16 November 2021

METALS & MINING

Flashnote

Marketing Communication (Connected Research)

PYX Resources#

BBG Ticker: PYX AO / LN *Price: A$1.68/sh. / £1.00/sh.* *Mkt Cap: A$722m / £426m* **BUY**

Dual Listed

LSE Listing Complete

PYX Resources (PYX AO/LN) has now been admitted to trading on the LSE and completed its first day of dealings yesterday closing at 99.6p/sh. This is a major milestone for the company which is now dual listed on the National Stock Exchange of Australia and on the standard list of the LSE Main Market.

Zircon Prices Increase Further

The company has increased prices by US$910/t YTD to US$2,305/t while Bloomberg indicates that Indonesian prices exceeded US$2,400/t in October, with a wider premium over other key benchmarks, implying a higher starting point for 2022F than we previously forecast. We have modestly increased our forecasts to reflect this. The key market fundamentals that created a strong backdrop for higher prices remain; strong demand post COVID-19 led to inventory drawdowns as major mineral sands producers reduced output in 2020 in response to lockdowns and initial perceptions that China's recovery would be slow. This tight market was highly vulnerable therefore to the closure of Richards Bay in South Africa, a major source of zircon. While this operation has now resumed, the ramp up is uncertain with force majeure still in place and the market remains undersupplied. Prices have continued to rise into Q4 despite it seasonally being a weaker period, highlighting the market tightness.

Ramp Up & Mining Transition Progress Update

The company reported H1 2021 production of 3.5kt, up 25% YoY, however, with the addition of a Mining Field Unit, which is currently undergoing testing, the company expects to have capacity of 24ktpa by year end. Having raised US$8.4m earlier this year, the company is well-positioned for the low capital modular growth programme. This combined with the transition to low-cost, in-house mining will enable PYX to capitalise on the strong market fundamentals and the large scale Mandiri and Tisma resources which have world-leading zircon grades that give PYX the potential for industry leading margins.

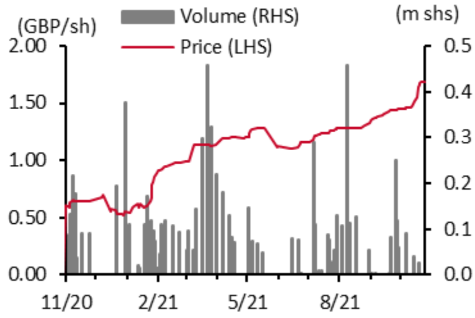
Target Price and Recommendation

Our risked DCF valuation continues to show upside potential based on strong zircon market fundamentals and the execution of PYX' growth programme. **We reiterate our Buy recommendation and increase our target price to A$2.90/sh and £1.60/sh.**

Company Description

Zircon Production in Kalimantan, Indonesia.

One Year Price Performance



Price % chg	1mn	3mn	12mn
	16.8%	32.8%	175.4%
12mn high/low			A$1.68/0.53

SOURCE: Eikon, as of 15 November 2021 close.

Market:	NSX/LSE
Shares in issue	429.5m
Target Price (A$/£/sh.)	2.90/1.60
Free float:	32.8%
Net cash (Dec 2021):	A$8.5m
Enterprise value:	A$713m

Major shareholders	
Phoenix Fund Solutions Ltd	21.5%
Takmur SPC Ltd	19.6%
Tisma (HK) Limited	12.0%

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Zircon Strong Fundamentals Underpin Investment Case

Through 2021, PYX has announced four price increases in March, May, June and September totalling US$910/t YTD with the latest increase being a significant jump of US$555/t to US$2,305/t. However, benchmark Indonesian prices have continued to increase in the fourth quarter with the key drivers including low inventories, strong demand, and reduced supply (in large part due to disruption at Richards Bay) continuing to keep the market tight.

