

Heron Resources Limited (ASX:HRR)

Project slippage but now on home straight

Events

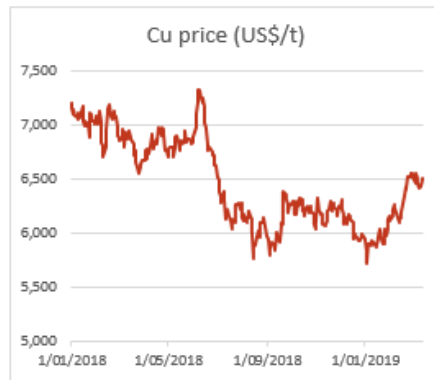
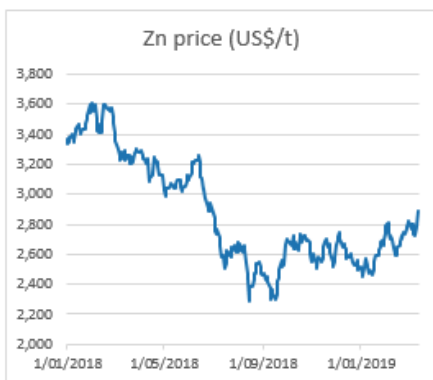
On 12 March 2019, Heron Resources (ASX:HRR) announced an update for its Woodlawn Zn-Cu Project.

- First underground development ore delivered to the ROM pad
- Underground development advance exceeding plan
- Hydraulic mining commissioning well advanced
- Overall process plant completion at 98% as at end of February
- Process plant commissioning at 63% as at end February
- First concentrate production now scheduled for early in the June 2019 quarter

State One comment

Maiden production at Woodlawn has slipped from an initial target in the March 2019 quarter to early in the June 2019 quarter. On 4 February the EPC contractor Sedgman lodged a claim for A\$49.9m in progress fees above and beyond its A\$109m Guaranteed Maximum Price (GMP) contract. While this claim was rejected by the Contract Superintendent on 18 February, the contractor has followed up with an increased claim of A\$53m; this is currently being assessed by the Contract Superintendent. While we note management's comments in its 4 February announcement that the progress claim dispute was not influencing construction, commissioning or production activities, we suspect the protracted nature of the dispute has had (or is having) some impact on the principal/contractor working relationship.

On a more positive note, we see that Zn and Cu prices have recovered from their January 2019 lows – this is a positive development as the two metals in aggregate account for 75% of our forecast Woodland Project LOM revenues. The current (LME) Zn price of US\$2,888/t is some 11% above our base-case forecast Zn price of US\$2,600/t (real); the current (LME) Cu price of US\$6,500/t is some 5% above our base-case forecast Cu price of US\$6,175/t (real). Thus, near-term revenues could be higher than forecast, and mitigate against the slippage in first concentrate production.



Risk-weighted target price: A\$1.35ps (A\$1.40ps previously)

Relative to current share price levels, our risk-adjusted NPV-derived target price of A\$1.35ps (A\$1.40ps previously) offers significant (>100%) upside potential. **We maintain a Speculative Buy (Higher Risk) recommendation.**

Risks to our earnings profile and target price include, but are not limited to: commodity price (Cu, Zn, Pb, Au, Ag) and AUD:USD exchange rate volatility, grade volatility and/or lower than expected Resource tonnage, metallurgy and recovery rates – particularly at the high grade u/g operations, commissioning, production start-date and ramp-up profile, offtake beyond current three-year offtake agreements, capital and operating cost, changes to mining and environmental regulation.

15 March 2019

Share Price: A\$0.665

Target Price: A\$1.35

Target Upside: 103%

Recommendation

Speculative Buy

Risk Assessment

Higher

Resources – Zinc/Copper/Lead/Silver/Gold

David Brennan, CFA

Senior Investment Analyst

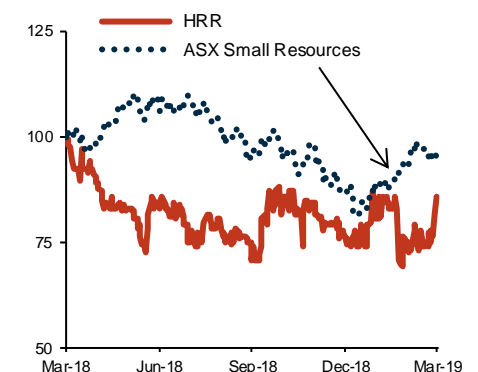
dbrennan@stateone.com.au

+61 02 9024 9142

Heron Resources Limited

| | |
|------------------------------|-----------------|
| ASX Code | HRR |
| 52-week range (A\$cps) | A\$0.53-A\$0.83 |
| Market Cap (A\$m) | 149 |
| Shares outstanding (m) | 242 |
| Av Daily Turnover (shares) | 22k |
| ASX All Ordinaries | 6,250 |
| FY19E BV per share (A\$c) | 0.77 |
| FY19E EPS (A\$c) | 0.09 |
| FY19E Net (Debt)/Cash (A\$m) | -6 |

