INVESTMENT RESEARCH

BW EQUITIES

3 September 2019

Superior Lake Resources (SUP)

BFS Confirms Project's Appeal

BFS & Reserve Out: The results of SUP's bankable feasibility study (BFS) on the high-grade Superior Lake zinc project (Canada), were broadly in line with our expectations and pave the way for the company to move forward with finance & offtake negotiations. The BFS incorporates the maiden ore reserve and targets a zinc/copper operation producing 38ktpa of contained zinc metal at AISC of US$0.47/lb over a 9-year mine life.

Key Operational Updates: Higher milled tonnes (+10%) incorporated recent exploration success, and following detailed scheduling work the mine life has been extended to 9 years. Commentary notes the mill has been designed to allow for a doubling of throughput should potential exploration success delineate sufficient additional reserves. Zinc head grade was lower (13.7% vs 14.1% in the restart study) driven by higher mining dilution estimates (31% vs 25%), however this was offset by improved zinc recovery & payability assumptions.

Financial Metrics Remain Robust: The project NPV derived in the BFS was revised modestly downwards to US$115m (post-tax), driven by improved unit costs and a lower discount rate, offset by lower zinc price assumptions and higher capex. The BFS data provides a higher level of confidence in project parameters, and crucially cash margins remain very strong despite recent softness in base metals markets.

What's Next: Indicative project finance proposals have been received ranging between US$50-70m. In conjunction with offtake financing, which could provide an additional +US$10m, SUP is well positioned to take the project into construction with a manageable equity component. With the funding process and project optimisation work well advanced, we expect to see certainty on the funding route firm up in the near term.

Revised Estimates: We have updated our financial model to incorporate the revised operational and cost assumptions released in the BFS. Given the lower zinc price and higher capex estimate, our 12 month target price set equal to the valuation derived using our NPV analysis, has reduced from 6.5¢/share to 5.6¢/share.

Valuation & Recommendation: SUP provides investors exposure to an emerging zinc producer in a stable jurisdiction, with lightly explored ground and proven production history. The project can come into production quickly (we expect 2021) with the benefit of existing infrastructure and permitting. The shares trade at a significant discount to valuation, set using 1.0x P/NPV based on our DCF valuation. We reiterate a Buy rating. Key risks include the availability of funding, zinc prices and operational issues.

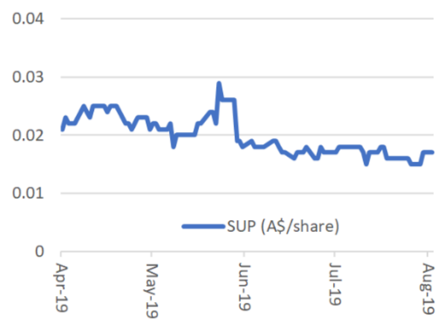
Recommendation	**BUY**
Target Price (AUD)	5.6¢
Share Price (AUD)	1.7¢
Forecast Capital Return	228%
Forecast Dividend Yield	0.0%
Total Shareholder Return	**228%**
Market Cap	A$18.4m
Net Cash (Debt)	A$5.2m
Enterprise Value	A$13.2m
Shares On Issue	1082m
Share Options On Issue	105m

Daniel Seeney | Senior Analyst

Key Executives	
Non Exec Chairman	Keong Chan
Exec Director	Grant Davey
Non Exec Director	Peter Williams
CEO	David Woodall
Project Director	Keith Bowes

Catalysts	
Finalise financing	Dec Qtr 19
Permitting Completion	Q2 2020
Commence Construction	Q2 2020
First Ore	Q3 2021

Substantial Shareholders	
Sonja Heath	10.4%
Tolga Kumova	7.5%
Grant Davey	6.7%
Shandong Ishine Mining	5.8%
Flannery Group	5.3%
Tribeca Investment Partners	5.3%



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FINANCIAL SUMMARY — Superior Lake Resources (SUP)