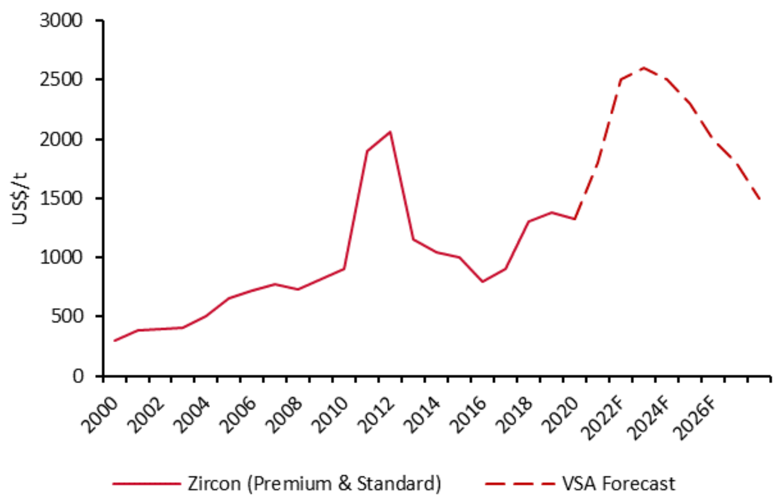
Furthermore, the benchmark in Indonesia has outperformed versus Australia where zircon prices have risen, albeit not as fast. Over the long run this is likely to normalise but in the short to medium term, the factors underpinning this change are likely to remain. We see three factors as key to this trend; cheaper shipping and logistics costs from Indonesia to China relative to other markets, China is also limiting purchases from Australia due to the ongoing geopolitical tensions and finally the export ban on low grade zircon which means that the Indonesian benchmark reflects only 65%+ zircon whereas reported prices from producers such as **Iluka (ILU AU)** are a blended price reflecting their unique product mix.

ILU reported a US$70/t increase in pricing in the early part of 2021, and in Q3 2021, the company announced a further US$125/t increase implying a weighted averaged zircon price of US$1,487/t (covering both standard and premium zircon). The company also indicated a planned US$120-170/t increase in Q4 2021 and highlighted that zircon sales are fully committed for the quarter. ILU zircon production of 231kt was up 86% YoY having been curtailed in 2020 owing to COVID-19, however, further increases are now likely to be limited given that the company highlighted running at full capacity for zircon output. We also note that ILU has indicated a higher proportion of zircon in concentrate to be produced in Q4 2021 which means that the weighted average cost will be softened due to the weaker product mix.

The 15% reduction in global output in 2020 to 1mnt of zircon was driven by a combination of disruption and curtailment as groups such as ILU attempted to second-guess the market reducing output as China's recovery surprised market participants. This forced a drawdown in inventories leaving the market tight. Therefore, the increases in supply by groups such as ILU have been insufficient to keep the market balanced, particularly with the shutdown of Rio Tinto's Richards Bay operation. Operational disruption dogged the Richards Bay operation for a number of months, which is the largest mineral sands and beneficiation company in South Africa. In June 2021, Rio announced after months of operational disruption that it was declaring force majeure on customer contracts. Security issues arising from protests by workers meant that Rio could not safely operate the assets. The announcement of force majeure was followed up by the announcement that the proposed US$473m expansion at Zulti South would not go ahead. Originally, this zircon expansion was planned to go ahead once the wider Richards Bay Minerals operation had been normalised. The expansion has been repeatedly delayed since 2016, and estimates suggest that zircon output would be 80-90ktpa. However, we note that in August Rio announced that operations would resume albeit with the force majeure remaining in place. Guidance has now been reinstated at 1mnt of TiO_2 slag, a 10% decline YoY, however, we note that the zircon output from Rio's operations outside of Richards Bay is minimal and is not routinely broken out in guidance or production updates.

In relation to **Tronox (TROX US)**, we highlight that although they have also reported strong YoY increases for zircon production where guidance is to be above 2020 and 2019 volumes. YoY increases were 81%,78% and 91% in Q3, Q2 and Q1, respectively, highlighting a significant increase. However, the company has guided that sales volumes in Q4 would be closer to production volumes with inventory having been worked down. Therefore, maintaining sales volumes at current rates is not sustainable, underpinning our view that incumbent producers are broadly at the upper end of their production capacity rates.

