Flashnote

Marketing Communication (Connected Research)

PYX Resources#

BBG Ticker: PYX AO / LN *Price: A$1.30/£0.72/sh.* *Mkt Cap: A$558m/£308m* **BUY**

Full Year Results 2021

Earnings Highlights

PYX Resources (PYX AO/LN) achieved a 39% increase in revenue to US$12.4m in 2021 on the back of significant increases in zircon prices and modestly higher production and sales. Production of 7.2kt zircon was up 10% YoY, while the timing of sales meant that sales increased 2% YoY to 6.9kt. Operating margins strengthened with gross profit of US$1.9m, up 43% YoY whilst one-off costs reduced significantly meaning that the loss before tax narrowed from US$14.1m to US$4.5m, while the attributable net loss narrowed from US$13.8m to US$4.3m. Capex was limited at US$1.1m owing to the low cost nature of the capacity increases. This combined with a share placement during the year meant PYX finished the year with a strong balance sheet with no debt and cash of US$6.6m.

Zircon Prices Increase Further

PYX announced significant price increases through the year from around US$1,395/t in January to US$2,465/t by year end. Bloomberg data shows that the benchmark Indonesian price has continued to strengthen, up 19% through Q1 2022 to a current high of US$2,865/t. The Indonesian data continues to show a premium over public data from industry leaders **Iluka (ILU AU)** owing to geopolitical tensions between Australia and China, ILU's weaker product mix which includes <66% zircon, and shipping cost advantages from Indonesia.

Growth Outlook

Although production gains appear modest, the company made important progress expanding nameplate capacity, and in December, PYX achieved a step change in output of 1.2kt zircon, up 124% YoY. Given this and with nameplate capacity increased 33% to 24ktpa, we expect increased traction for production growth in 2022 underpinned by recent investment (post period end) of an initial US$4.5m with potential for a further US$9m. This will support the transition to low-cost, in-house mining that will enable PYX to capitalise on the strong market fundamentals and the large scale Mandiri and Tisma resources, which have world-leading zircon grades giving PYX the potential for industry leading margins.

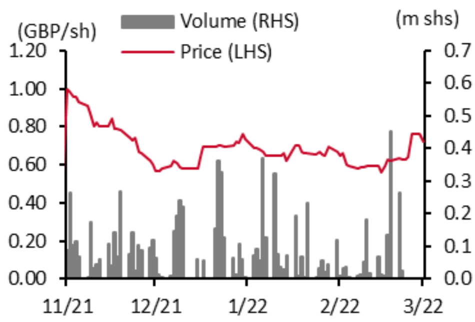
Target Price and Recommendation

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 target price of A$2.90/sh and £1.60/sh.**

Company Description

Zircon Production in Kalimantan, Indonesia.

One Year Price Performance



Price % chg	1mn	3mn	12mn
	9.1%	-26.3%	n/a
12mn high/low			£1.00/0.56

SOURCE: Eikon, as of 15 March 2022 close.

Market:	ASX/LSE
Shares in issue:	434.7m
Target Price (p/sh.):	A$2.90/£1.60
Free float:	32%
Net cash (Dec 2021):	£4.6m
Enterprise value:	£303.4m
Major shareholders	
Phoenix Fund Solutions Ltd	21.5%
Takmur SPC Ltd	19.6%
Phoenician Group Ltd	14.58%

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Earnings Highlights

PYX produced 7,233t of zircon in 2021, up 10% YoY while sales increased 2% YoY to 6,855t, generating revenue of US$12.4m implying average realised prices of US$1,811/t over the year. PYX announced significant price increases through the year from around US$1,395/t in January to US$2,465/t by year end. Bloomberg data shows that the benchmark Indonesian price has continued to strengthen, up 19% through Q1 2022 to a current high of US$2,865/t.

Cost of sales increased 38% YoY to US$10.5m in large part due to the ongoing use of contract miners meaning that costs are linked to realised prices of contained zircon. The transition to in-house mining breaks this link and is a major driver of our positive earnings outlook. That said, gross profit increased by 43% YoY to US$1.9m on the back of the higher top line. SG&A reduced by 55% owing to one-off costs in the prior year associated with the NSX listing costs and asset acquisition costs, however, these came in higher than our forecast although we note that US$2.4m were non-cash charges.