Share Price	A$/sh	0.017
Shares on Issue	m	1,082
Market Cap (A$m)	A$m	18.4
Net Debt / (Cash) (A$m)	A$m	(5.2)
Enterprise Value (A$m)	A$m	13.2

Rating	**BUY**
Target Price	0.056
Upside / (Downside)	228%
Dividend Yield	0.0%
Total Return Forecast	228%

Profit & Loss	**Units**	**Dec-18**	**Dec-19e**	**Dec-20e**	**Dec-21e**	**Dec-22e**
Sales	A$m	-	-	-	19	63
Expenses	A$m	(4)	(4)	(2)	(11)	(36)
EBITDA	A$m	**(4)**	**(4)**	**(2)**	**8**	**27**
D&A	A$m	(0)	(0)	(0)	(1)	(5)
EBIT	A$m	**(4)**	**(4)**	**(2)**	**6**	**22**
Net Interest	A$m	0	0	2	(8)	(9)
Profit Before Tax	A$m	(4)	(4)	(1)	(1)	14
Tax	A$m	-	-	(0)	(0)	(3)
Adjusted NPAT	A$m	**(4)**	**(4)**	**(1)**	**(2)**	**10**

Cashflow	**Units**	**Dec-18**	**Dec-19e**	**Dec-20e**	**Dec-21e**	**Dec-22e**
Cash From Operations	A$m	(1)	(3)	(1)	9	30
Interest	A$m	0	0	2	(8)	(9)
Tax	A$m	-	-	(0)	(0)	(3)
Net Cash From Operations	A$m	**(1)**	**(2)**	**1**	**1**	**18**
Capex (incl. exploration)	A$m	(1)	(2)	(102)	(27)	(8)
Acquisitions (Net)	A$m	-	-	-	-	-
Other	A$m	(1)	(0)	-	-	-
Free Cash Flow	A$m	**(3)**	**(4)**	**(101)**	**(27)**	**10**
Proceeds from issue of shares / (buyback)	A$m	7	39	-	-	-
Proceeds / (Repayment) of Borrowings	A$m	-	-	80	5	-
Dividend	A$m	-	-	-	-	-
Net Increase / (Decrease) in Cash	A$m	**4**	**35**	**(21)**	**(22)**	**10**

Balance Sheet	**Units**	**Dec-18**	**Dec-19e**	**Dec-20e**	**Dec-21e**	**Dec-22e**
Cash	A$m	4	40	18	(3)	7
Receivables	A$m	0	-	-	1	2
Inventory	A$m	-	-	-	3	5
PP&E	A$m	0	0	100	125	125
Other	A$m	0	0	0	0	0
Assets	A$m	**5**	**42**	**123**	**131**	**147**
Creditors	A$m	1	-	-	2	3
Debt	A$m	-	-	80	85	85
Provisions	A$m	0	0	0	0	0
Tax Liabilities	A$m	0	0	0	0	0
Liabilities	A$m	**1**	**0**	**80**	**87**	**88**
Minorty Interest	A$m	-	-	-	-	-
Net Assets	A$m	**4**	**42**	**43**	**44**	**59**

Liquidity & Leverage	**Units**	**Dec-18**	**Dec-19e**	**Dec-20e**	**Dec-21e**	**Dec-22e**
Net Debt / (Cash)	A$m	(4)	(40)	62	88	78
Net Debt / EBITDA	x	1.0x	9.4x	(27.9)x	11.2x	2.9x
EBIT Interest Cover	x	273.7x	8.9x	1.5x	0.9x	2.6x
Net Debt / Equity	%	-99%	-94%	145%	201%	133%

Per Share Data (¢)	**Dec-18**	**Dec-19e**	**Dec-20e**	**Dec-21e**	**Dec-22e**
Shares Out (m)	857	2,166	2,166	2,166	2,166
EPS (¢)	(0.4¢)	(0.3¢)	(0.0¢)	(0.1¢)	0.5¢
Growth (%)	n/a	n/a	n/a	n/a	n/a
Dividend (¢)	-	-	-	-	-
Payout Ratio (%)	0%	0%	0%	0%	0%
Net Tangible Assets (A$)	0.00	0.02	0.02	0.02	0.03
Book Value (A$)	0.00	0.02	0.02	0.02	0.03
Free Cash Flow (A$)	(0.00)	(0.00)	(0.05)	(0.01)	0.00

