

GALENA MINING (G1A)

Galena delivers a robust DFS for its Abra Lead project

Analyst Stuart McIntyre
Email steuartmcintyre@boeq.com.au
Phone +61 2 8072 2909
Date 22 July 2019

We say

Price

Target

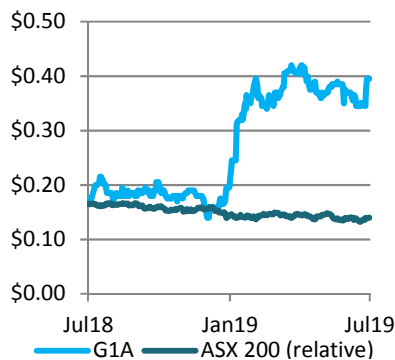
Strategic Target

BUY

0.40 0.55 0.80

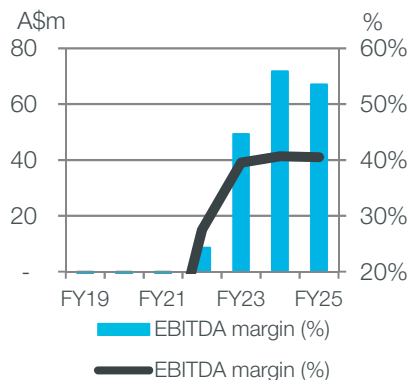
Galena delivered a robust DFS for its 60%-owned Abra lead project in WA. While the capex was 10% higher on the PFS, the NPV was up 5% due to higher grades, lower unit costs and a longer mine life. On our forecasts Galena has the necessary equity in place and once the offtake and debt is finalised (both due near-term), the company should be fully funded to build Abra. After updating our forecasts for the Abra DFS, we ease our Price Target 15% to 55c, but maintain our Buy rating.

SHARE PRICE CHART



Source: IRESS, Blue Ocean Equities

FORECAST EBITDA (A\$m) & MARGIN (%)



Source: Company, Blue Ocean estimates

COMPANY DATA & RATIOS

Enterprise value	\$106m
Diluted market cap*	\$168m
Diluted shares*	421m
Free float	68%
12 month price range	\$0.14-0.43
GICS sector	Materials
Board & Management hold ~32%. *Diluted for 56.3m options & performance rights.	

IMPLIED RETURN

Implied all-in return	38%
-----------------------	-----

SOLID FUNDAMENTAL OUTLOOK FOR LEAD

LME inventories for lead are sitting at 5 year lows and in our view the fundamental outlook for lead appears solid. Over the last 6-7 weeks the lead price has rallied a substantial 15% from US81c to US93c. Interestingly, Galena's share price is largely unchanged over this period which suggests to us a "catch-up" may be due. Galena remains one of the few *pure* lead equity exposures globally.

~\$28M CASH; PROJECT EQUITY IN PLACE

Within the ABRA DFS release Galena disclosed at 30 June it had A\$28m in cash including funds in the 60/40 JV with Toho. On our estimates the split is ~A\$10m in the Galena parent and ~A\$18m sitting in the JV. Toho is set to pay another A\$70m into the JV as part of its acquisition. A\$10m shortly (on completion of the DFS) and A\$60m on completion of debt finance.

IMPLIED POTENTIAL RETURN OF ~40%

We ease our Price Target 15% to 55c from 65c after updating our forecasts for the Abra DFS. Our previous forecasts had "baked-in" the improved grade of the updated resource, however the DFS for Abra included a 10% increase in initial capex to A\$170m and higher sustaining capex, which offset most of this benefit. On our forecasts, using spot prices, Galena is trading on a P/NPV of ~0.70x.

A ROBUST DFS FOR ABRA

On 22 July 2019, Galena released the Definitive Feasibility Study (DFS) for its 60%-owned Abra lead project in WA. The table below highlights the key changes since the PFS.

While the capex was 10% higher on the PFS, the NPV was up 5% due to higher grades, lower unit costs and a longer mine life.

