Lithium: Producer / Developer

GXY.asx
Buy

GALAXY RESOURCES LTD (GXY)

Almost there

GXY has announced that it has almost commissioned the Mt Cattlin lithium facility. Over the next two weeks the aim is for 24-hour continuous production. Product specifications still need to be confirmed, and hence it is too early, in our view, to declare commercial production, but we are getting very close.

CY17 could be an upgrade, but for now happy to go back and wait.

The Company guidance is to reach 1.6Mtpa throughput for 160kt pa of spodumene at 50% recoveries. Phase 2 is the plan to install flotation to increase yields to >80% (256ktpa). The expectation is that recoveries can be optimised to ~70% without a float (>224kt pa), but we have gone back to be more conservative and assume ~50% recoveries for most of CY17. In late CY17 we assume an additional $20m of capex (flotation circuit) is invested, which then gradually builds recoveries to 85% by 2H18. If the circuit, pre-flotation, does recovery lithium as envisaged (rather than only 50%), we estimate CY17 production forecasts should be increased. However, given the delays in commissioning from hardrock lithium projects, we are happy to stay on the conservative end (and slightly below lower end guidance). We assume CY17 production of 134kt. Our selling price assumptions are unchanged, and we expect higher spodumene prices CY17 (US$750/t).

Refinance required

The Company recently announced a $16m increase to the working capital facility (brings it to $47m, and hence Mt Cattlin is now fully funded). There is A$16m due 31 March 2017 and A$31m is due 24 February 2017, neither of which will be payable without a refinance. The Company says that it is “now well advanced in negotiations with an international bank to provide a revolving facility for an amount of up to US$30 million, which will be applied to refinancing its existing facilities”. Given the cash flows the project should deliver, we believe refinance should be easily achievable.

Maintain Buy

Our last report was before the completion of the merger, and we had a Buy recommendation on the Mergeco. We are now in the final teething stages of the Mt Cattlin restart, and soon (sometime in CY17) GXY should be producing strong free cash flow. There are still risks to production, in our view, but equally we believe there are still upside risks to spodumene prices over coming years. Hence, we retain our Buy for GXY. Assuming no value for Sal De Vida or James Bay, our valuation would be 25cps. Our base case (assuming value for all three assets) is 58cps.

Fig. 1: Hartleys Mt Cattlin Assumptions

Mt Cattlin Production Summary	Unit	Dec 16	Dec 17	Dec 18	Dec 19	Dec 20	Dec 21
Processed Mill Throughput	Mt	0.03	1.36	1.55	1.55	1.55	1.55
Mined grade Li	%		1.2%	1.2%	1.2%	1.2%	1.2%
Produced Spodumene - Technical	kt	0.0	0.0	0.0	0.0	0.0	0.0
Produced Spodumene - Battery	kt	2	134	223	253	253	253
Produced Tantalite	klb pa	4	231	314	314	314	314
Produced Spodumene - Battery Eq	kt	3	147	239	269	275	275
LCE equiv	Kt	0	20	32	36	37	37

Source: Hartleys Research

17 Nov 2016	
Share Price	$0.350
Valuation	$0.58
Price Target (12 month)	$0.52

Brief Business Description:
Commissioning the Mt Cattlin spodumene mine. Developing the large lithium brine operation Sal de Vida.

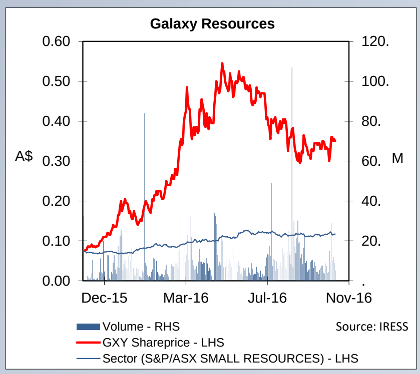
Hartleys Brief Investment Conclusion
One of the few Companies that is in production of lithium ore and has offtake agreements for product. Growth potential from James Bay project and Sal De Vida.