Valuation Metrics	**Dec-18**	**Dec-19e**	**Dec-20e**	**Dec-21e**	**Dec-22e**
EV / Sales	n/a	n/a	n/a	0.7x	0.2x
EV / EBITDA	n/a	n/a	n/a	1.7x	0.5x
EV / EBIT	n/a	n/a	n/a	2.0x	0.6x
P/E (x)	n/a	n/a	n/a	n/a	3.7x
Dividend Yield (%)	n/a	n/a	n/a	0.0%	0.0%

Operating Metrics (%)	**Dec-18**	**Dec-19e**	**Dec-20e**	**Dec-21e**	**Dec-22e**
EBITDA Margin	n/a	n/a	n/a	42%	43%
EBIT Margin	n/a	n/a	n/a	35%	36%
Net Profit Margin	n/a	n/a	n/a	-9%	17%
ROIC	n/a	n/a	n/a	5%	16%
Return on Assets	n/a	n/a	n/a	-1%	7%
Return on Equity	n/a	n/a	n/a	-4%	18%
Effective Tax Rate	n/a	n/a	n/a	-45%	25%

Key Assumptions	**Dec-18**	**Dec-19e**	**Dec-20e**	**Dec-21e**	**Dec-22e**
Zinc (US$/t)	-	2,703	2,767	2,836	2,908
Copper (US$/t)	-	6,631	6,788	6,959	7,135
Gold (US$/oz)	-	1,407	1,440	1,476	1,513
Silver (US$/oz)	-	18.1	18.5	19.0	19.5
AUDUSD	-	0.72	0.72	0.72	0.72

Production	**Dec-18**	**Dec-19e**	**Dec-20e**	**Dec-21e**	**Dec-22e**
Zinc in con (kt)	-	-	-	5	16
Copper in con (kt)	-	-	-	0	1
Gold in con (koz)	-	-	-	0	1
Silver in con (koz)	-	-	-	16	55

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Project Overview

The Superior Lake Zinc Project is a high-grade, underground zinc mine situated in the Canadian province of Ontario 200km north-east of the city of Thunder Bay.

Superior Lake Zinc Project location:

Source: Company Reports

The ore reserve currently defined is 1.96mt at 13.9 % Zn, 0.6% Cu.

The operation retains substantial underground and surface infrastructure from previous mining conducted by Inmet from 1988-1998. The prior operation ceased in 1998 primarily due to the poor zinc price environment at the time of ~US$0.42/lb.

A bankable feasibility study was completed by SUP in Aug-19 which outlined an operation producing an average 38ktpa of zinc in concentrate over a 9 year mine life at an all in sustaining cost of US$0.47/lb. Initial capex has been estimated at US$86m, and the mine is currently expected to commence construction in Q2 2020 with first ore in Q4 2021.

Bankable Feasibility Study Key Metrics:

Description	Units	Value (approx.)
Tonnes Mined	Tonnes	2,200,000
Plant Throughput	Tonnes per annun	325,000
Head Grade - Zinc	% Zn	13.7%
Head Grade - Copper	% Cu	0.60%
Zn Conc production (steady state)	Tonnes per annum	38,000
Cu Conc production (steady state)	Tonnes per annum	1,400
Life of Mine	years	9.0
Start-up Capital	US$m	97
AISC	US$/lb Zn	0.47
NPV at 8% - pre-tax	US$m	US$158m
NPV at 8% - post-tax	US$m	US$115m
IRR at 10% - pre-tax	31%	
IRR at 10% - post-tax	27%	

Source: Company Reports

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Risks

The following risks are important factors for investors to be mindful of when considering an investment in shares of the company. This list is by no means exhaustive and should be read carefully in conjunction with the body of the report.

