zed) Rusike	Non-Executive Director
Dev Shetty	Non-Executive Director
HeNian Chen	Non-Executive Director

Share price graph



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Prospect Resources (PSC)

Full Year Ended 30 June

Profit and Loss A\$M	2021a	2022e	2023e	2024e
Revenue	0	0	0	0
Operating costs adj.	3	6	6	6
EBITDA adj.	-3	-6	-6	-6
D&A	0	0	0	0
EBIT adj.	-3	-6	-6	-6
Net Interest exp / (income)	0	0	0	0
PBT adj.	-3	-5	-5	-6
Tax exp / (benefit) adj.	0	0	0	0
NPAT pre minorities adj.	-3	-5	-5	-6
Minorities adj.	0	0	0	0
NPAT adj.	-3	-5	-5	-6
NPAT reported	-3	443	-5	-6
EPS diluted adj. (\$)	-0.01	-0.01	-0.01	-0.01
DPS (\$)	0.00	1.00	0.00	0.00

Cashflow A\$M	2021a	2022e	2023e	2024e
EBITDA adj.	-3	-6	-6	-6
Change in WC	0	0	0	-1
Net interest	0	0	0	0
Tax underlying	0	0	0	0
Share based expense	0	0	0	0
Asset sale costs & taxes	0	-57	0	0
Operating Cashflow	-3	-62	-4	-6
Purchase of PP&E	0	0	0	0
Acquisitions	0	-1	0	0
Capitalised expenses	-3	-4	-4	-4
Investments	0	0	0	0
Asset sale	0	528	0	0
Investing Cashflow	-3	523	-4	-4
Equity issue	13	18	0	0
Debt proceeds	0	0	0	0
Debt repayments	0	0	0	0
Dividend paid	0	-465	0	0
Other	-1	-1	0	0
Financing cash flow	12	-448	0	0
Net cash flows	6	14	-8	-10

Balance Sheet A\$M	2021a	2022e	2023e	2024e
Cash	8	22	13	4
Receivables	1	1	1	0
Inventories	0	0	0	0
PPE	1	0	0	0
Capitalised expl'n	26	10	14	18
Intangibles	0	0	0	0
Other	0	0	1	1
Total Assets	35	33	30	24
Accounts payable	1	1	2	0
Provisions	0	0	0	0
Debt	0	0	0	0
Other	0	0	2	2
Total Liabilities	0	2	4	3
Capital & reserves	88	88	106	106
Retained earnings	-53	-75	-80	-85
Equity attrib.	35	31	26	21
Minorities	1	0	0	0
Equity total	34	31	26	21

Financial Metrics	2021a	2022e	2023e	2024e
Wtd ave shares (M)	326	414	469	469
Wtd ave share diluted (M)	326	443	469	469

Valuation multiples	2021a	2022e	2023e	2024e
P/E x	nm	nm	nm	nm
EV/EBITDA x	nm	nm	nm	nm
Yield %	0%	119%	0%	0%

Company Valuation	Unrisked		Risky	
Segment	A\$M	A\$/share	A\$M	A\$/share
Net proceeds from Arcadia sale	466	\$0.99	443	\$0.94
Chisanya REE	7	\$0.01	7	\$0.01
Other Zimbabwe expl'n - lithium	28	\$0.06	28	\$0.06
Cash from in-money options	11	\$0.02	11	\$0.02
Net cash end Sep 21+ Oct placement	23	\$0.05	23	\$0.05
Total	535	\$1.14	512	\$1.09
Shares now M	429			
Options-in-money at val M	41			
Fully diluted shares M	469			

Commodity Assumptions	2021a	2022e	2023e	2024e	
Prices:					
Petalite 4% TG cif	US\$/t	699	1,078	1,232	1,161
Spodumene 6% BG cif	US\$/t	589	891	994	924
Petalite 4% BG cif	US\$/t	393	594	663	616
Tantalite	US\$/lb	75	86	87	89
A\$	US\$	0.72	0.75	0.75	0.74

Production:					
Petalite 4% TG cif	kt	-	-	-	-
Spodumene 6% BG cif	kt	-	-	-	-
Petalite 4% BG cif	kt	-	-	-	-
Tantalite	klb	-	-	-	-
AISC cif	US\$/t	-	-	-	-

Resources and Reserves	Ore Mt	Li ₂ O %	Li ₂ O kt	Ta ₂ O ₅ ppm	Ta ₂ O ₆ Mlbs
JORC Resources	Mt	%	kt	ppm	Mlbs
Measured	15.8	1.12%	77	113	3.9
Indicated	45.6	1.06%	484	124	12.5
inferred	11.3	0.99%	111	119	2.9
Total	72.7	1.06%	770	121	19.4
JORC Reserves	42.3	1.19%	504	121	11.3%

Capital structure	M
Ordinary shares	429
Options	41
Fully diluted	470

Source: Company; Foster Stockbroking estimates.