The reduction in one-off costs was the major reason for the narrowing in the bottom line with the net loss of US$4.3m in 2022 substantially lower than the prior year's US$13.8m.

Earnings Highlights

	2021	2020	% Change YoY
Production (t)	7,233	6,555	10%
Sales (t)	6,855	6,737	2%
Revenue (US$ '000)	12,417	8,957	39%
Gross Profit (US$ '000)	1,906	1,327	44%
PBT (US$ '000)	(4,530)	(14,083)	-68%
Net Income (US$ '000)	(4,321)	(13,821)	-69%
Capex (US$ '000)	(1,066)	(749)	42%
YE Cash Position (US$ '000)	6,624	3,509	89%

SOURCE: *Company Data, VSA Capital Research.*

Capital spending of US$1.1m was limited and primarily attributable to the development at Mandiri, highlighting the low-cost nature of PYX growth strategy. Given the narrowed loss and limited capex combined with a significant fundraise of cUS$8.4m, the company ended the year with cash of US$6.6m and no debt.

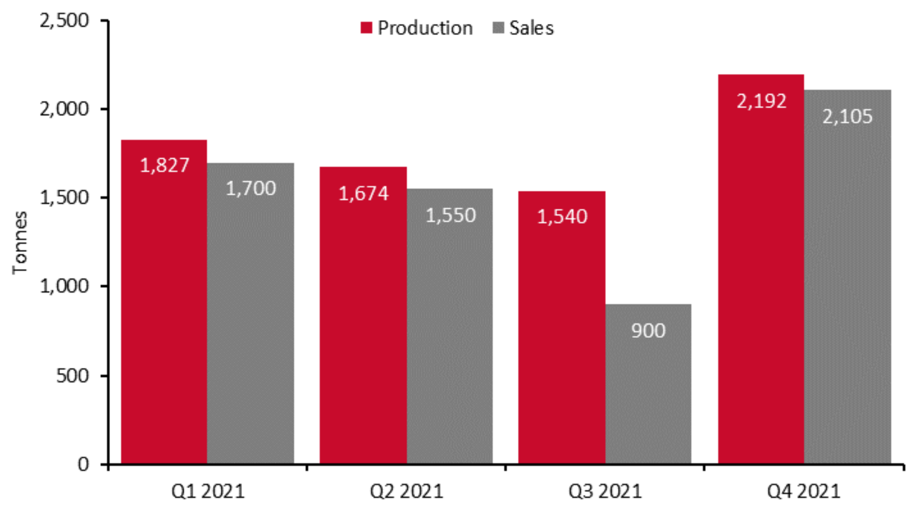
This has been further strengthened post period end with the announcement of a US$4.5m investment by L1 Capital, a US institutional investor who has the right to make further investments in equal tranches totalling US$9m. The initial tranche was issued in exchange for 3m shares. with the remaining tranches subject to mutual agreement between the company and the investor. This is a further significant injection of capital into PYX which will strengthen the company's ability to execute its growth strategy, in our view, at a time of rising prices.

Production Update

Looking at production within the year, output varied significantly but ended strongly with PYX having overcome some challenges in early H2 2021 due to flooding and the impact of the Delta wave of COVID-19. Although PYX successfully ensured that 100% of its workforce received two doses of the vaccine, the impact on the wider country created additional headwinds relating to logistics etc.

Flooding in Palangkaraya in November caused further disruption and we highlight that December accounted for over half of Q4's output at 1.2kt once operations normalised. This step change was achieved on the back of the expansion in nameplate capacity and increase in feed rates of heavy minerals to the plant. Sales volumes were also affected by these same factors, however, the disruption led to a slight discrepancy is sales and production which we expect to be made up in 2022 given that PYX has broadened its customer base and has reduced the reliance on its top three customers who now occupy 52% of volumes compared to 61% in the previous year.

