

ORION MINERALS

ORION - 1 YEAR ON

Updating our valuation for PCZM and the inclusion of the Okiep Scoping Study Project raises Orion's valuation to ZAR 97.1cps

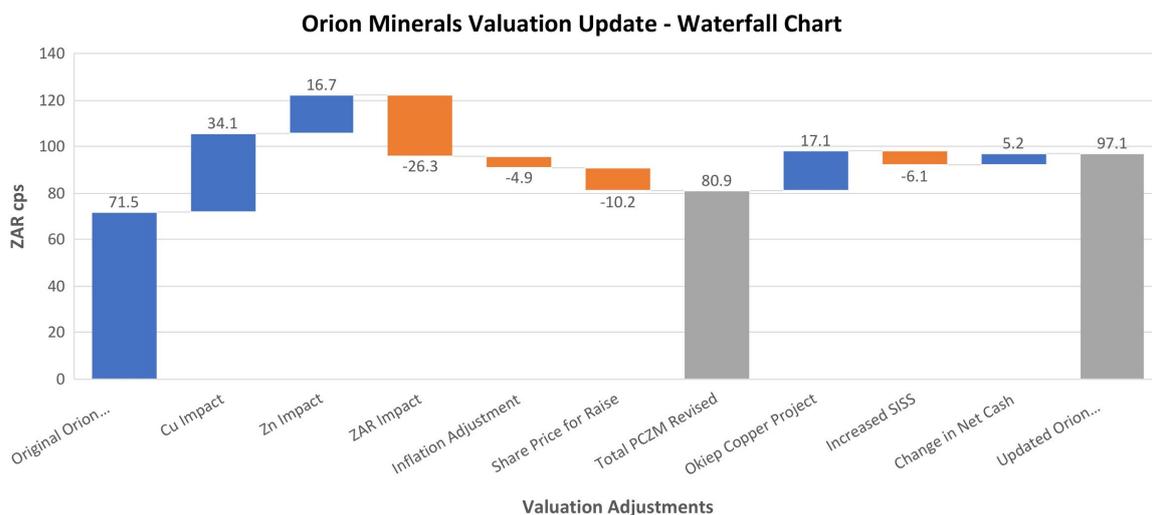
In November 2020, we initiated on Orion Minerals Ltd with a base case valuation of ZAR71.5cps that was largely under-pinned by its Prieska Copper Zinc Mine Project (PCZM). In this note, we revisit our valuation of Orion one year later. We have adjusted PCZM for up-to-date commodity prices and exchange rates whilst allowing for a year's inflation creep on costs and capex. We have included a scoping study valuation for the Okiep Copper Project, also updated. Lastly, we have made the necessary adjustments to reflect the current share price, the number of shares in issue and the current net cash position on the balance sheet.

ASX / JSE : ORN	
Price (4/11/2021)	ZAR 36cps
S2R Valuation	ZAR 97cps
Market Cap	ZAR 1,556m
Shares in Issue	4,321m

The adjustments to the valuation inputs may be summarised as follows;

- The copper price used has been increased to US\$ 9,500/t (US\$ 6,834/t).
- The zinc price has been increased to US\$ 3,000/t (US\$ 2,535/t).
- The South African exchange rate has been reduced to ZAR/US\$15.00 (ZAR/US\$ 17.25).
- An inflationary adjustment of 5% has been made to both capex and working costs.
- The share price used for future corporate activities has been reduced to ZAR 30cps (ZAR 38cps) and a 10% discount to this has been applied.

Our new base case valuation for Orion Minerals after these adjustments is ZAR97.1cps (AUD8.4cps) with the changes to valuation summarised in the chart below;



Further upside to this base case valuation is anticipated from life of mine extensions and modern processing efficiencies at PCZM, further development of mining opportunities at Okiep and other on-going exploration activities by Orion within its tenement portfolio.

Background

In November 2020, we initiated on Orion Minerals Ltd (Orion) with a base case valuation of ZAR 71.5cps. The valuation was predominantly attributable to the Prieska Copper-Zinc Mine Project (PCZM) with additional value from other exploration assets held in the Northern Cape and in Australia. Earlier the same year, Orion had published an updated feasibility study on PCZM and was looking to finalise funding arrangements.

