

# Chatham Rock Phosphate

## Delays and funding squeeze bite

Since our last update in May, Chatham Rock Phosphate's (CRP) momentum has slowed. Delays to regulatory approval processes have weighed on confidence and investor sentiment. Following a soft result from a recent public offer, CRP has launched a new success-linked share offer to bridge it to and beyond separate consenting and approval processes. Our unrisksed valuation rises slightly to NZ\$2.04/share.

| Year end | Revenue (NZ\$m) | PBT* (NZ\$m) | EPS* (c) | DPS (c) | P/E (x) | Yield (%) |
|----------|-----------------|--------------|----------|---------|---------|-----------|
| 03/12    | 0.0             | (0.8)        | (1.6)    | 0.0     | N/A     | N/A       |
| 03/13    | 0.0             | (1.4)        | (1.3)    | 0.0     | N/A     | N/A       |
| 03/14e   | 0.0             | (0.5)        | (0.4)    | 0.0     | N/A     | N/A       |
| 03/15e   | 0.0             | (0.8)        | (0.5)    | 0.0     | N/A     | N/A       |

Note: \*PBT and EPS are normalised, excluding intangible amortisation, exceptional items and share-based payments

### Progress stalls with approvals

In our [last Update](#) in May we highlighted an upswing in forward momentum by CRP, underpinned by increasing clarity towards regulatory processes and timelines. Explicit positive sentiment received by CRP from government authorities in April, informing that its mining permit application would be treated with priority, has yet to bear fruit. Uncertainty has weighed on investor confidence, which was an undertone to a weak result from a recently completed public capital raising.

### Focus on funding and work programme

In June CRP launched, and in July completed, an on-market public offer to raise what it hoped would be the final tranche of pre-production capital it would need. Seeking up to NZ\$10m, the offer raised NZ\$1.6m. The result sees CRP facing a near term but not unfamiliar funding crunch. We estimate a further NZ\$7m is needed to fund its pre-development work programme, the largest component of which will be NZ\$3.5m in costs associated with CRP's application for environmental consents during H114. CRP has launched a further offer to professional investors that, if successful and combined with an assumed early part-exercise of a significant tranche of success-related share options by an existing cornerstone investor, should serve to meet its remaining pre-commissioning capital needs.

### Valuation: Stable, but risk profile up

At a minimum, the recasting of its critical path to reflect extended approval processes means CRP is facing a delay of at least six months to the timelines it had been targeting until as recently as June. We assume CRP will receive a response on its mining permit application in October. Following this and securing new capital, a marine consent application can be lodged, the result of which would be expected in late-H114. During this time the technical work programme led by Boskalis, which is currently effectively stalled, can recommence. While our base case valuation lifts slightly to NZ\$2.04/share, it importantly now assumes a lower diluted capital base as a result of the early strategic exercising of share options.

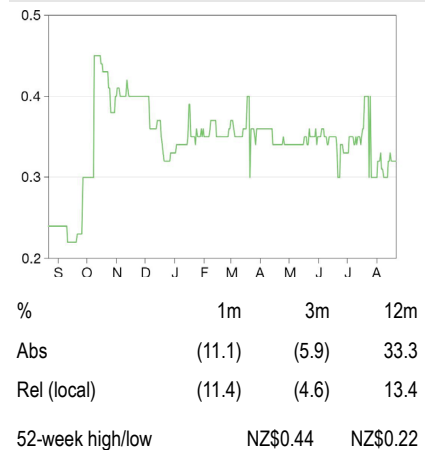
Mining

22 August 2013

**Price** **NZ\$0.32**  
**Market cap** **NZ\$45m**

|                                  |          |
|----------------------------------|----------|
| Current cash on hand (estimated) | NZ\$0.7m |
| Shares in issue                  | 140.3m   |
| Free float                       | 68%      |
| Code                             | CRP      |
| Primary exchange                 | NZX      |
| Secondary exchange               | N/A      |

### Share price performance



### Business description

Chatham Rock Phosphate holds an exploration licence over 4,726km<sup>2</sup> off the east coast of New Zealand known to house significant seabed deposits of rock phosphate and other minerals.