Production & Sales Output



SOURCE: *Company Data, VSA Capital Research.*

The impact of the flooding was the main reason that production and the top line came in lower than our forecasts, however, based on the last month it shows that our estimates going forward are achievable. Furthermore, we highlight the acquisition of the Mine Field Unit (MFU) for roughly US$1.1m which enabled the company during 2021 to optimise the design and undertake a full-scale trial. This equipment will form the basis of the modular growth strategy and transition to in-house mining which will see costs dramatically reduced and we anticipate that the increase in December output was at least in part attributable to this.

The MFU is movable and enables the first stage of processing to be undertaken at the mine site, but it is operated in conjunction with a water management plan that includes site drainage, surface water catchment etc. This means that PYX post transition would be less exposed to disruption related to flooding events.

Changes to Earnings Estimates

Our macro forecasts are unchanged having upgraded our zircon estimates in December 2021. The impact of increasingly widespread lockdowns in China appears to be having a more significant impact on the economy than earlier waves of COVID. This adds a layer of uncertainty and could lead to some weakness in near-term pricing; however, this has been shown previously to be followed by a rapid recovery in pricing and is why we have not marked to market for the further price increase into 2022.

VSA Commodity Price Forecasts

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

SOURCE: *VSA Capital Research.*

At Mandiri, our expectations are unchanged with a target of 13.5kt zircon. The company demonstrated in December that this monthly output can be achieved and although seasonal factors such as Ramadan may impact output in Q2 2022, the recent investment should enable the company to progress with the growth strategy and transition to in-house mining. Currently, PYX pays contract miners a mining fee which is linked to the value of contained zircon. As prices rise, PYX benefits from a two thirds / one third split, with the contractors retaining a third of the upside.

Earnings Changes, US$'000

	Revenue			EBITDA			Net Income			Capex		
	Old	New	% Chg	Old	New	% Chg	Old	New	% Chg	Old	New	% Chg
2021F	18,416	12,417	-33%	3,604	(4,331)	-220%	2,534	(3,679)	-245%	(1,000)	(1,066)	7%
2022F	55,206	36,346	-34%	13,200	6,351	-52%	19,312	2,411	-88%	(6,750)	(5,750)	-15%
2023F	104,287	84,673	-19%	42,002	34,263	-18%	45,232	36,059	-20%	(3,000)	(6,500)	117%

SOURCE: *Company Data, VSA Capital Research.*

We have also updated our capex forecasts given the limited spending in 2021, with assumed spending at Mandiri pushed across into 2022F while at Tisma, all of our assumptions are pushed out by a year which accounts for the changes to the top line estimates in 2022F, with the knock-on impact on earnings dropping down.

The near-term investments are centred around further expansion of the company's Mandiri operations where production began in 2015, as well as the recently acquired greenfield Tisma deposit. Tisma will require modestly higher capex due to the need to build a plant rather than just additional equipment. However, Mandiri provides indicative estimates for much of the 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. Further expansions of the same increment are likely to be around US$10m per increment at both projects, unlocking the production size suitable for the size of resources and associated earnings potential through modular expansion.