Zircon Price Chart, US$/t



***SOURCE:** Iluka, VSA Capital Research.*

Earnings Outlook

We have made further updates to our zircon forecasts primarily in years 2022F onwards due to the higher base going into the end of the year. Bloomberg reports that the Indonesian benchmark for 65% zircon has increased over 65% YTD to US$2,235/t. For 2021F, where we currently forecast US$1,800/t for 2020F, we highlight that our forecast average realised price for PYX is US$1,908/t based on the weighted average of our forecast sales. We therefore leave our forecasts unchanged for 2021F.

PYX announced production of 3,501t of zircon output in H1 2021, up 25% YoY. With 98% of employees having received a first dose of the vaccine we believe the company has put itself in a strong position to mitigate the impacts of further waves of COVID-19 operational performance which is supportive for near term production estimates as the company seeks to ramp up production towards the current 18ktpa and then 24ktpa capacity level before moving to 40ktpa and beyond.

VSA Commodity Price Forecasts

		2021	2022	2023	2024	2025	2026	2027	2028
Zircon (old)	USD/t	1,800	2,300	2,500	2,250	1,800	1,600	1,500	1,500
Zircon (new)	USD/t	1,800	2,500	2,600	2,500	2,300	2,000	1,800	1,500

***SOURCE:** VSA Capital Research.*

Currently, the company has 18ktpa of capacity and intends to increase this to 24ktpa imminently. Our forecasts broadly assume that production will increase to meet this in 2022F. We previously updated our capital spending forecasts to reflect the fundraise earlier in the year of US$8.4m, at a price of A$1.03/sh, although have now updated our production forecasts to reflect the ramp up guidance presented by the company across the two assets in line with the latest announcement which shows the company is targeting 7ktpa at Tisma and ramping up to 24ktpa at Mandiri.

Operating Highlights Table, US$ 000's

	2019A	2020A	2021F	2022F	2023F	2024F	2025F
Zircon production, kt	4,966	6,555	9,651	20,899	37,958	64,397	75,917
Ilmenite production, kt	-	-	-	1,680	2,880	4,320	5,760
Rutile production, kt	-	-	-	1,878	3,219	4,828	6,437
Operating costs, USD/t zircon	1,111	1,156	1,349	1,617	822	523	507
Revenue	6,858	8,957	18,416	55,206	104,287	169,091	183,588
EBITDA	86	(1,213)	3,604	13,200	42,002	77,082	89,636
Operating Profit	10	(14,063)	3,419	23,175	62,346	127,165	131,876
Net Income	(58)	(13,821)	2,534	19,312	45,232	94,776	97,167
P/E, x	neg	neg	nm	28.2x	12.0x	5.7x	5.6x
EV/EBITDA, x	0.1x	neg	nm	41.3x	13.0x	7.1x	6.1x
Capex	(148)	(749)	(5,000)	(6,750)	(3,000)	(500)	(13,000)
FCF	246	(3,365)	(1,326)	14,299	46,626	102,385	90,364

SOURCE: *Company data, VSA Capital Research.*

Our investment case centres around PYX transitioning to low-cost, in-house mining away from contract mining and investing free cash flow in growth to gain market share and capitalise on an historic opportunity within the zircon market. We expect that at Mandiri the transition to in-house mining will take between 18 months to two years before the full benefits of the switch are reflected in earnings. In the latest announcement, the company announced that US$1.1m was spent in H1 2021 on a Mining Field Unit. This is currently undertaking a test phase of production before being deployed and is an important step to successfully unlocking the value potential which we anticipate. Once testing is complete this will be deployed as the first in house mining capacity.

This in house mining will only account for a portion of the 2022F forecast, hence our gradual forecast reduction in unit costs. Indeed, with higher prices now forecast in 2022F due to the nature of the contract mining a portion of higher prices goes to the third-party miners. Longer term, PYX will be able to capture the full margin.