Table 4: Selected key study outcomes – FS vs. prior PFS

	FS (22 Jul 2019)	PFS (25 Sep 2018)	FS B/(W) PFS ¹	FS B/(W) PFS ¹
Average annual mill throughput	1.2Mtpa	1.2Mtpa	n/c	n/c
Mine life	16-years	14-years	2-years	14%
Total LOM lead metal production	1.24Mt	1.1Mt	0.14Mt	13%
Total LOM silver metal production	10.6Moz	9.6Moz	1.0Moz	10%
Pre-production capital expenditure	A\$170M	A\$154M	(A\$16M)	(10%)
Lead C1 direct cash cost of production	US\$0.44/lb	US\$0.48/lb	US\$0.04/lb	8%
Pre-tax NPV	A\$553M	A\$528M	A\$25M	5%

Source: Company

PROJECT EQUITY IN PLACE

On our forecasts, Galena now has sufficient equity in place as per the table below, subject to arranging A\$100-120m in debt finance. With the help of its JV partner (Toho Zinc), we believe Galena should be able to secure low cost project debt with the assistance of the Japanese export credit agencies.

In terms of the A\$100m equity in the table below:

- At 30 June 2019 the cash balance in the JV was: **A\$18m**
- Payments due from Toho into the JV are: **A\$70m**
(A\$10m on DFS, \$60m on debt finance)
- Leaving an equity requirement of **A\$12m**
(G1A's 60% share being ~A\$7m)

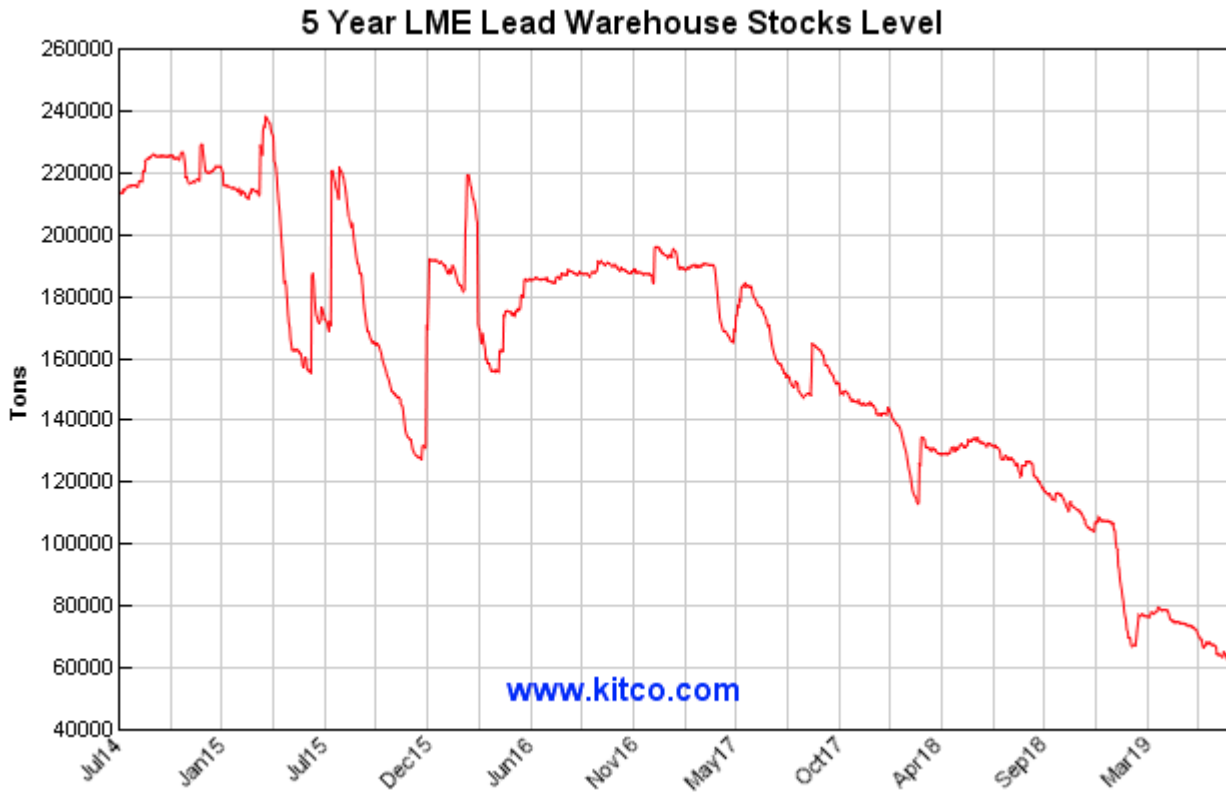
At 30 June 2019, Galena had A\$10m in cash (outside the JV).