Operating Highlights Table, US$'000

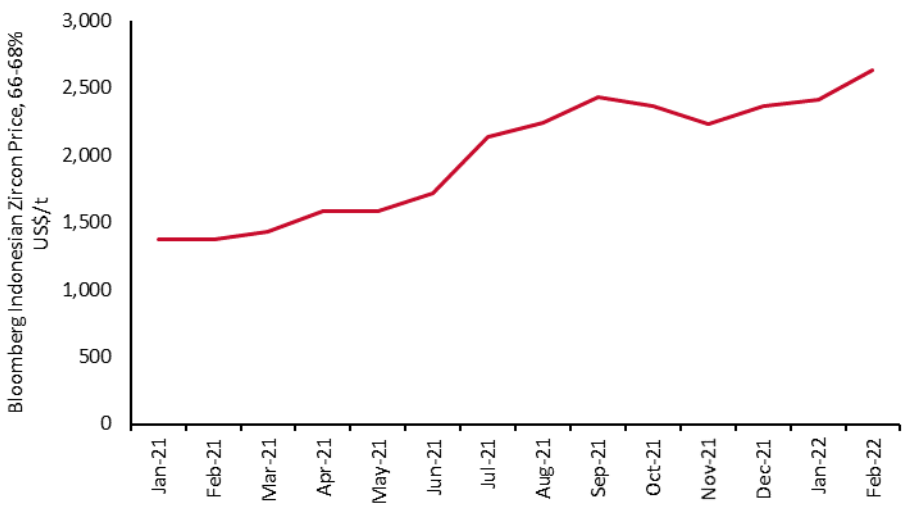
	2020A	2021F	2022F	2023F	2024F	2025F	2026F
Zircon production, kt	6,555	7,233	13,439	30,499	49,478	75,917	98,956
Ilmenite production, kt	-	-	1,680	2,880	4,320	5,760	8,640
Rutile production, kt	-	-	1,878	3,219	4,828	6,437	9,656
Operating costs, per tonne zircon	1,156	1,453	1,858	970	717	517	498
Revenue	8,957	12,417	36,346	84,673	131,371	183,588	210,896
EBITDA, US$	(14,517)	(4,331)	6,351	34,263	60,317	86,256	110,317
Operating Profit	(14,063)	(4,518)	3,613	44,744	80,191	128,479	140,533
Net Income	(13,821)	(3,679)	2,411	36,059	64,861	105,114	114,260
P/E, x	neg	neg	nm	15.3x	8.5x	5.2x	4.8x
EV/EBITDA, x	neg	neg	nm	16.1x	9.1x	6.4x	5.0x
Capex	(749)	(1,066)	(5,750)	(6,500)	(3,500)	(3,250)	(20,000)
FCF	(3,365)	(4,520)	(3,406)	30,101	60,655	99,954	91,010
FCF Yield, %	-5%	-6%	-5%	41%	84%	138%	125%
EBITDA margin, %	-14%	-35%	17%	40%	46%	47%	52%

SOURCE: *Company data, VSA Capital Research.*

Zircon Update

Through 2021, PYX announced four price increases in March, May, June and September totalling US$910/t to US$2,305/t with the company reporting that the realised price at the end of December had further increased to US$2,495/t in line with the increases in the Bloomberg Indonesia zircon price index. Post year end, this has continued to increase in Q1 2022 and now stands at US$2,895/t. However, the latest news from China is that widespread lockdowns are now in progress with ports and industry disrupted. This anecdotally feels more significant than prior waves and we therefore would not rule out near-term price volatility. Given the prior experience that prices tend to bounce back strongly, we are comfortable with our current forecast of US$2,600/t for the full year, particularly as the Indonesian premium is strongly geared to the China market.

Indonesian Zircon Price



SOURCE: *Bloomberg, VSA Capital Research.*

Over the long run, this premium is likely to normalise but in the short to medium-term, the factors underpinning this change are likely to remain. These factors are; 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.

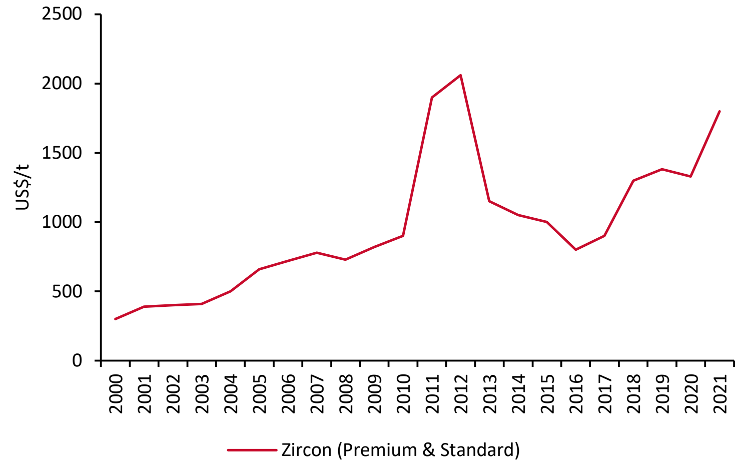
ILU reported strong zircon price performance in their 2021 full year results with a price increase of US$220/t effective from January 1 2022, up from a weighted average realised price of US$1,590/t. Full year sales of 355kt were up strongly by 48% YoY reflecting a recovery in production post COVID-19 and sales from inventory.