Relative Price Performance



Heron Resources Limited

Year ending June

| Profit & Loss Statement (A\$M) | FY18A | FY19E | FY20E | FY21E | FY22E |
|--------------------------------------|---------------|-------------|--------------|--------------|--------------|
| Revenue (net of TC/RC) | 0.0 | 33.8 | 188.6 | 224.0 | 268.6 |
| Mining | 0.0 | (5.1) | (26.1) | (38.5) | (42.6) |
| Processing | 0.0 | (4.4) | (21.3) | (25.7) | (26.4) |
| Corporate/Royalty/Other | (6.5) | (8.7) | (25.9) | (29.9) | (35.0) |
| EBITDA | (6.5) | 15.6 | 115.3 | 129.9 | 164.6 |
| Depreciation & Amortisation | (0.1) | (7.5) | (15.0) | (15.0) | (15.0) |
| Operating profit | (6.5) | 8.1 | 100.3 | 114.9 | 149.6 |
| NOI | (0.5) | 0.0 | 0.0 | 0.0 | 0.0 |
| EBIT | (7.0) | 8.1 | 100.3 | 114.9 | 149.6 |
| Interest income | 1.4 | 2.0 | 1.9 | 3.1 | 4.5 |
| Interest expense | (0.2) | (5.1) | (6.5) | (3.9) | (1.3) |
| Tax expense | 0.0 | 0.0 | 0.0 | 0.0 | (45.8) |
| Reported NPAT | (5.8) | 5.0 | 95.6 | 114.2 | 107.0 |
| Normalised NPAT | (5.3) | 5.0 | 95.6 | 114.2 | 107.0 |
| EBITDA Margin (%) | na | 46% | 61% | 58% | 61% |
| Operating profit margin (%) | na | 24% | 53% | 51% | 56% |
| EPS Reported (A\$) | (0.02) | 0.02 | 0.39 | 0.46 | 0.43 |
| EPS Normalised (A\$) | (0.02) | 0.02 | 0.39 | 0.46 | 0.43 |
| EPS growth (%) | nm | nm | nm | 19% | -6% |
| DPS - Declared (A\$) | 0.00 | 0.00 | 0.00 | 0.14 | 0.13 |
| Avg. no. of fully-diluted shares (m) | 211 | 248 | 248 | 248 | 248 |
| YE no. of fully-diluted shares (m) | 248 | 248 | 248 | 248 | 248 |

| Cash Flow Statement (A\$M) | FY18A | FY19E | FY20E | FY21E | FY22E |
|--------------------------------|----------------|---------------|---------------|---------------|---------------|
| EBITDA | (6.5) | 15.6 | 115.3 | 129.9 | 164.6 |
| Investment in working capital | 2.7 | (3.4) | (15.2) | (2.7) | (3.3) |
| Tax expense | 0.0 | 0.0 | 0.0 | 0.0 | (45.8) |
| Operating Cash Flow | (3.8) | 12.3 | 100.1 | 127.3 | 115.4 |
| Capex | (121.5) | (60.0) | (21.0) | (15.0) | (22.0) |
| Other investments | (0.1) | (2.1) | 0.0 | 0.0 | 0.0 |
| Investing Cash Flow | (121.6) | (62.1) | (21.0) | (15.0) | (22.0) |
| Net interest received / (paid) | 1.2 | (3.1) | (4.6) | (0.8) | 3.2 |
| Debt draw down / (repayment) | 24.9 | 55.0 | (26.6) | (26.6) | (26.6) |
| Dividends paid | 0.0 | 0.0 | 0.0 | (34.2) | (32.1) |
| Equity raised / (repaid) | 135.7 | 0.0 | 0.0 | 0.0 | 0.0 |
| Financing Cash Flow | 161.8 | 51.9 | (31.3) | (61.7) | (55.5) |
| Non-operating & Other | 17.4 | (5.6) | (5.6) | (5.6) | (5.6) |
| Inc/(Dec) in Cash | 53.7 | (3.5) | 42.2 | 45.0 | 32.3 |