Funding Uses (100% basis, JV level)		Funding Sources	
	A\$m		A\$m
Initial capex	170	Equity	100
Working capital	30	Debt	100
Total	200	Total	200

Source: Company, Blue Ocean estimates

LEAD: LME INVENTORIES AT 5 YEAR LOWS

In our view, the fundamental outlook for lead appears relatively robust with LME inventories sitting at 5 year lows. In our view, this bodes well for the outlook for lead prices and over the last 6-7 weeks the lead price has rallied a substantial 15% from US81c to US93c.



Source: Kitco, July 2019

We remain believers in the mainstream adoption of Electric Vehicles (EVs) and we were surprised to learn that Electric Vehicles still use conventional lead-acid batteries (batteries have represented ~65-80% of lead demand for many years).

While lead-acid batteries are heavier, they are *much* cheaper than lithium-ion batteries and also have *much* lower rates of self-discharge. Which is one of the primary reasons EVs still use lead-acid batteries as a secondary battery system for critical elements: i.e. ignition and key safety components like lights.

NEAR-TERM CATALYSTS

In our view the key near term de-risking milestones for Galena are:

- **Debt Finance:** Galena should have debt in place **by Q4 CY19** to enable construction to begin this year. Toho will assist Galena in procuring debt from Japanese export credit agencies, which typically offer debt on more attractive terms than tradition project finance (lower interest rates, longer tenor and generally less constraints)
- **Offtake agreements:** Toho has the right to its pro-rata 40% share of the offtake for Abra. Galena will no doubt seek an offtake for its 60% share of production, and given Abra is set to produce a very high grade, high quality concentrate, we expect this offtake to be highly sought after. The DFS for Abra does **not** include the potential premium for Abra’s high-quality concentrate. **We believe the benefit of this premium could be material and could potentially lift our valuation between 5-10%.**

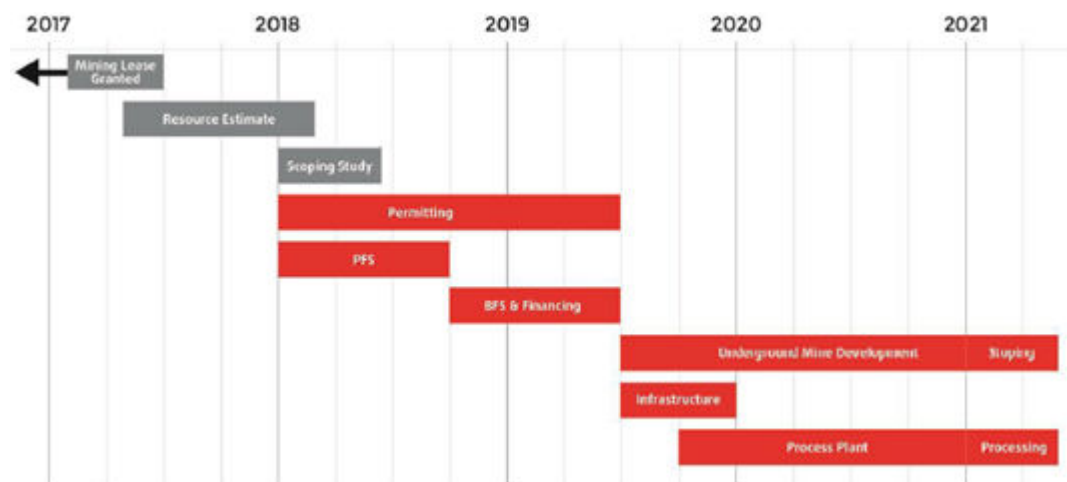
DEVELOPMENT TIMETABLE

Galena now has all relevant major permits in place to develop Abra. Our forecasts assume the following development timetable for Abra:

- Debt and offtake in place by end Q3/Q4 CY19
- Construction begins late CY19 / early CY20 and takes ~18 months
- First production in mid CY21

Our forecast timetable is a little more conservative than the company’s target development schedule, which is set out below.

Project Development Timetable



Source: Company

PRICE TARGET & RATING

Our revised 55c Price Target (previously 65c) is based on:

- Updated forecasts to reflect the DFS for Abra
- Our Price Target includes an unchanged 10% discount to NPV

Our NPV₁₀ for Abra is predominately based on the DFS operating assumptions, together with essentially unchanged Blue Ocean commodity price forecasts (US\$0.95/lb lead, US\$16.00/oz silver), which are broadly in line with spot prices (US\$0.93/lb lead, US\$16.23/lb silver).