The company reported two other factors which are notable for PYX. Firstly, ILU is forecasting global production to fall by around 25% by 2025F from approximately 1mntpa in 2021 on the back of declining output from existing projects and a limited pipeline of projects globally. Furthermore, they highlight that of the project pipeline that does exist, more than half of the potential volumes cannot be sold into high quality markets due to high uranium and thorium contents above 500ppm. PYX performs well on this metric and the high-quality nature of the zircon at its Mandiri and Tisma projects means the combined content is below 450ppm; a key reason why PYX has been able to realise such strong pricing.

Operational disruption dogged the Richards Bay operation for a number of months; it is the largest mineral sands and beneficiation company in South Africa and Rio Tinto output in 2021 was 9% lower YoY on a titanium slag basis. In August, Rio announced that operations would resume albeit with the force majeure remaining in place. Zircon output from Rio's operations outside of Richards Bay is minimal and is not routinely broken out in guidance or production updates but the titanium slag guidance indicates some recovery in 2022.

In relation to **Tronox (TROX US)**, it appears that inventories have now been worked down with production volumes in line with sales volumes and revenue increases now largely attributable to changes in price. Output is also thought to be close to nameplate capacity.

Long Term Zircon Price Chart, US$/t

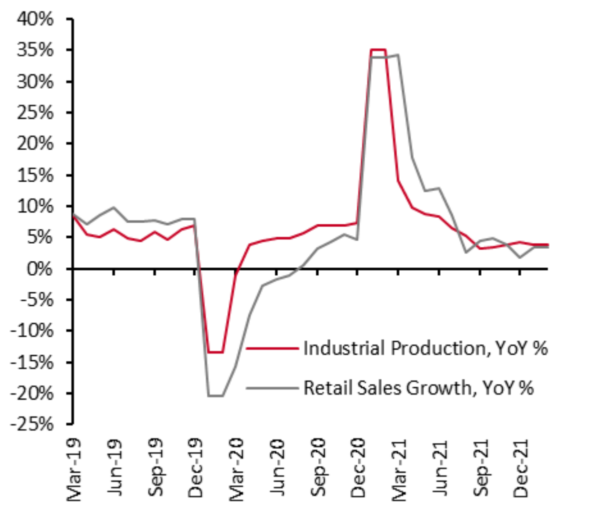


SOURCE: *Iluka, VSA Capital Research.*

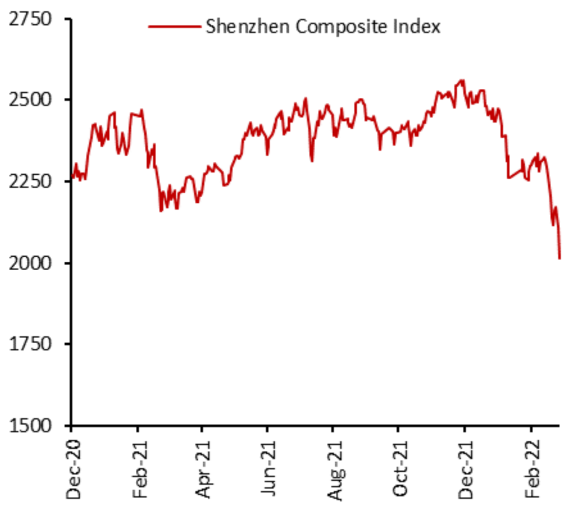
China's equity markets are under severe pressure currently both in terms of mainland valuations (Shenzhen) and offshore (Hong Kong), down 18% and 14% respectively YTD. A global rotation out of highly valued tech stocks on the back of rising cost of capital has driven this compounded by concerns over China's real estate market and high-profile defaults of Evergrande and Kaisa Group. We have previously written about how China's equity markets are a more useful barometer of sentiment rather than the strength of the underlying economy. This has been highlighted by today's bounce as the government committed to keep capital markets stable, support overseas stock listings, continue dialogue on US ADRs and indicated that the tech crackdown would end soon.