| Balance Sheet (A\$M) | FY18A | FY19E | FY20E | FY21E | FY22E |
|--|--------------|--------------|--------------|--------------|--------------|
| Cash & Equivalents | 65.5 | 61.9 | 104.1 | 149.1 | 181.3 |
| Receivables | 2.6 | 3.4 | 18.9 | 22.4 | 26.9 |
| Inventories | 0.0 | 2.5 | 14.1 | 16.8 | 20.1 |
| Other Current Assets | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| PPE and Exploration & Development | 166.0 | 218.5 | 224.5 | 224.5 | 231.5 |
| Deferred tax asset | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Other Non Current Assets | 5.9 | 8.0 | 8.0 | 8.0 | 8.0 |
| Total Assets | 240.0 | 294.3 | 369.5 | 420.7 | 467.8 |
| Payables and other current Liabilities | 7.5 | 7.5 | 19.4 | 23.0 | 27.4 |
| Short Term Debt | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Long Term Debt | 24.9 | 79.9 | 53.3 | 26.6 | 0.0 |
| Other Liabilities (incl silver stream) | 38.5 | 33.0 | 27.4 | 21.8 | 16.1 |
| Total Liabilities | 71.0 | 120.4 | 100.0 | 71.3 | 43.5 |
| Total Equity | 169.0 | 173.9 | 269.5 | 349.4 | 424.3 |
| Net Cash / (Debt) | 40.6 | (18.0) | 50.8 | 122.4 | 181.3 |

| Substantial Shareholders | % | Date |
|---------------------------|-------|--------|
| Citicorp Nomness Limited | 28.4% | |
| CastleLake | 19.4% | Sep-18 |
| Greenstone Management LLC | 18.7% | |

Source: Company, IRESS, State One Stockbroking forecasts

| Woodlawn NPV assumptions | FY18A | FY19E | FY20E | FY21E | FY22E |
|--|-----------|-----------|-----------|-----------|-----------|
| Mill throughput (kt) | na | 225 | 1,075 | 1,250 | 1,250 |
| ...from reclaimed tailings (kt) | na | 150 | 150 | 700 | 700 |
| ...from underground (kt) | na | 75 | 375 | 550 | 600 |
| Zinc production (kt) | na | 6 | 36 | 38 | 51 |
| Copper production (kt) | na | 1 | 4 | 8 | 6 |
| Lead production (kt) | na | 2 | 11 | 10 | 16 |
| Gold production (oz) | na | 736 | 4,601 | 4,797 | 2,531 |
| Silver production (koz) | na | 167 | 856 | 844 | 962 |
| Zinc equivalent production (kt) | na | 10 | 61 | 71 | 84 |
| ...from reclaimed tailings (kt) | na | 4 | 21 | 21 | 20 |
| ...from underground (kt) | na | 6 | 40 | 51 | 64 |
| Operating Costs (US\$/lb Zn Eq) | na | 0.51 | 0.45 | 0.57 | 0.46 |
| AISC Costs (US\$/lb Zn Eq) | na | 0.84 | 0.75 | 0.81 | 0.69 |

| Price assumptions | FY18A | FY19E | FY20E | FY21E | FY22E |
|------------------------|-------|-------|-------|-------|-------|
| Zinc price (US\$/t) | na | 2,600 | 2,652 | 2,705 | 2,759 |
| Copper price (US\$/t) | na | 6,175 | 6,299 | 6,424 | 6,553 |
| Lead price (US\$/t) | na | 2,000 | 2,040 | 2,081 | 2,122 |
| Gold price (US\$/oz) | na | 1,200 | 1,250 | 1,275 | 1,301 |
| Silver price (US\$/oz) | na | 14.5 | 15.0 | 15.3 | 15.6 |
| AUD:USD exchange rate | na | 0.70 | 0.75 | 0.75 | 0.75 |

Woodland Project Mineral Resources (excluding gold and silver) as at Nov 2017

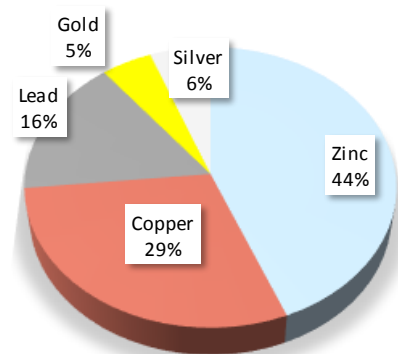
| | Mt | ZnEq (%) | Zn (%) | Cu (%) | PB (%) |
|--------------|-------------|-------------|------------|------------|------------|
| Tailings | 10.9 | 6.2 | 2.3 | 0.5 | 1.3 |
| Underground | 7.2 | 16.0 | 6.3 | 1.9 | 2.3 |
| Total | 18.1 | 10.1 | 3.9 | 1.1 | 1.7 |

Woodland Project Ore Reserves (excluding gold and silver) as at Nov 2017

| | Mt | ZnEq (%) | Zn (%) | Cu (%) | PB (%) |
|--------------|-------------|------------|------------|------------|------------|
| Tailings | 9.5 | 6.0 | 2.2 | 0.5 | 1.3 |
| Underground | 2.8 | 14.0 | 5.5 | 1.6 | 1.9 |
| Total | 12.3 | 9.2 | 3.5 | 0.9 | 1.5 |