We highlight that in terms of capital, Mandiri provides indicative estimates for much of the capital costs, and pre-production costs for Tisma are projected at US$15m, with the main cost items being US$3.5m for the mining equipment and US$3.5m for separation plant and equipment to give 24ktpa capacity which we expect to be operational in 2023F. Further expansions of the same increment are likely to be around US$10m per increment at both projects.

We anticipate that through an increase to c200ktpa zircon output by 2030F, PYX can achieve annual EBITDA in excess of US$200mpa, assuming that unit costs of around US$420/t are achieved as we expect. Given the minimal sustaining capital required once the modular expansions of production capacity are achieved, EBITDA is a strong proxy for free cash flow generation. We believe that each modular 24ktpa expansion drives EBITDA growth of US$28mpa based on our long run US$1,500/t zircon price forecast (currently well below the spot price). This ability to deliver strong cash flow growth is the key to our investment case and we believe will be the major driver of future share price growth.

The transition to in-house mining will also have a significant and positive impact on PYX ESG credentials, in our view. Currently, by using contract miners, PYX has relatively less control over the activities and operating methods compared to in-house mining. PYX currently operates an Environmental Monitoring Plan, however, with wholly owned equipment and a directly employed workforce PYX will clearly be better able to directly enforce operating standards commensurate with a professional mining company.

Valuation

Our valuation of **PYX Resources (PYX NSX)** is based on a risked DCF valuation.

Our DCF valuation separates Mandiri and Tisma. Both are valued on an 11% WACC, suitable given the growth risks and jurisdiction. Our 15-year DCF implies that 50% of the resource will be exploited, we therefore apply a terminal value using a 2% growth rate to value the remaining portion of the resource. At Mandiri, which is an established producer, we do not apply a risk factor, however, with Tisma as a greenfield development asset we use 0.7x.

PYX is a top performer this year in the zircon and mineral sands space, up 67% YTD. This is due to the company's current 100% exposure to zircon, whereas for the peer group, zircon contributes just a portion of earnings. The second factor is the operationally leveraged nature of the business currently and the disproportionately positive impact on earnings of higher prices whilst the cost base is high. As the company transitions to low-cost, in-house mining, we believe that this will support the realisation of a higher future valuation. The funding round earlier in the year has unlocked the first stage of the growth programme and transition to in house mining and once this is executed over the next two years we expect PYX to have transitioned to being a producer with industry-leading margins across two of the highest grade zircon deposits in the world whilst having built up a strong marketing presence and track record of delivering high quality zircon. Indeed, the company has already significantly diversified its customer base with multiple offtakers with significant contracts.

The company produces a premium product with a unique weighting towards high value zircon. Mineral assemblage has a direct relationship to mineral sands mining profitability; with the value per tonne of mined product increasing against an unchanged cost base (ceteris parabis). Therefore, mineral assemblage has a direct bearing on valuation, in our view and informs our margin forecasts. PYX weighting to zircon is higher even than the majors.