The central government has changed its view on monetary policy in light of the downturn in the real estate market, which accounts for about 25% of GDP, loosening key interest rates in Q1 2022. It has also instructed banks to accelerate mortgage approvals although rules on cash down payments remain strict (lessons were learnt from the US subprime crisis to avoid a repeat). These will likely begin to feed through into a stronger performance in-house prices and sales as 2022 continues, with knock-on impacts to white goods demand and other industries linked to real estate performance. The impact of this is visible in the slowdown in industrial production rates to 4.3% and 3.75% in December and January (this figure hasn't typically fallen below 5% in the past). This means that prices have been strong in an environment where demand for zircon was likely constrained, however, with the loosening cycle now providing policy support this could lead to a recovery later in the year.

China Industrial Production



Shenzhen Composite Index



SOURCE: *Eikon, VSA Capital Research.*

Therefore, while the near-term focus of markets is Omicron, and this could have a near term negative impact the broader trend is now of stimulus which should support a strong bounceback after the omicron wave recedes and given the experience of other countries whilst it may lead to the government losing face the impact should recede quickly.

Valuation

Our valuation of **PYX Resources (PYX LN/AO)** 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 apply a discount factor of 0.7x. Despite adjustments to our near-term forecasts rolling over, our model brings forward the higher earnings potential at Mandiri with a positive offsetting impact.

With the support from the recently announced investment we see PYX moving more actively into the execution phase for its ambitious growth programme. This funding should unlock the self-sustaining growth programme which we believe will enable PYX to realise the upside potential from its inherently large and high grade zircon projects.

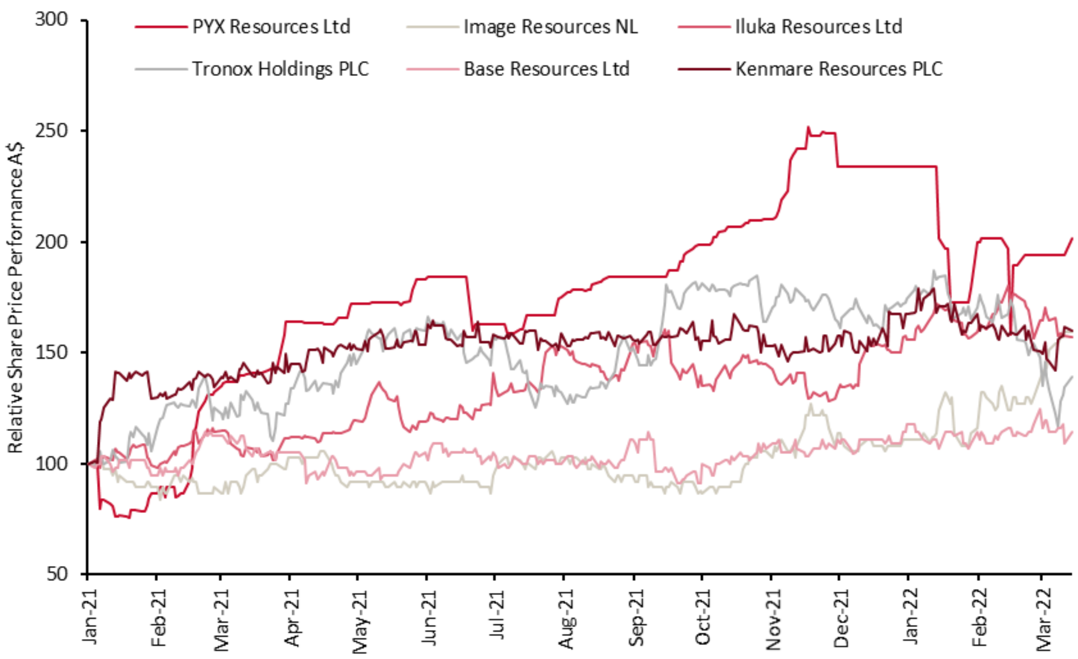
As the company transitions to low-cost, in-house mining, we believe that this will support the realisation of a higher valuation. At that point, we expect PYX to have transitioned to being a producer with industry-leading margins across two of the highest-grade zircon deposits in the world whilst having built up a strong marketing presence and track record of delivering high quality zircon. We do, however, highlight that PYX is uniquely placed in Indonesia, which previously acted as a swing producer in the last zircon boom and is not able to respond in the same way due to the low-quality product typically produced by informal miners which does not meet the new export criteria.