### Next events

|                                    |               |
|------------------------------------|---------------|
| Capital raising outcomes           | Aug-Sept 2013 |
| Mining permit application decision | Q413          |
| Submit marine consent application  | Q413-Q114     |

### Analysts

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## Focus returns to regulatory timings and outcomes

### Mining permit uncertainty

Our [2012 Outlook report](#) and subsequent [May 2013 Update note](#) coincided with a period of momentum upswing for CRP, particularly in respect of regulatory processes and timelines. The transferring during Q213 of legislative responsibility for offshore mining activities from the Continental Shelf Act 1964 to the Crown Minerals Act 2013 (CMA) appeared to bring significant forward clarity to CRP's critical path. A letter of comfort provided by government officials to CRP during the transition appeared to reinforce this, by providing CRP with confidence that its mining permit application would be handled as a priority once the new regime was fully in place.

On 24 May CMA regulations came into force. Since then, momentum appears to have slowed. There is no statutory prescription in CMA regulations to specify when a decision on a mining permit application must be returned, thus timelines sit at the discretion of the Minister of Energy and Resources and the government agency delegated to handle mining permit applications, New Zealand Petroleum and Minerals (NZP&M). Under CMA regulations NZP&M must consider a number of technical (eg geology, resource delineation, mine plan) and economic (eg financial feasibility, project economics) aspects to inform and support its recommendation to the minister. NZP&M must also undertake consultation with iwi (local Maori) and various other central and local government authorities. It is unclear what stage NZP&M's process is currently at.

### Separate marine consent process still to come

The other major regulatory approval process CRP must navigate relates to its application for marine consents under the also recently enacted Exclusive Economic Zone and Continental Shelf (Environment Effects) Act 2012. The application will be handled by the Environmental Protection Agency (EPA). Our May update note provided an overview of the EPA process.

On 5 August CRP announced a decision to delay submitting its formal marine consent application until outcomes from its mining permit application become known. With the cost of the application process to CRP likely to approximate NZ\$3.5m, CRP's ability to fund the EPA process is also an issue, which we discuss below.

### Critical path delayed

The delay to regulatory and funding work streams have pushed CRP's timings out by, we estimate, at least six months. Key deferrals relate to the CMA, EPA and Boskalis technical design timings. The timeline, as we now assume it, is summarised in Exhibit 1. There remain risks to this timetable if further delays and/or process complexities unfold, for example if opponents to CRP's mining concept seek a judicial review of a decision to grant a mining permit.

**Exhibit 1: Success case assumed forward CRP milestones and timelines**

| Milestone event  | Likely timing |
|--|---------------|
| Issue of mining licence                                      | Sept-Oct 2013 |
| Boskalis commits to initial development spend                | Oct-Nov 2013  |
| Lodgement of final application for EEZ marine consent to EPA | Nov 2013      |
| Public hearings commence towards EEZ marine consent          | Mar 2014      |
| Release of EPA decision                                      | Jun 2014      |
| Boskalis FID, sanction of vessel fit out                     | Q314          |
| Vessel fit out/conversion                                    | H214-2015     |
| First production   | Q116          |

Source: Company announcements, Edison Investment Research

In respect of project sanction, we now consider it more likely that a distinct two-stage investment decision will unfold, with the stages reflecting the sequenced granting of a mining permit and marine consents. The first stage will likely see contract miner Boskalis commit to an initial capex programme involving low-risk, transferable equipment that can be redeployed in the event of further delay or worse. The main commitment will come following the project receiving marine consents, probably in mid-2014, which would act as a trigger for Boskalis to commit the substantial (c US\$300m) spend to procure and fit out the mining vessel.

## **Funding equation**

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### **Soft support from public offer**

In June 2013, CRP announced a public offer seeking up to NZ\$10m at NZ\$0.35/share, from which a total NZ\$1.6m was raised. We understand that the strong majority of the new capital was sourced from direct marketing, with a small percentage sourced through broker channels.