In-situ value of Reserve : US\$3.31bn

Note: based on spot prices



| SOTP Valuation | (A\$m) | (A\$/share) | Comment |
|--|------------|-------------|-----------------------------------|
| Woodland Project mine inventory | 508 | 2.05 | NPV |
| Woodland Resource not in inventory | 19 | 0.08 | ~5% of ZnEq inventory NPV |
| Total Resource | 527 | 2.13 | |
| Project discount | 33% | | Timing, operational, costs |
| Woodland Project value (risked) | 353 | 1.43 | |
| Exploration upside (nominal) | 10 | 0.04 | A\$10m nominal |
| Investments (FY19E) | 6 | 0.02 | Listed stocks |
| Net debt plus silver stream (FY19E) | (35) | (0.14) | |
| SOTP valuation | 334 | 1.35 | |

Note: Per share valuation based on 248 million shares (diluted)

Alan Hill
Executive Chairman
Phone: +61 8 9288 3388
ahill@stateone.com.au

Ric Heydon
Equities & Derivatives Advisor
Phone: +61 8 9288 3307
rheydon@stateone.com.au

Mark Sullivan
Institutional Dealer
Phone: +61 2 9024 9134
msullivan@stateone.com.au

Thomas Tan
Equities Advisor
Phone: +61 2 9024 9131
ttan@stateone.com.au

Morris Levitzke
Equities Advisor
Phone: +61 8 9288 3315
mlevitzke@stateone.com.au

Graeme Johnson
Equities & Derivatives Advisor
Phone: +61 8 9288 3316
gjohnson@stateone.com.au

Yitz Barber
Equities Advisor
Phone: +61 2 9024 9107
ybarber@stateone.com.au

Tammie Wong
Equities Advisor
Phone: +61 2 9024 9133
twong@stateone.com.au

Dawn Chia
Business Development Manager
Phone: +61 8 9288 3336
Dawn.Chia@stateone.com.au

David Zhang
Equities Advisor
Phone: +61 2 9024 9130
dzhang@stateone.com.au

David Brennan
Senior Investment Analyst
Phone: +61 2 9024 9142
dbrennan@stateone.com.au

Wayne Osterberg
Equities Advisor
Phone: +61 8 9288 3318
Wayne.Osterberg@stateone.com.au

General Advice Warning

The contents of this document have been prepared without taking account of your objectives, financial situation or needs. You should, before taking any action to acquire or deal in, or follow a recommendation (if any) in respect of any of the financial products or information mentioned in this document, consult your own investment advisor to consider whether that is appropriate having regard to your own objectives, financial situation and needs.

Whilst State One Stockbroking Ltd believes information contained in this document is based on information which is believed to be reliable, its accuracy and completeness are not guaranteed and no warranty of accuracy or reliability is given or implied and no responsibility for any loss or damage arising in any way for any representation, act or omission is accepted by State One Stockbroking Ltd or any officer, agent or employee of State One Stockbroking Ltd. If applicable, you should obtain the Product Disclosure Statement relating to the relevant financial product mentioned in this document (which contains full details of the terms and conditions of the financial product) and consider it before making any decision about whether to acquire the financial product.

This report was prepared solely by State One Stockbroking Limited. ASX Limited ABN 98 009 642 691 and its related bodies corporate ("ASX") did not prepare any part of the report and has not contributed in any way to its content. The role of ASX in relation to the preparation of the research reports is limited to funding their preparation by State One Stockbroking Limited, in accordance with the ASX Equity Research Scheme. ASX does not provide financial product advice. The views expressed in this research report may not necessarily reflect the views of ASX. To the maximum extent permitted by law, no representation, warranty or undertaking, express or implied, is made and no responsibility or liability is accepted by ASX as to the adequacy, accuracy, completeness or reasonableness of the research reports.

Disclosure

The directors and associated persons of State One Stockbroking Ltd may have an interest in the financial products discussed in this document and they may earn brokerage, commissions, fees and advantages, pecuniary or otherwise, in connection with the making of a recommendation or dealing by a client in such financial products.

The Research Analyst who prepared this report hereby certifies that the views expressed in this research document accurately reflect the analyst's personal views about the company and its financial products. The research analyst has not been and will not be receiving direct or indirect compensation for expressing the specific recommendations or views in this report.

This research at all times remains the property of State One Stockbroking Ltd. And as such cannot be reprinted, distributed, copied, posted on the internet, in part or whole, without written prior approval from an Executive Director of State One Stockbroking Ltd.