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	**0.93**	**401**	**435**	**14.9**	**1,145**	**29.19**	**2.5%**
Strandline Resources Ltd	0.24	267	317	28.4	518	11.16	2.2%
Image Resources NL	0.22	218	196	20.1	405	9.73	2.4%
Iluka Resources Ltd	7.16	3,035	2,917	185	367	15.77	4.3%
Tronox Holdings PLC	19.30	2,971	5,367	78.1	345	68.72	19.9%
Base Resources Ltd	0.22	254	218	70.7	324	3.08	1.0%
Kenmare Resources PLC	5.76	545	620	181.9	224	3.41	1.5%
Sheffield Resources Ltd	0.34	118	117	313.0	176	0.38	0.2%
Diatreme Resources Ltd	0.02	46	47	4.8	575	9.70	1.7%
Astron Pty Ltd	0.57	70	78	22.1	554	3.52	0.6%
Iluka Sierra Rutile 2016	n/a	n/a	337	8.2	1,015	41.07	4.0%

SOURCE: *Company data, 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. / £1.60/sh. which implies 123% upside potential.

Valuation Summary

Division	Division NAV, A$'000	Attributable NAV, A$mn	P/NAV	Fair Equity Value, A$mn	Fair Equity Value, £mn
Mandiri	1,014,896	1,014,896	1.00	1,014,896	558,193
Tisma	337,136	337,136	0.70	235,995	129,797
Total NAV, £mn				**1,250,891**	**687,990**
Consolidate Net Debt				(8,360)	(4,598)
Total Equity Value				**1,259,251**	**692,588**
# of shares				434,703,116	239,086,714
Current price, AUD/£ p/sh.				1.30	0.74
12-mo Target Price, AUD/£ p/sh.				**2.90**	**1.60**

SOURCE: *Company data, VSA Capital Research.*

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), Dec Year End

Profit & Loss	2020A	2021F	2022F	2023F	2024F
Revenue	**8,957**	**12,417**	**36,346**	**84,673**	**131,371**
Cost of sales	(7,630)	(10,511)	(25,222)	(29,579)	(35,463)
Gross Profit	1,327	1,906	11,124	55,095	95,908
Corporate and administration expenses	(7,732)	(4,196)	(7,511)	(10,351)	(15,717)
Selling & Distribution Expenses	(492)	(951)	-	-	-
Foreign Exchange Loss	(29)	(350,011)	-	-	-
Listing Costs	(5,357)	(928)	-	-	-
Acquistion Costs	(1,889)	-	-	-	-
Other Income	-	-	-	-	-
(Loss)/profit before income tax	**(14,063)**	**(4,518)**	**3,613**	**44,744**	**80,191**
Finance Income	-	-	-	-	-
Finance costs	(21)	(12)	-	-	-
Net finance costs	**(21)**	**(12)**	**-**	**-**	**-**
Profit before taxation	(14,083)	(4,530)	3,613	44,744	80,191
Finance Income	-	-	-	-	-
Finance costs	**(21)**	**(12)**	**-**	**-**	**-**
Profit before taxation	(14,083)	(4,530)	3,613	44,744	80,191
Mining and income tax	263	209	(1,316)	(10,402)	(18,418)
Profit for the year	(13,821)	(4,321)	2,297	34,342	61,773
Non-controlling interest	(1,045)	(642)	(115)	(1,717)	(3,089)
Attributable to equity holders of the company	**(12,775)**	**(3,679)**	**2,411**	**36,059**	**64,861**