Funding was anticipated to be in place by the end of June the following year, 2021. Whilst there is no doubt that global COVID uncertainty played a part in the financing delay, domestic political uncertainty, social unrest and contract/tender related violence highlighted the risk of doing business in South Africa.

We now revisit our valuation for Orion one year later. The Covid crisis appears to have passed its peak and commodity prices are holding steady at much higher levels than a year ago. We now expect funding for PCZM to be finalised in the first half of calendar 2022 implying a 12-month delay on project cashflows.

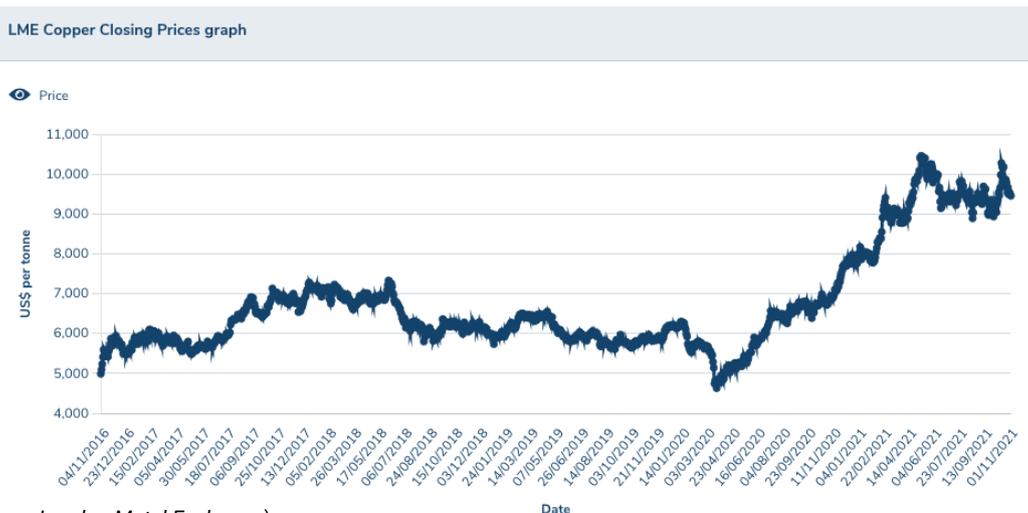
PCZM Update

In revisiting the valuation of PCZM, we have adjusted certain valuation inputs to take into account both the 12-month delay and changes in market fundamentals. The most significant impacts on valuation resulting from this delay arrive from a more optimistic outlook on metal prices, offset by a stronger than expected base currency (ZAR) and the inflationary creep on capital and working costs over the last 12 months. We have also modeled the impact of the lower share price that would increase the dilutionary impact of the equity raise that we expect to form part of the funding for this project.

Commodity Price Forecasts

Both the copper price and the zinc price have exceeded original expectations, the copper price much more so than the zinc price. Both equally impact the revenue line as each commodity contributes approximately 50% of revenue.

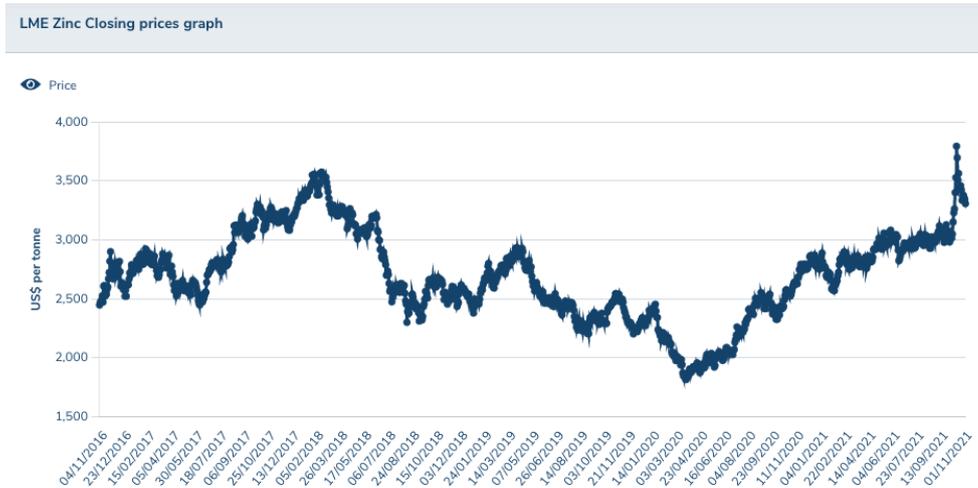
The copper price has benefitted from the consensus view of a robust demand profile supported by an increasingly green/electrified economy. At the same time, the supply side of the equation remains characterised by declining production profiles of existing producers and a lack of availability of meaningful new projects with short lead times to market to fill the gap.