The new capital is well short of that required to bridge CRP fully to commissioning. With the settling of accrued payables CRP now has c NZ\$700k net cash on hand, which will fund it until the end of October. As a response to its funding requirements and delays to the CMA process, CRP has decided to defer submitting its final EPA application while it awaits outcomes from the CMA process and addresses funding.

### **Back to private placement market**

CRP has launched a new non-retail offer to sophisticated investors, the second tranche of which is dependent upon the company being awarded a mining permit. The offer is in two stages:

1. up to 5m shares at NZ32cps to close 30 August 2013. If fully subscribed this first tranche would raise NZ\$1.6m; and
2. up to 5m shares at NZ35cps to close two weeks after the granting of a mining licence. If fully subscribed this second tranche would raise NZ\$1.75m.

Both tranches are linked such that investors who participate in Tranche 1 must also participate in Tranche 2 for the same number of shares. New shares will be issued with a 2:1 NZ70cps option exercisable within three months of receipt of marine consents. In total, CRP seeks up to NZ\$3.35m.

A further, existing 36.4m tranche of NZ30cps unlisted options held by current 26% cornerstone shareholder Subsea Investments, which lapse in March 2015 would, if exercised in full, raise a further NZ\$10.9m. Due to the size of the parcel and the long-dated timing, Subsea's options form an important component to CRP's potential capital profile. Importantly, we understand that Subsea may be prepared to exercise part of its holding early to bridge a likely funding gap otherwise likely to emerge in mid-2014 (Exhibit 2). Subsea's potential appetite to part-exercise early is understandable: on current and anticipated near-term inflows, CRP would otherwise be likely to face raising further new capital from the market to bridge to first production, which would dilute existing holders, including Subsea. An early-exercise scenario therefore has a material impact on CRP's ultimate (at first production) fully diluted capital base. At the current share price Subsea's options are already in the money; however, if CRP does succeed in securing a mining permit during H213 as it anticipates, significant further share price appreciation could reasonably be expected as the project is further de-risked.

The funding scenario presented in Exhibit 2 assumes CRP secures 25% of the maximum it is seeking from its current placement and that Subsea exercises 25% of its options early in Q413 following CRP's assumed success in being granted a mining permit.

**Exhibit 2: Base case funding profile and outlook**

| Timing         |  | Capital flow<br>NZ\$m | Issue price<br>cps | New shares<br>issued m | Shares out<br>m |
|----------------|--|-----------------------|--------------------|------------------------|-----------------|
| <b>Current</b> | <b>Cash on hand and issued share capital</b>       | <b>0.7</b>            |                    |                        | <b>140.3</b>    |
| 31 Aug 2013    | Tranche 1 of placement (pre mining licence)        | 0.4                   | 0.32               | 1.3                    | 141.6           |
| Oct 2013       | Tranche 2 of placement (post mining licence)       | 0.4                   | 0.35               | 1.3                    | 142.8           |
| Nov 2013       | Assumed part-exercise of Subsea options            | 2.7                   | 0.30               | 9.1                    | 151.9           |
| H213-H114      | EPA cost recovery of marine consent process        | (1.2)                 |                    |                        | 151.9           |
| H213-H114      | CRP costs of NZP&M and EPA consent processes       | (2.2)                 |                    |                        | 151.9           |
| H213-H114      | Corporate overhead cash burn                       | (0.5)                 |                    |                        | 151.9           |
|                | <b>Cash/capital situation at end-H114</b>          | <b>0.4</b>            |                    |                        | <b>151.9</b>    |
| Q314           | Exercise of options issued with Aug 2013 placement | 0.9                   | 0.70               | 1.3                    | 153.1           |
| Q115           | Exercise of residual Subsea options                | 8.2                   | 0.30               | 27.3                   | 180.4           |
| Q115           | Exercise of residual supplier options              | 0.4                   | 0.50               | 0.8                    | 181.2           |
| H214-Q116      | Corporate overhead cash burn                       | (1.8)                 |                    |                        | 181.2           |
|                | <b>Cash/capital situation at first production</b>  | <b>8.1</b>            |                    |                        | <b>181.2</b>    |