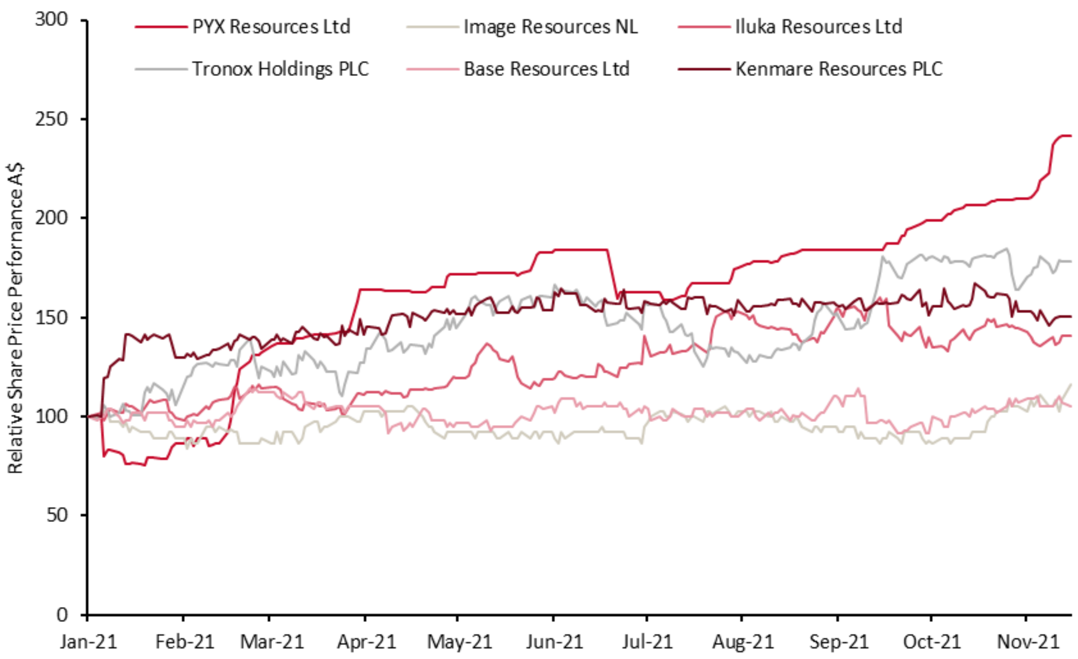
Our perception of the company is that it is a development company with a significant resource that is ramping up towards being a major industry player. Currently the valuation attributed to the stock reflects rising zircon prices, the scale of the resources and their unique high-grade nature. However, the ambition of the company to mine a resource in a manner commensurate to its scale means that currently we see the stock trading on 5.7X EV/EBITDA 2024F which for a mining development project is undemanding, in our view, since the broader development peer group currently has no production or revenue currently, however, the company does need to execute successfully on its expansion to realise this.

Peer Group Comparison

Company Name	Price Close	Company Market Cap	Current EV	Resources (in situ THM)	Weighted Avg Assemblage Value	EV/Resources	% Value
	Lcl Ccy	US$ m	US$ m	Mt	US$	US$/t	
PYX Resources Ltd	1.23	529	563	14.9	1,145	37.76	3.3%
Strandline Resources Ltd	0.15	173	94	30.0	518	3.14	0.6%
Image Resources NL	0.16	160	133	16.1	405	8.22	2.0%
Iluka Resources Ltd	6.70	2,836	2,700	126.8	367	21.29	5.8%
Tronox Holdings PLC	24.72	3,804	6,226	74.4	345	83.68	24.2%
Base Resources Ltd	0.22	259	194	70.9	324	2.74	0.8%
Kenmare Resources PLC	5.46	599	673	182.0	224	3.70	1.7%
Sheffield Resources Ltd	0.26	89	85	407.3	176	0.21	0.1%
Diatreme Resources Ltd	0.02	51	51	4.7	575	10.77	1.9%
Astron Corp (Private)	n/a	n/a	-	182.8	554		0.0%
Iluka Sierra Rutile 2016	n/a	n/a	337	8.2	1,015	41.07	4.0%

SOURCE: *Company data, Eikon, VSA Capital Research.*

Mineral Sands Relative Performance



SOURCE: *eikon, VSA Capital Research.*

Our sum of the parts target price for PYX is A$2.90/sh. which implies 73% upside potential.