We retain our Buy rating on Galena and our 55c Price Target represents an implied potential return of ~40%.

STRATEGIC TARGET

We derive our longer term 80c Strategic Target (previously 95c) for Galena by looking forward a few years once the A\$170m capex for Abra has been spent.

KEY RISKS

Galena is exposed to all the normal risks associated with developing and operating mining projects, including funding and construction risk, as well as normal project ramp up and commissioning risks.

Assuming Galena makes the transition into production, its revenues will be derived from the sale of lead concentrates (and a modest silver credit). Fluctuations in the prices of these commodities as well as the Australian dollar could impact the company's reported cash flow (in A\$), profitability and share price.

As Galena's Abra project is based in Western Australia, an investment in Galena also carries Australian sovereign risk. However, it is worth noting that Australia is considered materially lower sovereign risk than many of the other jurisdictions around the world.

MODEL SUMMARY: FINANCIALS & VALUATION
Stock Details

Recommendation:	BUY		
Target	\$0.55	Share Price	\$0.40
NAV	\$0.57	52 Week High	\$0.43
Implied Return	38%	52 Week Low	\$0.14

Enterprise Value	\$106m
Diluted MCap	\$168m
Diluted Shares	421m
Free Float	68%
Avg Daily Value	\$0.22m

Macro Assumptions	FY18A	FY19E	FY20E	FY21E	FY22E
Exchange Rate (A\$/US\$)	0.78	0.73	0.71	0.70	0.70
Lead Price (US\$/lb)	1.10	0.95	0.95	0.95	0.95
Silver Price (US\$/oz)	16.71	15.12	16.00	16.00	16.00

Profit & Loss (A\$m)	FY18A	FY19E	FY20E	FY21E	FY22E
Revenue	-	-	-	-	31
Operating Costs	-	-	-	-	(18)
Operating Profit	-	-	-	-	14
Corporate & Other	(1)	(3)	(4)	(4)	(5)
Exploration Expense	(0)	(0)	-	-	-
EBITDA	(1)	(3)	(4)	(4)	9
D&A	(0)	(0)	(0)	(0)	(1)
EBIT	(1)	(3)	(4)	(4)	7
Net Interest Expense	-	-	-	-	(6)
Pre-Tax Profit	(1)	(3)	(4)	(4)	2
Tax Expense	-	-	-	-	(0)
Underlying Profit	(1)	(3)	(4)	(4)	1
Significant Items (post tax)	-	-	-	-	-
Reported Profit	(1)	(3)	(4)	(4)	1

Cash Flow (A\$m)	FY18A	FY19E	FY20E	FY21E	FY22E
Operating Cashflow	(1)	(2)	(4)	(4)	9
Tax	-	-	-	-	(0)
Net Interest	0	0	-	-	(6)
Net Operating Cash Flow	(1)	(2)	(4)	(4)	3
Exploration	(5)	(5)	-	-	(2)
Capex	(0)	(0)	(34)	(68)	(1)
Acquisitions / Disposals	-	-	-	-	-
Other	(0)	(0)	-	-	-
Net Investing Cash Flow	(5)	(5)	(34)	(68)	(3)
Equity Issue	14	10	1	3	-
Borrowing / Repayments	-	-	-	60	-
Dividends	-	-	-	-	-
Other	-	16	42	-	-
Net Financing Cash Flow	14	26	43	63	-
Change in Cash Position	8	19	5	(9)	(1)
FX Adjustments	-	-	-	-	-
Cash Balance	9	27	32	23	22

Balance Sheet (A\$m)	FY18A	FY19E	FY20E	FY21E	FY22E
Cash	9	27	32	23	22
Other Current Assets	0	0	0	0	0
PP&E	0	0	34	102	101
Exploration & Development	9	12	12	12	15
Other Non Current Assets	-	0	0	0	0
Total Assets	18	40	78	137	138
Debt	1	1	1	61	61
Other Liabilities	0	0	0	0	0
Net Assets	17	39	77	76	77