**SALE OF ARCADIA REALISES VALUE****Price in line with our valuation**

- On 23 December 2021, PSC announced it had executed a binding agreement with Zhejiang Huayou Cobalt Co (Huayou) for sale of its 87% interest in the Arcadia lithium project. Consideration is approximately US\$378M (\$528M), being only 9% below our \$582M risked valuation of Arcadia, highlighting a positive outcome for PSC given the project was pre-FID, pre-construction, and pre-financing. The cash consideration is equivalent to \$1.23/share.

We estimate \$500M cash at transaction close

- From the gross sales of \$528M, we estimate the company will need to pay Zimbabwe capital gains tax of appx. US\$30M (\$42M), plus \$15M across transaction costs (legal, advisor fees etc.) and a damages fee on breaking its existing offtake agreement. The transaction is also expected to complete in late 1Q/early 2Q 2022, the company still expending on corporate expenses, likely exploration, and new projects development up until then. In summary, we estimate PSC will to have ca. \$500M after deducting expenses and tax, and including cash prior to transaction announcement (ca. \$23M) and from in-the-money options we expect to be mostly exercised (\$11M).
- Subject to and following completion of the sale, PSC intends to retain a cash balance of up to US\$50M (\$70M), with the balance intended distributed to shareholders.

Estimate payout to shareholders in range \$0.92 to \$1.05

- In Figure 1, we expect the return to shareholders to be between \$0.92 and \$1.05/share, assuming options exercised and depending on whether the maximum or an adequate minimum amount of cash is retained.

Figure 1: Estimate of PSC cash post-transaction and payout scenarios A\$M

Cash retained	\$10M	\$35M	Max \$70M
Cash end Sep. 2021	6	6	6
Placement October	18	18	18
Placement costs	-1	-1	-1
Corp & expl costs until transaction close	-6	-6	-6
Gross Arcadia proceeds	528	528	528
Zimbabwe capital gains tax	-42	-42	-42
Transaction fees & offtake damages	-15	-15	-15
Cash from in-the-money options	11	11	11
Net cash available close transaction	500	500	500
Ordinary shares M	429	429	429
Options-in-the-money M	41	41	41
Diluted shares M	469	469	469
per diluted share	\$1.07	\$1.07	\$1.07
Cash retained in PSC	10	35	70 (US\$50M)
Per share	\$0.02	\$0.07	\$0.15
Cash returned to s'holders	490	465	430
per diluted share	\$1.05	\$1.00	\$0.92

Source: Foster Stockbroking estimates.



Key conditions should be satisfied given due diligence

- Key conditions precedent include PSC shareholder approval, Chinese regulatory approvals for Huayou, Zimbabwe Government approval, and termination of existing offtake. Given the extensive due diligence undertaken, the competitive tension, and number of parties that submitted proposals during the partnering process, we expect low risk of the transaction not completing.
- As the sale is at project level, FIRB approval for PSC is not required, which we believe better facilitates regulatory processes for Huayou. We understand the Zimbabwe Government is supportive of the transaction, especially with Huayou's demonstrable mining experience in Africa and sizeable balance sheet. The other shareholders of Arcadia, who own 13%, have also agreed to sell their interest to Huayou.
- Huayou has now paid a deposit of US\$20M to PSC, which is non-refundable in certain circumstances where the transaction does not complete, including Chinese regulatory approvals not obtained. A standard no-shop, no-talk US\$20M break-fee is payable by PSC should the sale not be concluded in certain circumstances.

PSC 2.0 post-transaction – more battery metals upside

- PSC has stated its intention to possess cash up to US\$50M (\$70M), the company expecting to progress its other battery metals projects in Zimbabwe, as well as pursue projects globally. We expect that should PSC maintain a balance close to the maximum US\$50M, it would signal that it would be close to acquiring an interest in a developed project.
- We anticipate the initial focus will be in the familiar hunting ground of Zimbabwe, where PSC enjoys some advantages, namely:
 - **Less-crowded jurisdiction.** Zimbabwe flies low under the radar vs other countries and regions concerning competitive bidding for battery assets. Popular destinations for battery metals explorers and developers include WA, Canada, USA, Tanzania, Chile, Argentina, and other Africa. However as Arcadia and Bikita have demonstrated, Zimbabwe is at least potentially a rich source of lithium.
 - **Inherent experience and success of Board in the country.** As the Arcadia sale demonstrates PSC's experience and nous facilitates operating in the country, dealing with government and private entities, and identifying, acquiring, and developing assets.
 - **Existing assets give company a ready-start.** PSC currently has at least two early stage projects: Chishanya rare earths, and a project encompassing an area within 20km of Arcadia excised from the transaction. We assume the latter is prospective for spodumene and/or petalite.