Source: Edison Investment Research

## Valuation

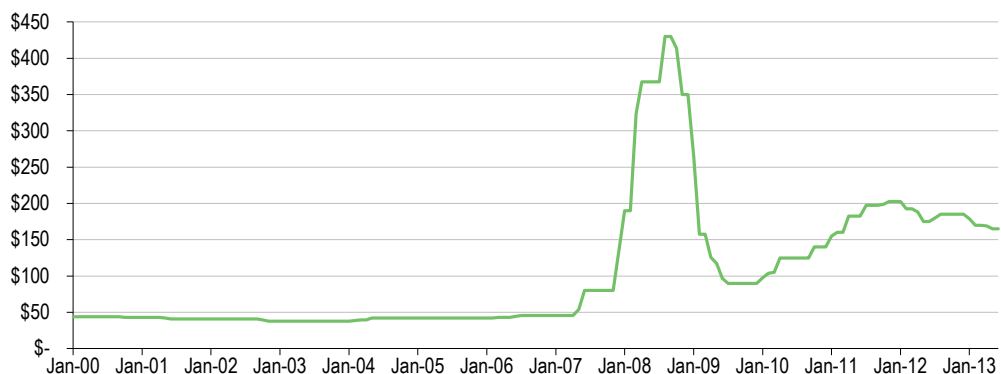
### Unrisked project economics stable

We have updated our modelling to incorporate the delays to project timings and change to capital profile. We conclude an unrisksed base case NPV10 valuation of NZ\$2.04/share, up slightly from NZ\$2.00/share at our last update.

The key changes to our assumption set are:

- **Project delay:** we assume first production in Q216 (the start of CRP's FY17). The standalone impact of this change to our valuation is -11cps.
- **Forex:** we have updated our NZ\$/US\$ and NZ\$/€ assumptions to 0.793 and 0.591 respectively (previously 0.820 and 0.638). The standalone impact is -5cps.
- **Capital:** we have adjusted for the IPO outcome and recast for the capital scenario in Exhibit 2. This is a material change to our assumption set, which had previously assumed CRP would raise US\$7.5m of new funding in addition to converting all Subsea and other options held to ords. The result is that our assumed fully diluted issued share capital base at first production reduces by 9.5% from 200.1m in our May update to 181.2m ords. The standalone impact is +21cps.

We have left our long-term base 32% P<sub>2</sub>O<sub>5</sub> rock price and contract mining rate assumptions unchanged at US\$150/t and €70/t respectively. We note that the reference rock price has eased slightly from US\$170/t to US\$165/t since our May update.

**Exhibit 3: Rock phosphate prices, 32% P<sub>2</sub>O<sub>5</sub>, US\$/tonne**


Source: Bloomberg, Edison Investment Research

As essentially a commodity trader that will hold materially no tangible assets, we again highlight the sensitivity of CRP's economics to variations in its key value drivers. In particular, valuation is highly responsive to forex, rock pricing and contract mining rate. Exhibits 4 and 5 show outcomes of our sensitivity analysis on each variable.

**Exhibit 4: Valuation sensitivity to rock phosphate price and US\$**

|                   |         | Long-term US\$/NZ\$ |      |      |       |      |      |      |
|-------------------|---------|---------------------|------|------|-------|------|------|------|
|                   |         | 0.65                | 0.70 | 0.75 | 0.807 | 0.85 | 0.90 | 0.95 |
| Rock price US\$/t | \$75.0  | 0.59                | 0.29 | 0.01 | -     | -    | -    | -    |
|                   | \$100.0 | 1.46                | 1.13 | 0.84 | 0.61  | 0.34 | 0.11 | -    |
|                   | \$125.0 | 2.32                | 1.93 | 1.59 | 1.33  | 1.02 | 0.79 | 0.57 |
|                   | \$150.0 | 3.19                | 2.73 | 2.34 | 2.04  | 1.68 | 1.41 | 1.17 |
|                   | \$175.0 | 4.05                | 3.53 | 3.08 | 2.74  | 2.34 | 2.04 | 1.76 |
|                   | \$200.0 | 4.91                | 4.33 | 3.83 | 3.45  | 3.00 | 2.66 | 2.35 |
|                   | \$225.0 | 5.78                | 5.13 | 4.58 | 4.16  | 3.66 | 3.28 | 2.94 |