Ratio Analysis		FY18A	FY19E	FY20E	FY21E	FY22E
Diluted Shares	m	388	416	416	416	416
EPS - Diluted	Ac	(0.4)	(0.9)	(1.0)	(1.0)	0.3
P/E	x	n.m.	n.m.	n.m.	n.m.	n.m.
CFPS - Diluted	Ac	(0.3)	(0.5)	(1.0)	(1.0)	0.7
P/CF	x	n.m.	n.m.	n.m.	n.m.	61.2x
FCF - Diluted	Ac	(0.3)	(0.5)	(9.1)	(17.3)	1.8
P/FCF	x	n.m.	n.m.	n.m.	n.m.	22.8x

Dividends	Ac	-	-	-	-	-
Dividend yield	%	-	-	-	-	-
Payout Ratio	%	-	-	-	-	-
Franking	%	-	-	-	-	-
Enterprise Value	A\$m	161	142	137	206	207
EV/EBITDA	x	(132.7x)	(43.4x)	(34.3x)	(51.6x)	24.1x
ROE	%	(7%)	(9%)	(5%)	(6%)	1%
ROA	%	(7%)	(8%)	(5%)	(3%)	1%
Net Debt / (Cash)		(8)	(26)	(31)	38	39
Gearing (ND/(ND+E))	%	(82%)	(210%)	(67%)	33%	33%
Gearing (ND/E)	%	(45%)	(68%)	(40%)	50%	50%

Reserves & Resources (100% Basis) Updated: December 2018

Abra Resource	mt	Pb %	Ag g/t
Measured	-	-	-
Indicated	15.0	8.7%	22.0
Inferred	22.4	6.7%	15.0
Total	37.4	7.5%	18.0
Abra Reserve	mt	Pb %	Ag g/t
Probable	10.3	8.8%	24.0

Earnings Sensitivity		FY23E	FY24E	FY23E	FY24E
		A\$m	A\$m	%	%
Lead Price	US\$/lb +10%	8	11	27%	25%
Silver Price	US\$/oz +10%	1	1	2%	2%
Exchange Rate	A\$/US\$ -10%	9	13	30%	27%

Valuation	Discount	Stake	A\$m	A\$/sh
Abra (unrisked)		60%	226	0.54
Abra (risk-adjusted)	10%	60%	203	0.48
Exploration & Projects		60%	15	0.04
Corporate & Other			(43)	(0.10)
Debt			-	-
"Effective" Cash*			63	0.15
Option Strikes			4	0.01
Risk adjusted NAV			241	0.57
				0.70

*(1) ~A\$10m in cash at end June 2019 + (2) 60% share of \$18m in JV at 30 June 2019 + \$70m to come from Toho

MODEL SUMMARY: OPERATIONAL INPUTS & FREE CASH FLOW

Operational Summary		FY18A	FY19E	FY20E	FY21E	FY22E
Abra (100% Basis)						
Ore Mined	mt	-	-	-	-	0.23
Mill Throughput	mt	-	-	-	-	0.23
Lead Head Grade	%	-	-	-	-	8.1%
Lead Recovery	%	-	-	-	-	94%
Lead-in-conc Produced	kt	-	-	-	-	18
Group (60% Basis)						
Lead-in-conc Produced	kt	-	-	-	-	11
C1 Cost (post credits)	A\$/lb Pb	-	-	-	-	0.63
Royalties	A\$/lb Pb	-	-	-	-	0.11
Sustaining Capex	A\$/lb Pb	-	-	-	-	0.05
All-in Sustaining Cost	A\$/lb Pb	-	-	-	-	0.79
All-in Sustaining Cost	US\$/lb Pb	-	-	-	-	0.55

Macro Assumptions		FY18A	FY19E	FY20E	FY21E	FY22E
A\$ Exchange Rate	A\$/US\$	0.78	0.73	0.71	0.70	0.70
Lead Price	US\$/lb	1.10	0.95	0.95	0.95	0.95
Silver Price	US\$/oz	16.71	15.12	16.00	16.00	16.00
Lead Price Realised	A\$/lb	1.42	1.30	1.34	1.36	1.36
Silver Price Realised	A\$/oz	21.55	20.79	22.54	22.86	22.86

Abra (60% Basis)	A\$m	FY18A	FY19E	FY20E	FY21E	FY22E
Lead Revenue		-	-	-	-	30
C1 Cost (post credits)		-	-	-	-	14
Royalties		-	-	-	-	2
Sustaining Capex		-	-	-	-	1
All-in Sustaining Cost		-	-	-	-	17
All-in Sustaining Margin		-	-	-	-	13
Growth Capex		0	-	34	68	-
Exploration		5	4	-	-	2
All-in Margin		(5)	(4)	(34)	(68)	10