Valuation Summary

Division	Division NAV, US$'000	Division NAV, A$'000	Attributable NAV, A$mn	P/NAV	Fair Equity Value, A$mn	Fair Equity Value, £mn
Mandiri	745,653	987,619	987,619	1.00	987,619	543,191
Tisma	279,569	370,289	370,289	0.70	259,203	142,561
Total NAV, A$mn					**1,246,822**	**685,752**
Consolidated Net Debt					(8.5)	(4.7)
Total Equity Value					**1,246,831**	**685,757**
# of shares					429,520,222	
Current price, AUD and £/share					1.68	1.00
Target Price, AUD/sh. and £/sh.					**2.90**	**1.60**

SOURCE: *Company data, VSA Capital Research. AUDGBP0.55*

Risks

- **Commodity Prices**. The company is primarily exposed to the mineral sands market and unexpected changes to commodity prices are likely to affect our valuation. Prices are based on industry benchmarks and often through direct negotiation which reduces transparency.
- **Political Risk.** Located in Indonesia and operating as a foreign owner of a mining business, the company is subject to a higher than normal level of jurisdictional risk as mining laws change frequently.
- **Macro Risk.** The company may choose to sell into global markets in which case currency exposure could be a risk.
- **Execution Risk.** The potential for delays and operating issues are an inherent industry risk, this may include delays in receiving financing or hold ups to the completion of development milestones.
- **Financing Risk.** Access to financing is a perennial risk for junior natural resources companies.

Appendix 1: Financial Statements

Profit and Loss (US$ 000's), Dec Year End

Profit & Loss	**2019A**	**2020A**	**2021F**	**2022F**	**2023F**
Revenue	**6,858**	**8,957**	**18,416**	**55,206**	**104,287**
Cost of sales	(5,596)	(7,630)	(13,016)	(25,775)	(30,685)
Gross Profit	1,262	1,327	5,400	29,430	73,602
Corporate and administration expenses	(1,094)	(7,732)	(1,980)	(6,255)	(10,744)
Selling & Distribution Expenses	(261)	(492)	-	-	-
Foreign Exchange Loss	(12)	(29)	-	-	-
Listing Costs	-	(5,357)	-	-	-
Acquistion Costs	-	(1,889)	-	-	-
Other Income	-	-	-	-	-
(Loss)/profit before income tax	**10**	**(14,063)**	**3,419**	**23,175**	**62,857**
Finance Income	-	-	-	-	-
Finance costs	(57)	(21)	-	-	-
Net finance costs	**(57)**	**(21)**	**-**	**-**	**-**
Profit before taxation	(47)	(14,083)	3,419	23,175	62,857
Finance Income	-	-	-	-	-
Finance costs	**(57)**	**(21)**	**-**	**-**	**-**
Profit before taxation	(47)	(14,083)	3,419	23,175	62,857
Mining and income tax	(11)	263	(752)	(2,847)	(14,846)
Profit for the year	(58)	(13,821)	2,667	20,328	48,012
Non controlling interest	38	(1,045)	(133)	(1,016)	(2,401)
Attributable to equity holders of the company	**(96)**	**(12,775)**	**2,534**	**19,312**	**45,611**

SOURCE: *Company data, VSA Capital Research.*

Balance Sheet (US$ 000's), Dec Year End

Balance Sheet	2019A	2020A	2021F	2022F	2023F
Non-current Assets					
Property, Plant & Equipment	655	1,318	6,133	12,625	15,183
Pre-production Expenditure	-	-	-	-	-
Total Non-Current Assets	**752**	**1,736**	**6,551**	**13,043**	**15,602**
Current Assets					
Trade & Other Receivables	469	369	505	1,512	2,857
Available for sale investments	-	77	77	77	77
Cash and bank balances	93	3,509	8,483	21,855	65,695
Total Current Assets	**963**	**4,430**	**9,669**	**24,553**	**70,410**
Total Assets	**1,715**	**6,166**	**16,220**	**37,597**	**86,012**
Equity					
Share Capital	1	14,873	22,817	22,817	22,817
Exchange Reserve	-	2,782	2,782	2,782	2,782
Retained Earnings	(102)	(12,877)	(10,210)	10,118	58,129
Total Equity	**705**	**4,521**	**15,132**	**35,460**	**83,471**
Current Liabilities					
Obligations Under Finance Leases	41	2	2	2	2
Trade & Other Payables	456	1,627	1,070	2,119	2,522
Total Current Liabilities	**990**	**1,629**	**1,072**	**2,120**	**2,524**
Total Equity & Liabilities	**1,715**	**6,166**	**16,220**	**37,597**	**86,012**