Chairman & MD
Martin Rowley (Exec. Chairman)
Anthony Tse (MD)

Major Shareholders

Company Address
Suite 8/18 Kearns Cr
Ardross, WA, 6153

Issued Capital			1832.5m
- fully diluted			1881.5m
Market Cap			A$641.4m
- fully diluted			A$658.5m
Cash (31 Dec 16e)			A$2.0m
Debt (31 Dec 16e)			A$47.0m
Prelim. (A$m)	**CY17e**	**CY18e**	**CY19e**
Prod (Li Spod. eq)	147.2	239.3	269.0
Op Cash Flw	103.7	145.3	163.8
Norm NPAT	56.0	139.0	150.8



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SUMMARY MODEL

Galaxy Resources — **Share Price**
GXY — **$0.350**

17 November 2016
Buy

Key Market Information	
Share Price	**$0.350**
Market Capitalisation - ordinary	A$659m
Net Debt (cash)	$45m
Market Capitalisation - fully diluted	A$659m
Issued Capital	1832.5m
Options	49.0
Issued Capital (diluted for options)	1881.5m
12month price target	**$0.52**

Directors	Company Information
Martin Rowley (Exec. Chairman)	Suite 8/18 Kearns Cr
Anthony Tse (MD)	Ardross, WA, 6153
Michael Fotios (Non-exec)	Ph +61 8 9215 1700
George Zheng (Non-exec)	www.galaxylithium.com

Top Shareholders

P&L	Unit	31 Dec 17	31 Dec 18	31 Dec 19	31 Dec 20
Net Revenue	**A$m**	**147.7**	**247.3**	**270.5**	**204.1**
Total Costs	**A$m**	**-85.7**	**-101.2**	**-103.2**	**-100.1**
EBITDA	A$m	62.0	146.0	167.3	103.9
- margin		42%	59%	62%	51%
Depreciation/Amort	A$m	-2.5	-4.1	-14.0	-38.5
EBIT	**A$m**	**59.5**	**142.0**	**153.3**	**65.4**
Net Interest	A$m	-3.5	-3.0	-2.5	-8.0
Pre-Tax Profit	**A$m**	**56.0**	**139.0**	**150.8**	**57.4**
Tax Expense	A$m	0.0	0.0	0.0	0.0
Normalised NPAT	**A$m**	**56.0**	**139.0**	**150.8**	**57.4**
Abnormal Items	A$m	0.0	0.0	0.0	0.0
Reported Profit	A$m	56.0	139.0	150.8	57.4
Minority	A$m	0.0	0.0	0.0	0.0
Profit Attrib	**A$m**	**56.0**	**139.0**	**150.8**	**57.4**

Balance Sheet	Unit	31 Dec 17	31 Dec 18	31 Dec 19	31 Dec 20
Cash	**A$m**	**117.2**	**236.6**	**239.5**	**87.0**
Other Current Assets	A$m	18.2	30.5	33.4	25.2
Total Current Assets	**A$m**	**135.4**	**267.1**	**272.8**	**112.2**
Property, Plant & Equip.	A$m	46.0	63.3	225.9	516.6
Exploration	A$m	4.1	8.5	12.9	17.3
Investments/other	A$m	0.0	0.0	0.0	0.0
Tot Non-Curr. Assets	**A$m**	**50.1**	**71.8**	**238.8**	**533.9**
Total Assets	**A$m**	**185.4**	**338.9**	**511.6**	**646.1**
Short Term Borrowings	A$m	0.2	0.2	0.2	0.2
Other	A$m	79.7	94.2	96.1	93.2
Total Curr. Liabilities	**A$m**	**80.0**	**94.5**	**96.3**	**93.5**
Long Term Borrowings	A$m	81.0	81.0	101.0	181.0
Other	A$m	-	-	-	-
Total Non-Curr. Liabil.	**A$m**	**81.0**	**81.0**	**101.0**	**181.0**
Total Liabilities	**A$m**	**161.0**	**175.5**	**197.3**	**274.5**
Net Assets	**A$m**	**24.4**	**163.5**	**314.3**	**371.7**
Net Debt	A$m	-35.9	-155.4	-138.2	94.2

Cashflow	Unit	31 Dec 17	31 Dec 18	31 Dec 19	31 Dec 20
Operating Cashflow	A$m	107.1	148.3	166.3	109.3
Income Tax Paid	A$m	0.0	0.0	0.0	0.0
Interest & Other	A$m	-3.5	-3.0	-2.5	-8.0
Operating Activities	**A$m**	**103.7**	**145.3**	**163.8**	**101.2**
Property, Plant & Equip.	A$m	-19.6	-21.4	-176.6	-329.2
Exploration and Devel.	A$m	-2.6	-4.4	-4.4	-4.4
Other	A$m	0.0	0.0	0.0	0.0
Investment Activities	**A$m**	**-22.2**	**-25.8**	**-181.0**	**-333.6**
Borrowings	A$m	50.0	0.0	20.0	80.0
Equity or "tbc capital"	A$m	0.0	0.0	0.0	0.0
Dividends Paid	A$m	0.0	0.0	0.0	0.0
Financing Activities	**A$m**	**50.0**	**0.0**	**20.0**	**80.0**
Net Cashflow	**A$m**	**131.5**	**119.5**	**2.8**	**-152.4**