Source: Edison Investment Research

**Exhibit 5: Valuation sensitivity to rock phosphate price and contract mining costs**

|                   |         | Contract mining rate €/t |      |      |      |      |      |      |
|-------------------|---------|--------------------------|------|------|------|------|------|------|
|                   |         | 40                       | 50   | 60   | 70   | 80   | 90   | 100  |
| Rock price US\$/t | \$75.0  | 1.22                     | 0.79 | 0.33 | -    | -    | -    | -    |
|                   | \$100.0 | 1.93                     | 1.49 | 1.06 | 0.61 | 0.11 | -    | -    |
|                   | \$125.0 | 2.64                     | 2.20 | 1.76 | 1.33 | 0.89 | 0.42 | -    |
|                   | \$150.0 | 3.34                     | 2.91 | 2.47 | 2.04 | 1.60 | 1.16 | 0.71 |
|                   | \$175.0 | 4.05                     | 3.62 | 3.18 | 2.74 | 2.31 | 1.87 | 1.43 |
|                   | \$200.0 | 4.76                     | 4.32 | 3.89 | 3.45 | 3.01 | 2.58 | 2.14 |
|                   | \$225.0 | 5.47                     | 5.03 | 4.59 | 4.16 | 3.72 | 3.29 | 2.85 |