**Valuing early stage lithium by nearology**

- In assigning a valuation to PSC's potential remaining lithium ground in Zimbabwe, at least that within vicinity of Arcadia, we have examined valuation of other companies that acquired ground to near existing lithium resources. Figure 2 shows the enterprise valuation of these nearology plays prior to reporting first drill results assays for their own project, with average of \$28M.

Figure 2: Average EV of Nearology Plays prior to Reporting of First Drill Results

Company	Code ASX	EV pre-first drill results \$M	Company project	Located near to:
Piedmont Lithium	PLL	12	Carolina	Kings Mountain
Lake Resources	LKE	28	Kachi	Hombre Muerto
Galan Lithium	GLN	40	Hombre Muerto West	Hombre Muerto
Charger Metals	CHR	26	Bynoe	Finniss
Lithium Energy	LEL	32	Olaroz	Olaroz (Allkem/Toyota)
		Average: 28		

Source: IRESS; Companies; Foster Stockbroking estimates.

EARNINGS FORECASTS**Removal of Arcadia**

- We assume sale of the Arcadia to be successful, and have removed the project from our earnings forecast for PSC. We have also removed future financing by equity and debt from our forecasts. We assume \$35M cash is retained (mid-range of expressed intention, Figure 1) and a payout of \$1.00/share.

VALUATION**PSC risked valuation lifted to \$1.09**

- Our risked valuation of PSC is unchanged at \$1.09 (0.96x unrisked valuation), with the removal of future equity dilution and increase in valuation of PSC's remnant lithium assets more than offsetting Arcadia proceeds being lower than our prior DCF. We value the existing near-Arcadia assets using the average EV for nearology lithium plays (Figure 2, \$28M). We do not include any assumptions of future project acquisitions.

Figure 3: PSC Valuation

Segment	Unrisked		Risked		Risk Factor
	A\$M	A\$/share	A\$M	A\$/share	
Net proceeds from Arcadia	466	\$0.96	443	\$0.94	95%
Chishanya REE	7	\$0.01	7	\$0.01	100%
Other expl'n – lithium near Arcadia	28	\$0.06	28	\$0.06	100%
Options-in-money at val	11	\$0.02	11	\$0.02	100%
Net cash	23	\$0.05	23	\$0.05	100%
Total	535	\$1.14	512	\$1.09	96%
Shares now M	429				
Options-in-money at val M	41				
Fully diluted shares M	469				

Source: Foster Stockbroking estimates.



RECOMMENDATION & PRICE TARGET

Maintain Buy, 12-month PT now \$1.09 (prior \$1.06)

- We maintain our Buy recommendation on PSC and lift our 12-month price target to \$1.09 from \$1.06 based on our risked valuation.
- We estimate the current share price offers PSC's existing exploration assets in Zimbabwe for free, plus management experience that can add value to new projects within Zimbabwe and globally.
- Catalysts for the stock are: 1) Progress of regulatory approvals; 2) Exploration results from existing lithium and rare earths projects in Zimbabwe; 3) Completion of Arcadia sale; and 4) New battery metal projects M&A.



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Specific disclosure: The analyst owns 71,000 PSC shares at the time of this report. Diligent care has been taken by the analyst to maintain honesty and fairness in writing the report and making the recommendation.

Specific disclosure: Foster Stockbroking acted as Joint Lead Manager to the \$18M placement of 45M PSC shares at \$0.40 in October 2021, for which it received fees.

Specific disclosures: As of close of business 13 January 2022, Foster Stockbroking and associated entities (excluding Cranport Pty Ltd) owned 1,132,027 PSC shares and Cranport Pty Ltd owned 3,050,000 PSC shares. The position may change at any time and without notice, including on the day that this report has been released. Foster Stockbroking and its employees may from time to time own shares in PSC, and trade them in ways different from those discussed in research. Foster Stockbroking may also make a market in securities of PSC, including buying and selling securities on behalf of clients.

Review disclosure: The report was authored by the analyst named on the front page of the report and was reviewed and checked by Keith Quinn, Compliance.

Disclosure review. All the disclosures in the report have been reviewed and checked by Keith Quinn, Compliance.