Shares (GXY terms)	Unit	31 Dec 17	31 Dec 18	31 Dec 19	31 Dec 20
Ordinary Shares - End	m	1848.4	1907.7	1907.7	1947.7
Ordinary Shares - W'ted	m	1842.2	1878.0	1907.7	1927.7
Diluted Shares - W'ted	m	1947.7	1947.7	1947.7	1947.7

Ratio Analysis (GXY)	Unit	31 Dec 17	31 Dec 18	31 Dec 19	31 Dec 20
Cashflow Per Share	A$ cps	5.6	7.7	8.6	5.3
Cashflow Multiple	x	6.2	4.5	4.1	6.7
Earnings Per Share	A$ cps	3.0	7.4	7.9	3.0
Price to Earnings Ratio	x	11.5	4.7	4.4	11.8
Dividends Per Share	AUD	-	-	-	-
Dividend Yield	%	0.0%	0.0%	0.0%	0.0%
Net Debt / Net Debt + Equity	%	313%	-1928%	-79%	20%
Interest Cover	X	17.1	47.9	60.4	8.1

Reserves & Resources		Mt	Li %	Ta_2O_5
Mt Cattlin	M+I	12.1	1.09%	166
Mt Cattlin	Inf	4.3	1.07%	132
Mt Cattlin	**Total**	**16.4**	**1.1%**	**149**
Mt Cattlin	**Reserve**	**10.0**	**1.0%**	**149**
James Bay	M+I	11.8	1.30%	
James Bay	Inf	10.5	1.20%	
James Bay	**Total**	**22.2**	**1.3%**	
James Bay	**Reserve**	**-**		
Global Spod.	**Total**	**38.6**	**1.18%**	
Global Spod.	**Reserve**	**9.974**	**1.04%**	**149**

		Cub. m.	mg/l	LC Mt	KCl Mt
Sal de Vida	**Resource**	**1.81**	**753**	**7.2**	**28.8**
Sal de Vida	**Reserve**			**1.4**	**4.2**

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Produced Tantalite	klb pa	4	231	314	314	314	314
Produced Spodumene - Battery Eq	kt	3	147	239	269	275	275
LCE equiv	Kt	0	20	32	36	37	37
Mine Life	yr	15	14	13	12	11	10
Assumed Mining Inventory	Mt	22.3	21.3	19.8	18.2	16.7	15.1
Assumed Mining Inventory - Li grade	%	1.1%	1.1%	1.1%	1.1%	1.1%	1.1%
Assumed Mining Inventory - Tant grade	%	149	149	149	149	149	149

Costs	Unit	Dec 16	Dec 17	Dec 18	Dec 19	Dec 20	Dec 21
Cost per milled tonne	$A/t		54.8	55.0	55.4	55.4	55.4
EBITDA / tonne milled ore	$A/t		45.5	94.2	107.9	67.1	65.6
Total cost per milled tonne	$A/t		62.9	65.3	66.6	64.6	64.7
Total Cash Costs	$A/t Spod. Batt. eq		582	423	384	365	365
- US$	$US/t Spod. Batt. eq		414	311	290	280	283
C1: Operating Cash Cost = (a)	$A/t Spod. Batt. eq		508	356	319	313	313
(a) + Royalty = (b)	$A/t Spod. Batt. eq		553	405	367	347	347
C2: (a) + depreciation & amortisation = (c)	$A/t Spod. Batt. eq		525	373	371	453	521
(a) + actual cash for development = (d)	$A/t Spod. Batt. eq		658	464	992	1,528	396
AISC: (c) + Royalty	$A/t Spod. Batt. eq		570	422	418	487	555
(d) + Royalty	$A/t Spod. Batt. eq		704	512	1,039	1,562	430

Price Assumptions	Unit	Dec 16	Dec 17	Dec 18	Dec 19	Dec 20	Dec 21
AUDUSD	US$/A$	0.74	0.71	0.73	0.76	0.77	0.78
LC	US$/t	10,941	12,239	12,672	12,672	10,941	10,941
Spodumene - Battery	US$/t	600	750	800	800	600	600
Tantalum	US$/lb	60	60	60	60	60	60