(Source : London Metal Exchange)

The value we calculated for PCZM in our initiation report assumed a price of US\$ 6,834/t for copper. We have adjusted our mid-point price forecast to US\$ 9,500/t. This upgrade in the copper price adds ZAR 34.1cps to Orion's valuation.

The zinc price has been less supported by this new-age demand hypothesis, it being more tied to basic GDP growth and related construction demand with no significant supply-side constraints visible. The market in zinc is anticipated to be more balanced and the price outlook more driven by cost curve fundamentals.



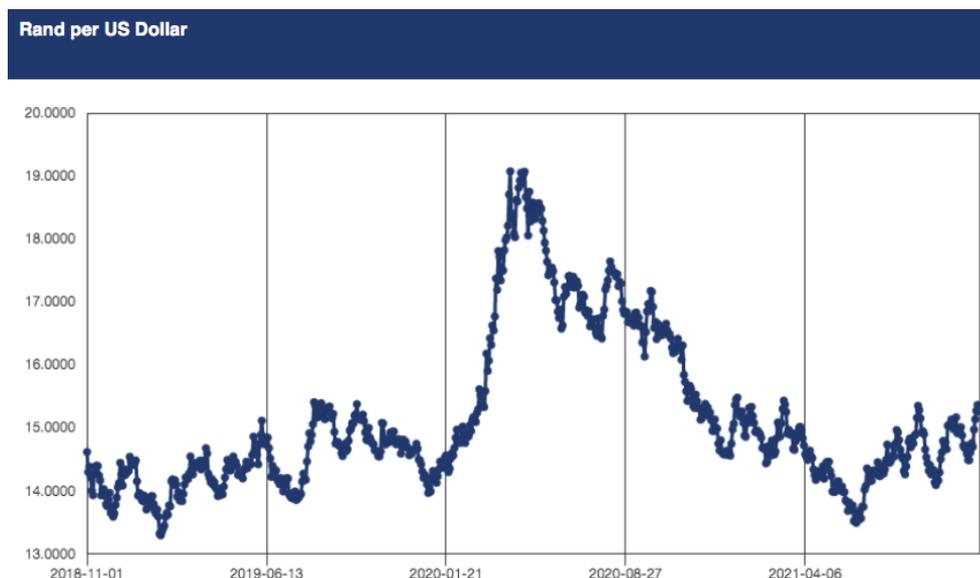
(Source : London Metal Exchange)

Zinc prices recently peaked at close to US\$ 3,800/t due to shortages in zinc concentrate related to COVID mine shutdowns and environmentally motivated closures in China. We consider these to be short-term in nature and have adjusted our mid-point price forecast to US\$ 3,000/t from US\$ 2,337/t. The upgrade in the Zinc price adds ZAR 16.7cps to Orion’s valuation.

Exchange Rates

The South African exchange rate (ZAR) has been firmer than expected. Macro-fundamentals for the currency have been supportive such as firm commodity prices and attractive local yields, whilst inflation has remained within the SARB’s target band.

The ZAR is the most important driver of valuation as the entire revenue stream is impacted whilst variable mining costs are less sensitive. Our valuation previously used a ZAR/US\$ 17.50 exchange rate. We have moved the mid-point for our currency forecast to ZAR/US\$ 15.00. The strengthening Rand offsets the commodity price benefits to some degree, reducing our valuation by ZAR 26.3cps.