Corporate	A\$m	FY18A	FY19E	FY20E	FY21E	FY22E
Cash Tax		-	-	-	-	0
Corporate & Other		1	(12)	(38)	4	5
FCF pre Debt Service		(6)	9	4	(72)	5
Net Interest		(0)	(0)	-	-	6
Debt Drawdown / (Repayment)		-	-	-	60	-
FCF post Debt Service		(6)	9	4	(12)	(1)

New Equity/Dividends	A\$m	FY18A	FY19E	FY20E	FY21E	FY22E
Proceeds from Shares/Options		14	10	1	3	-
Dividends Paid		-	-	-	-	-
Change in Cash		8	19	5	(9)	(1)
Cash Balance		9	27	32	23	22

Source: Company data, Blue Ocean Equities

CONTACTS

ANALYST

Steuart McIntyre

Senior Resource Analyst

P +61 2 8072 2909

E steartmcintyre@boeq.com.au

AUTHORITY

David O'Halloran

Executive Director

P +61 2 8072 2904

E doh@boeq.com.au

Philip Pepe

Senior Industrials Analyst

P +61 2 8072 2921

E philpepe@boeq.com.au

Stuart Turner

Senior Industrials Analyst

P +61 2 8072 2923

E stuartturner@boeq.com.au

Justin Pezzano

Research Associate

P +61 2 8072 2926

E justinpezzano@boeq.com.au

Michael Gerges

Investment Analyst

P +61 2 8072 2935

E michaelgerges@boeq.com.au

Mathan Somasundaram

Market Portfolio Strategy

P +61 2 8072 2916

E mathan@boeq.com.au

Jess Crawford

Dealing Associate

P +61 2 8072 2931

E jesscrawford@boeq.com.au

Adam Stratton

Institutional Dealing

P +61 2 8072 2913

E adamstratton@boeq.com.au

Scott Calcraft

Institutional Dealing

P +61 2 8072 2920

E scottcalcraft@boeq.com.au

Doc Cromme

Institutional Dealing

P +61 2 8072 2925

E doccromme@boeq.com.au

Mark Wallace

Institutional Dealing

P +61 2 8072 2922

E markwallace@boeq.com.au

Sebastian Weitmann

Institutional / HNW Dealing

P +61 2 8072 2906

E sweitmann@boeq.com.au

HEAD OFFICE

Blue Ocean Equities Pty. Ltd.

AFSL No. 412765

ABN 53 151186935

P +61 2 8072 2988

E info@boeq.com.au

W blueoceanequities.com.au

Level 29, 88 Phillip Street

Sydney NSW 2000

Australia

DISCLAIMER

This document is a private communication to clients and is not intended for public circulation or for the use of any third party, without the prior approval of Blue Ocean Equities Pty Limited. This is general investment advice for Institutional and Sophisticated Investors only and does not constitute personal advice to any person. Because this document has been prepared without consideration of any specific client's financial situation, particular needs and investment objectives you should consult your own investment adviser before any investment decision is made on the basis of this document.

While this document is based on information from sources which are considered reliable, Blue Ocean Equities Pty Limited has not verified independently the information contained in the document and Blue Ocean Equities Limited and its directors, employees and consultants do not represent, warrant or guarantee, expressly or by implication, that the information contained in this document is complete or accurate. Nor does Blue Ocean Equities Limited accept any responsibility for updating any advice, views opinions, or recommendations contained in this document or for correcting any error or omission which may become apparent after the document has been issued.

Except insofar as liability under any statute cannot be excluded. Blue Ocean Equities Pty Limited and its directors, employees and consultants do not accept any liability (whether arising in contract, in tort or negligence or otherwise) for any error or omission in this document or for any resulting loss or damage (whether direct, indirect, consequential or otherwise) suffered by the recipient of this document or any other person.

DISCLOSURE

Blue Ocean Equities Pty Limited, its employees, consultants and its associates within the meaning of Chapter 7 of the Corporations Law may receive commissions, underwriting and management fees from transactions involving securities referred to in this document, and may from time to time hold interests in the securities referred to in this document.

Blue Ocean Equities Pty Limited and associates may hold shares in Galena Mining at the date of this report and this position may change at any time without notice.

Steuart McIntyre does not own shares in Galena Mining.