Hedging	Unit	Dec 16	Dec 17	Dec 18	Dec 19	Dec 20	Dec 21
Spodumene			Yes				

Sensitivity Analysis	Valuation	FY21 NPAT
Base Case	**0.58**	**22.6**
Spot Prices	0.63 (9.4%)	58.9 (160.9%)
Spot USD/AUD 0.75, Chemical Spod $750/t, LC $9,000/t,Tant. $60/lb.		
AUDUSD +/--10%	0.47 / 0.70 (-17.9% / 21.9%)	12.9 / 34.5 (-43.1% / 52.7%)
Spodumene - Technical +/--10%	0.58 / 0.58 (0.0% / 0.0%)	22.6 / 22.6 (0.0% / 0.0%)
Spodumene - Chemical +/--10%	0.66 / 0.50 (13.8% / -13.8%)	36.1 / 9.0 (59.9% / -59.9%)
Tantalite +/--10%	0.58 / 0.57 (1.0% / -1.0%)	23.8 / 21.4 (5.4% / -5.4%)
Production +/--10%	0.72 / 0.43 (25.1% / -25.1%)	37.0 / 8.2 (63.7% / -63.7%)
Operating Costs +/--10%	0.52 / 0.64 (-10.2% / 10.2%)	16.2 / 29.0 (-28.5% / 28.5%)

Unpaid Capital

Year Expires	No. (m)	$m	Avg price	% ord
31-Dec-18	59.3	1.7	0.03	3%
31-Dec-19	0.0	0.0	0.00	0%
31-Dec-20	40.0	13.7	0.34	2%
31-Dec-21	0.0	0.0	0.00	0%
31-Dec-22	0.0	0.0	0.00	0%
TOTAL	**99.3**	**15.4**	**0.16**	**5%**

Valuation post merger	$m	$/GXY
100% Mt Cattlin (pre-tax NAV at disc. rate of 10%)	697	0.37
Sal de vida	599	0.32
Other Assets/Exploration	64	0.03
Corporate Overheads	-45	-0.02
Net Cash (Debt)	-45	-0.02
Tax (NPV future liability)	-180	-0.10
Options & Other Equity	2	0.00
Total	**1091**	**0.58**

Analyst: Trent Barnett
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17 Nov 16

"tbc capital" could be equity or debt. Our valuation is risk-adjusted for how this may be obtained.
Sources: IRESS, Company Information, Hartleys Research

Fig. 2: Key Assumptions and Risks for valuation

Assumption	Risk of not realising assumption	Downside risk to valuation if assumption is incorrect	Comment
~15 year mine life	Low	Meaningful	This appears reasonable based on current resources
Ramp-up to 1.6mtpa in CY16	Upside/downside	Meaningful	This seems reasonable given infrastructure in place, and potentially ramp-up could be faster than our assumptions
Recoveries take time to reach 70%, and capital is required to achieve 85%	Upside/downside	Meaningful	Hopefully our recovery estimates are too low, and the plant can be optimised quickly to achieve 70%
Spodumene prices in line with our estimates	Upside/downside	Meaningful	We assume prices are yet to peak
Sal De Vida is developed	High	High	Sal De Vida appears highly economic, but will take time for first cash flows
No new financing	Low	Meaningful	We assume the project is fully funded.
Exploration value	Moderate	Meaningful	We assume modest exploration value.
Conclusion	*Selling prices of spodumene and lithium carbonate and the development of Sal de Vida are significant risks to valuation.*		

Source: Hartleys

PRICE TARGET

We have reduced our price target to $0.52 (from 69cps previously).