Metal Prices & Exchange Rates

The expected cash flows from mining operations are significantly affected by fluctuations in metal prices and exchange rates. For the Superior Lake operation this includes zinc, copper, silver, gold prices, CAD:USD & AUD:USD exchange rates. Metal prices and exchange rates can be volatile and projections are subject to significant uncertainty. Metal prices are quoted in US$ and changes in exchange rates can have a material impact on revenue and profitability as revenues are priced in US$, and operating costs are predominantly in local currency (C$).

Interest Rates & Availability of Funding

Project financing is likely to incorporate a component of debt which will incur interest expense. The details of these arrangements are yet to be finalised and may include a fixed and floating interest rate component, and may include various covenants. Interest rates are currently at historical lows and market expectations are that they will move higher over the medium term. Fluctuations in interest rates and the availability of credit can have a material impact on profitability of the company and the ability of the company to continue as a going concern. If any covenants are breached creditors may recall credit facilities or amend the terms materially which may place significant financial strain on the ability of the company to continue to fund the operations in the future. Changes in the availability of credit/debt could lead to equity raisings at a point of significant uncertainty which could materially dilute existing shareholders. The current market capitalisation of the company is small relative to the capex requirements, and there is no guarantee that new or existing shareholders will provide the equity funding required to finance the project.

Operational Risk

Mining operations are subject to a range of operational uncertainties which can vary depending on the geographic location, nature of the operation, labour relations and reliability of critical infrastructure such as electricity & water supply, as well as transportation routes. Superior Lake is an underground operation and the Pick Lake deposit is relatively deep. The orebody is also relatively narrow and mining by the prior owners experienced higher than expected rates of dilution and as a consequence lower than expected grades processed. While some issues are known based on the history of the operation, and a different proposed mining method is proposed by SUP to address this, all mining operations are inherently challenging and material unforeseen issues can and do occur regardless of the preparation and expertise of capable management teams.

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Costs

Cost estimates are conducted as part of the restart study and refined in the feasibility work currently underway. These estimates are based on numerous assumptions and may be materially different to the actual cost required for the operation. This includes both the capital cost of bringing the operation into production as well as operating costs. Operating costs can change based on various uncertainties including general economic conditions, unemployment rates (particularly in the local area), commodity prices and exchange rates, and disruptions or limitations to the supply of key equipment or inputs. If unit costs escalate materially the profitability of the operation may be reduced either temporarily or permanently.

Political Risk

Superior Lake operates in the relatively stable developed country of Canada within a province which has a historical familiarity with and support for mining. The local economy has significant exposure to the mining industry including diamonds and gold. Nevertheless political conditions can change unfavourably at a Provincial and Federal level. The site is also situated on Pays Platt First Nation Territory and so striking agreements with, as well as receiving support generally from local native communities is critical to the successful operations.

Environmental Risk

Mining operations must adhere to environmental regulations which vary depending on the location. Increased community and political focus on environmental matters has lead to environment related regulatory reviews becoming increasingly costly, lengthy and complex. Obtaining these approvals can cause significant delays to the expected timeline of mining operations both in terms of commencement and closure as decommissioning activities can be prolonged. Potential unforeseen changes in regulations can make it difficult to accurately anticipate closure costs related to remediation and rehabilitation of the disturbed mining area.

Reserve & Resource Estimates

The presence and measurement of Reserves & Resources are subject to various estimations and limitations. Actual orebody size, shape and grade can vary significantly from that estimated by the geological work conducted. While variances can be both positive and negative, negative outcomes versus expectations can lead to higher operating costs and material revisions to the amount of economic reserves, and hence potential changes to the mine life.

Equity risk

We expect SUP will need to raise additional capital, if the share price is weak and continues to trade at a significant discount to our target price, a capital raise at 5¢ / share may not be possible. Equity funding to support development may require higher than expected dilution to secure an adequate financing package.

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APPENDIX 1

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