SOURCE: *Company data, VSA Capital Research.*

Statement of Cash Flows (US$ 000's), Dec Year End

Cashflow Statement	2019A	2020A	2021F	2022F	2023F
Cash Flows From Operating Activities					
Net income	**(58)**	**(13,821)**	**2,667**	**20,328**	**48,012**
Adjustments for:					
Depreciation	76	129	185	258	442
Share based payments	-	3,939	-	-	-
Loss on sale of available for sale investments	-	(103)	-	-	-
Impairment of available for sale investments	-	(41)	-	-	-
Impairment of exploration costs	-	(235)	-	-	-
Movements in working capital:	-	-	-	-	-
Decrease/(increase) in trade and other receivables	(389)	100	(136)	(1,008)	(1,345)
Decrease in trade and other payables	21	1,170	(557)	1,049	404
Change in working capital	(128)	1,167	(822)	(463)	(1,614)
Net cash generated by operating activities	**(110)**	**(2,087)**	**2,029**	**20,122**	**46,840**
Cash flows from investing activities					
Proceeds from sale of shares	-	-	-	-	-
Payment for property, plant and equipment	(148)	(785)	(5,000)	(6,750)	(3,000)
Payments for acquisitions, net of cash acquired	17	0	-	-	-
Other	2	(89)	-	-	-
Net cash (used in)/generated by investing activities	**(129)**	**(874)**	**(5,000)**	**(6,750)**	**(3,000)**
Cash flows from financing activities					
Proceeds from issue of share capital	0	9,379	8,400	-	-
Share issue costs	-	(2,618)	(420)	-	-
Net cash used in financing activities	**333**	**6,278**	**7,980**	**-**	**-**
Net increase in cash and cash equivalents	93	3,380	5,009	13,372	43,840
Cash and cash equivalents at the beginning of the year	**-**	**93**	**3,473**	**8,483**	**21,855**
Cash and cash equivalents at the end of the year	**93**	**3,473**	**8,483**	**21,855**	**65,695**

SOURCE: *Company data, VSA Capital Research.*

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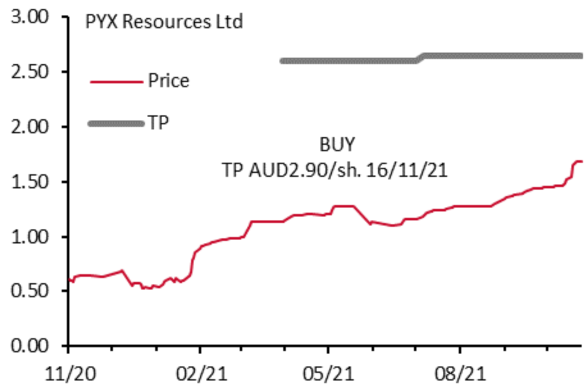
BUY: The stock is expected to increase by in excess of 10% in absolute terms over the next twelve months.
HOLD: The price of the stock is expected to move in a range between -10% and +10% in absolute terms over the next twelve months.
SELL: The stock is expected to decrease by in excess of 10% in absolute terms over the next twelve months.

In addition. on occasion. if the stock has the potential to increase by in excess of 10%. but on qualitative grounds rather than quantitative. a SPECULATIVE BUY may be used.

Distribution of VSA Capital Limited's Equities Recommendations

VSA Capital Limited must disclose in each research report the percentage of all securities rated by the member to which the member would assign a "BUY". "HOLD. or "SELL" rating. and also the proportion of relevant investments in each category issued by the issuers to which the firm supplied investment banking services during the previous twelve months. The said ratings are updated on a quarterly basis.

Recommendation and Target Price History



Valuation basis

Our valuation is derived from a risked NPV calculation and peer group EV/t in situ resource value.

Risks to that valuation

Commodity prices, political risk, execution risk, financing risk.

This recommendation was first published on 20 April 2021.