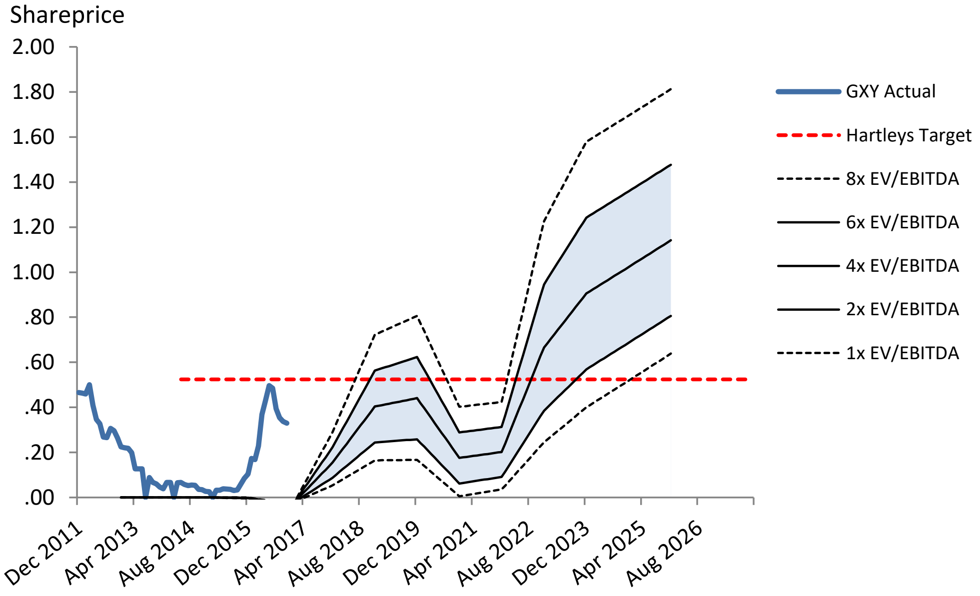
Price Target Methodology	Weighting	Spot	12 mth out
NPV base case	65%	$0.58	$0.64
NPV base case Mt Cattlin only	15%	$0.25	$0.27
NPV at spot commodity and fx prices	10%	$0.63	$0.70
Net cash	10%	$0.00	$0.00
Risk weighted composite		**$0.48**	
12 Months Price Target		**$0.52**	
Shareprice - Last - GXY		$0.350	
12 mth total return (% to 12mth target + dividend)		**50%**	

Source: Hartleys Estimate

RISKS

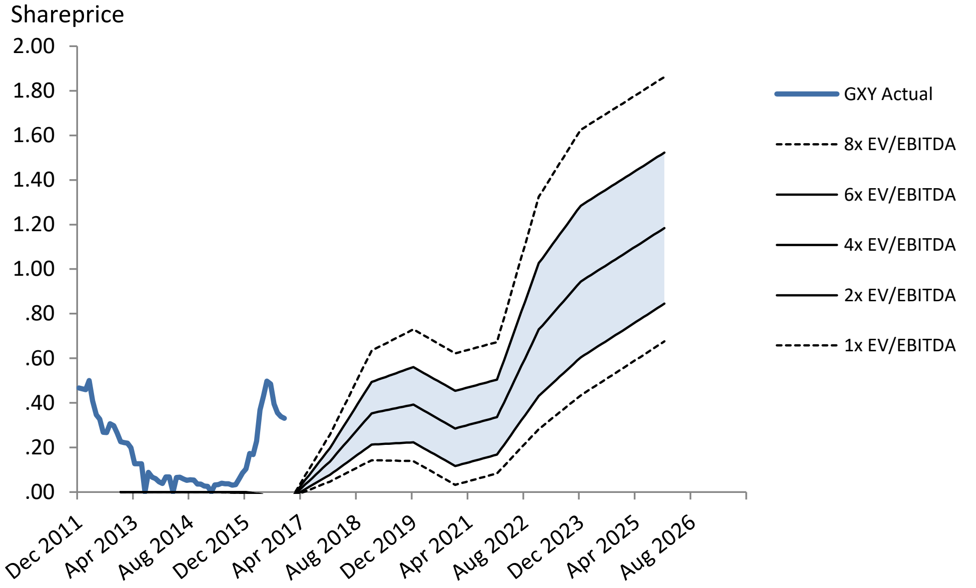
The largest risk for GXY are the selling prices of spodumene and lithium carbonate. Other risks are similar to most producers: mine planning, mill performance, force-majeure, counter party risks, mine life extensions, expansions.

Fig. 3: Using Hartleys base case commodity forecasts



Source: Hartleys Estimates, IRESS

Fig. 4: Using spot commodity prices



Source: Hartleys Estimates

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Hartleys Recommendation Categories

Buy	Share price appreciation anticipated.
Accumulate	Share price appreciation anticipated but the risk/reward is not as attractive as a "Buy". Alternatively, for the share price to rise it may be contingent on the outcome of an uncertain or distant event. Analyst will often indicate a price level at which it may become a "Buy".
Neutral	Take no action. Upside & downside risk/reward is evenly balanced.
Reduce / Take profits	It is anticipated to be unlikely that there will be gains over the investment time horizon but there is a possibility of some price weakness over that period.
Sell	Significant price depreciation anticipated.
No Rating	No recommendation.
Speculative Buy	Share price could be volatile. While it is anticipated that, on a risk/reward basis, an investment is attractive, there is at least one identifiable risk that has a meaningful possibility of occurring, which, if it did occur, could lead to significant share price reduction. Consequently, the investment is considered high risk.

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