Inflation

We have escalated both working costs and the project capital budget by 5% to adjust for the inflationary impact of the 12-month delay in the project start date. The impact of this inflation adjustment reduces the value to Orion shareholders by ZAR 4.9cps.

Share price devaluation

The Orion share price has fallen by some 20% since our initiation note in November 2020, from ZAR 38cps to ZAR 30cps. In our opinion, the PCZM Project will require an equity capital injection from Orion that would be funded by a significant capital raise. We have modeled an equity raise of approximately ZAR 1.3bn at a 10% discount to the prevailing market price, ZAR 30cps. The fall in share price requires more shares to be issued resulting in dilution of approx. ZAR 10.2cps.

Okiep Copper Project

In Feb 2021, Orion announced its ambition to re-develop the Okiep Copper District (Okiep) in the Northern Cape. In our report of 21 May 2021, we valued the “proof-of-concept” Scoping Study release at ZAR 14cps attributable to Orion shareholders. We have updated our valuation model for Okiep with the copper price and exchange rate noted above in the discussion of PCZM. Our new valuation for the Okiep Scoping Study increases accordingly to ZAR 17.1cps.

Shares in issue

Orion raised AUD\$ 25m in March 2021 to accelerate the development of the Okiep Copper Project, issuing 694m shares. In addition, there have been other smaller share issuances since November 2020 to satisfy various obligations including specific vendor obligations under the Okiep acquisition terms. In total, on a fully diluted basis, the number of shares in issue has increased from 3.648m as used in the original model to 4.321m currently. This has a dilutive effect ZAR 6.1cps.

Balance sheet cash

The Group raised AUD\$ 25m in March 2021 and converted the AUD\$ 5.0 loan facility granted by Tembo Capital in June 2021. These actions have moved the net debt position from AUD\$ 6.9m as at 30 June 2020 to net cash position of c.AUD\$12.9m as at 30 September 2021. To the extent that cash has been utilised to fund projects during the period, these cash flows would already be included in the NPV of that project and as such should not be considered as a reduction in net cash. We therefore allocate AUD\$ 25m to valuation based on the above, equating to ZAR 5.2cps.

Conclusion

We conclude that our base case valuation has increased from ZAR 71.5cps to ZAR 97.1cps on account of an uplift in the PCZM valuation of net ZAR9.4cps, due primarily to stronger commodity prices, and the inclusion of value attributable to shareholders associated with the Okiep Copper Project transaction that we calculate to be ZAR 17.1cps.

Significant further valuation upside opportunities exist at both PCZM and Okiep. At PCZM, life-of-mine extensions on account of resource conversion, pillar mining and the fact that the orebody is open at depth are highly likely. Further, improved processing efficiencies and recoveries based on the application of modern technologies not incorporated in the base case feasibility study can be anticipated.

At Okiep, exploration results obtained since the transaction have affirmed its potential to be redeveloped into a world-class copper mining district in line with Orion’s ambitions. Additional exploration activities along both the Areachap Belt in the Northern Cape of South Africa and the Fraser Range in Australia remain future value accretive options that sit within Orion’s opportunity portfolio.

ANALYST VERIFICATION

I, Simon Hudson Peacock, hereby certify that the views expressed in this research accurately reflect my personal views about Orion and no part of my compensation is directly or indirectly related to the inclusion of specific recommendations or views in this research.



Simon Hudson-Peacock is a Mining Engineer turned Investment Analyst and Portfolio Manager. Simon started his career as a Junior Mining Engineer at Impala Platinum Ltd before entering financial services as a Mining Analyst. Simon has over 25 years experience in the fund management industry both on the buy-side and sell-side, specialising in the mining sector. Simon has a B.Eng (Mining) with Commendation from the Camborne School of Mines, an MBA from the University of Cape Town and is a CFA Charter Holder.

S2 Research is a boutique investment research house specialising in the South African Mining Industry.

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