SOURCE: *Company data, VSA Capital Research.*

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

Balance Sheet	2020A	2021F	2022F	2023F	2024F
Non-current Assets					
Property, Plant & Equipment	1,318	2,228	7,610	13,479	16,031
Pre-production Expenditure	-	-	-	-	-
Total Non-Current Assets	**1,736**	**76,056**	**81,438**	**87,307**	**89,859**
Current Assets					
Trade & Other Receivables	369	969	996	2,320	3,599
Available for sale investments	77	279	279	279	279
Cash and bank balances	3,509	6,624	8,360	44,205	101,989
Total Current Assets	**4,430**	**8,740**	**10,470**	**48,301**	**108,005**
Total Assets	**6,166**	**84,797**	**91,908**	**135,608**	**197,864**
Equity					
Share Capital	14,873	96,651	96,651	96,651	96,651
Exchange Reserve	2,782	3,883	3,883	3,883	3,883
Retained Earnings	(12,877)	(16,556)	(14,259)	20,082	81,855
Total Equity	**4,521**	**83,037**	**85,333**	**119,675**	**181,447**
Current Liabilities					
Obligations Under Finance Leases	2	2	2	2	2
Trade & Other Payables	1,627	1,758	2,073	2,431	2,915
Total Current Liabilities	**1,629**	**1,760**	**2,075**	**2,433**	**2,917**
Total Equity & Liabilities	**6,166**	**84,797**	**87,408**	**122,108**	**184,364**

SOURCE: *Company data, VSA Capital Research.*

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

Cashflow Statement	**2020A**	**2021F**	**2022F**	**2023F**	**2024F**
Cash Flows From Operating Activities					
Net income	**(13,821)**	**(4,321)**	**2,297**	**34,342**	**61,773**
Adjustments for:					
Depreciation	129	188	368	631	947
Share based payments	3,939	2,062	-	-	-
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	100	(666)	(27)	(1,324)	(1,279)
Decrease in trade and other payables	1,170	(9)	315	358	484
Change in working capital	1,167	(1,275)	321	(1,628)	(1,435)
Net cash generated by operating activities	**(2,087)**	**(2,283)**	**2,986**	**33,345**	**61,284**
Cash flows from investing activities					
Proceeds from sale of shares	-	-	-	-	-
Payment for property, plant and equipment	(749)	(1,066)	(5,750)	(6,500)	(3,500)
Payments for acquisitions, net of cash acquired	0	-	-	-	-
Other	(89)	-	-	-	-
Net cash (used in)/generated by investing activities	**(838)**	**(1,066)**	**(5,750)**	**(6,500)**	**(3,500)**
Cash flows from financing activities					
Proceeds from issue of share capital	9,379	8,448	4,500	9,000	-
Share issue costs	(2,618)	(770)	-	-	-
Net cash used in financing activities	**6,278**	**6,759**	**4,500**	**9,000**	**-**
Net increase in cash and cash equivalents	3,416	3,115	1,736	35,845	57,784
Cash and cash equivalents at the beginning of the year	**93**	**3,509**	**6,624**	**8,360**	**44,205**
Cash and cash equivalents at the end of the year	**3,509**	**6,624**	**8,360**	**44,205**	**101,989**

SOURCE: *Company data, VSA Capital Research.*

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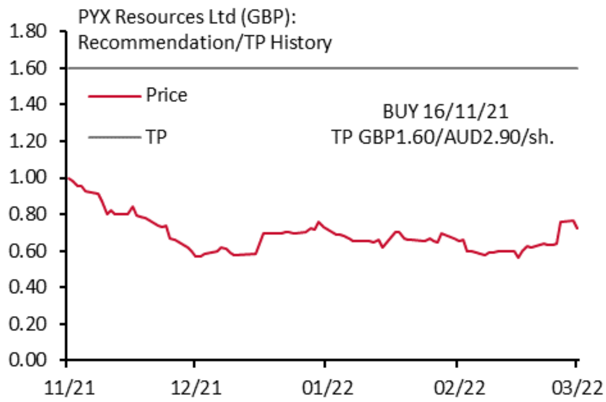
Recommendation and Target Price History



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.

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