Source: Edison Investment Research

**Exhibit 6: Financial summary**

|  | NZ\$'000s | 2010  | 2011    | 2012    | 2013    | 2014e   | 2015e |
|--|-----------|-------|---------|---------|---------|---------|-------|
| 31-Mar                                       |           |       |         |         |         |         |       |
| <b>PROFIT &amp; LOSS</b>                     |           |       |         |         |         |         |       |
| Revenue                                      | 0         | 0     | 0       | 0       | 0       | 0       | 0     |
| Cost of Sales                                | 0         | 0     | 0       | 0       | 0       | 0       | 0     |
| Gross Profit                                 | 0         | 0     | 0       | 0       | 0       | 0       | 0     |
| EBITDA                                       | (142)     | (529) | (761)   | (1,427) | (472)   | (767)   |       |
| Operating Profit (before amort. and except.) | (142)     | (529) | (761)   | (1,427) | (472)   | (767)   |       |
| Intangible Amortisation                      | 0         | 0     | 0       | 0       | 0       | 0       |       |
| Exceptionals                                 | (91)      | (123) | 8       | 0       | 0       | 0       |       |
| Other  | 0         | 0     | 0       | 0       | 0       | 0       |       |
| Operating Profit                             | (233)     | (652) | (754)   | (1,427) | (472)   | (767)   |       |
| Net Interest                                 | 0         | 0     | 0       | 0       | 0       | 0       |       |
| Profit Before Tax (norm)                     | (142)     | (529) | (761)   | (1,427) | (472)   | (767)   |       |
| Profit Before Tax (FRS 3)                    | (233)     | (652) | (754)   | (1,427) | (472)   | (767)   |       |
| Tax  | 0         | 0     | 0       | 0       | 0       | 0       |       |
| Profit After Tax (norm)                      | (142)     | (529) | (761)   | (1,427) | (472)   | (767)   |       |
| Profit After Tax (FRS 3)                     | (233)     | (652) | (754)   | (1,427) | (472)   | (767)   |       |
| Average Number of Shares Outstanding (m)     | 17.3      | 25.2  | 48.1    | 106.0   | 129.8   | 162.0   |       |
| EPS - normalised (c)                         | (0.8)     | (2.1) | (1.6)   | (1.3)   | (0.4)   | (0.5)   |       |
| EPS - normalised and fully diluted (c)       | (0.4)     | (1.3) | (1.4)   | (1.0)   | (0.3)   | (0.4)   |       |
| EPS - (IFRS) (c)                             | (1.3)     | (2.6) | (1.6)   | (1.3)   | (0.4)   | (0.5)   |       |
| Dividend per share (c)                       | 0.0       | 0.0   | 0.0     | 0.0     | 0.0     | 0.0     |       |
| Gross Margin (%)                             | N/A       | N/A   | N/A     | N/A     | N/A     | N/A     |       |
| EBITDA Margin (%)                            | N/A       | N/A   | N/A     | N/A     | N/A     | N/A     |       |
| Operating Margin (before GW and except.) (%) | N/A       | N/A   | N/A     | N/A     | N/A     | N/A     |       |
| <b>BALANCE SHEET</b>                         |           |       |         |         |         |         |       |
| Fixed Assets                                 | 738       | 4,398 | 11,389  | 17,677  | 21,162  | 21,687  |       |
| Intangible Assets                            | 440       | 4,283 | 11,374  | 17,434  | 21,162  | 21,687  |       |
| Tangible Assets                              | 15        | 15    | 0       | 0       | 0       | 0       |       |
| Investments/other financial assets           | 283       | 100   | 15      | 243     | 0       | 0       |       |
| Current Assets                               | 553       | 455   | 478     | 1,293   | 588     | 8,749   |       |
| Stocks                                       | 0         | 0     | 0       | 0       | 0       | 0       |       |
| Debtors                                      | 24        | 117   | 196     | 142     | 0       | 0       |       |
| Cash   | 508       | 231   | 270     | 1,152   | 588     | 8,749   |       |
| Other  | 21        | 107   | 12      | 0       | 0       | 0       |       |
| Current Liabilities                          | (132)     | (250) | (3,621) | (355)   | (42)    | (65)    |       |
| Creditors                                    | (132)     | (250) | (3,621) | (355)   | (42)    | (65)    |       |
| Short term borrowings                        | 0         | 0     | 0       | 0       | 0       | 0       |       |
| Long Term Liabilities                        | 0         | 0     | 0       | 0       | 0       | 0       |       |
| Long term borrowings                         | 0         | 0     | 0       | 0       | 0       | 0       |       |
| Other long term liabilities                  | 0         | 0     | 0       | 0       | 0       | 0       |       |
| Net Assets                                   | 1,159     | 4,603 | 8,245   | 18,615  | 21,708  | 30,372  |       |
| <b>CASH FLOW</b>                             |           |       |         |         |         |         |       |
| Operating Cash Flow                          | (133)     | (493) | (666)   | (1,372) | (684)   | (765)   |       |
| Net Interest                                 | 17        | 17    | 10      | 0       | 40      | 21      |       |
| Tax  | 18        | 3     | 3       | 5       | 0       | 0       |       |
| Capex  | (105)     | (819) | (3,839) | (5,237) | (3,485) | (525)   |       |
| Acquisitions/disposals                       | 0         | 0     | 0       | 0       | 0       | 0       |       |
| Financing                                    | 367       | 1,016 | 4,539   | 7,486   | 3,565   | 9,432   |       |
| Dividends                                    | 0         | 0     | 0       | 0       | 0       | 0       |       |
| Net Cash Flow                                | 163       | (276) | 48      | 882     | (564)   | 8,162   |       |
| Opening net debt/(cash)                      | (344)     | (508) | (231)   | (270)   | (1,152) | (588)   |       |
| HP finance leases initiated                  | 0         | 0     | 0       | 0       | 0       | 0       |       |
| Other  | (0)       | 0     | (9)     | 0       | 0       | 0       |       |
| Closing net debt/(cash)                      | (507)     | (231) | (270)   | (1,152) | (588)   | (8,749) |       |

Source: Chatham Rock Phosphate accounts, Edison Investment Research

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