EQUITY RESEARCH

Mining

16 February 2022

Peak Rare Earths Ltd (PEK.ASX)

Ngualla to Sate Shenghe's International Ambition

Event:

- **Shenghe Resources stake; share consolidation; revised PT.**

Investment Highlights:

- **Downstream expertise to replace financial sponsor:** PEK has a new substantial shareholder in Shenghe Resources, who replaces Appian Pinnacle, paying $0.99/sh at a 24.5% premium. We view this as a positive development, as the Shanghai listed US$4.9b rare earths refiner brings practical downstream expertise and demand for concentrate.
- **International agility and remit, thirsty for concentrate:** Shenghe clearly has international ambition which has played out with stakes in the recently revived MP Materials (MP.NYSE), Greenland Minerals (GGG.ASX), and Vietnam Rare Earth Co. Ltd. Shenghe's 15ktpa separation and 12ktpa processing capacity requires ore and concentrate feedstock, supplemented by international sources. While Shenghe is not currently deemed a SOE, we note the Chinese sector has undergone recent consolidation; the situation remains dynamic.
- **High grade, long life, massive resource likely the attraction:** we think Shenghe is attracted to PEK's Ngualla as an alternative high grade, long life source of feedstock, which makes strategic sense for Shenghe given MP's Mountain Pass grade and historical processing queries and GGG's Kvanefjeld licencing issues. PEK has reiterated its own unchanged downstream strategy at Teesside; in our view Ngualla is sufficiently large to accommodate both Shenghe and PEK's appetite for concentrate.
- **Sector and price environment go from strength to strength:** RE sector continues to enjoy strong NdPr prices, which has broken through US$160/kg, an almost fourfold increase since January 2020, and an eleven year high.

Earnings and Valuation:

- **We increase our PEK valuation to $2.46/share** (0.8x P/NPV; previously $1.80/sh post consolidation and 0.8x P/NPV). Our valuation is underpinned by our NPV_{10} of A$771M for Ngualla and Teesside, assuming US$365M initial capex for 2,800tpa NdPr 99% oxide production. We assume first production in FY25e, with an increased LT NdPr oxide price of US$80/kg (ex VAT, prior US$70/kg).
- We note **upside potential to our valuation** from risk discount unwind, sustained strong NdPr prices, and lower future dilution, while improvements may arise from the upcoming optimised BFS, though this will be likely tempered by cost inflation. Our unrisked valuation is $3.07/share (prior $2.20/share post consolidation).

Recommendation:

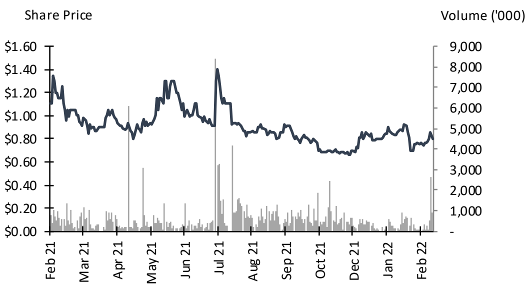
- We maintain our **Speculative Buy recommendation for PEK with an increased PT of $2.50/share (prior $1.80 post consolidation)** in line with our risked valuation. The Shenghe investment is a positive, while the company is still targeting framework agreement in 1Q22 and FID at CY22 end.
- **Catalysts for the stock** include: 1) formalising of Special Mining Licence by the Tanzanian government and framework negotiation; 2) optimised BFS; 3) financing; 4) offtake agreements; and 5) FID and construction.

Disclosure

The analyst does not own PEK securities.
Foster Stockbroking and associated entities (excluding Cranport Pty Ltd) own 275,868 PEK shares.
Cranport Pty Ltd owns 435,842 PEK shares.
Refer to end of report for details.
Foster Stockbroking acted as Joint Lead Manager to the $30M placement of 333.3M PEK shares at $0.09 in September 2021, and provides equity capital markets and corporate advice to PEK. Foster Stockbroking has received fees for these services.

Recommendation	**Speculative Buy**
Previous	Speculative Buy
Risk	High
Price Target	**$ 2.50**
Previous Target (post-consol)	$ 1.80
Share Price (A$)	**$ 0.80**
ASX Code	PEK
52 week low - high (A$)	0.66-1.40
Valuation (A$), risked	**$ 2.46**
Valuation Methodology	DCF
Capital structure	
Shares on Issue (M)	199
Market Cap (A$M)	**159**
Net Cash/(Debt) (A$M, est.)	15
EV (A$m)	**145**
Options and warrants (M)	13
12mth Av Daily Volume ('000)	598
Board	
Tony Pearson	Non-Executive Chairman
The Hon. Abdullah Mwinyi	Non-Executive Director
Giselle Collins	Non-Executive Director
Giles Stapleton	Non-Executive Director
Bardin Davis	Managing Director
Major Shareholders	
Shenghe Resources	19.9%

Share Price Graph



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SHENGHE RESOURCES REPLACES APPIAN

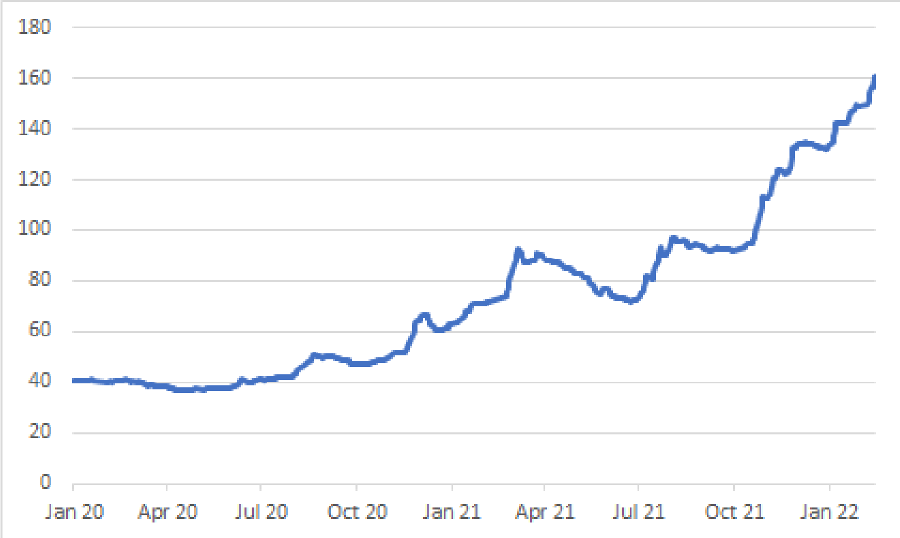
Injects Downstream Expertise and Demand for Concentrate

- PEK has a new substantial shareholder in Shenghe Resources, who replaces Appian Pinnacle, paying $0.99/sh at a 24.5% premium. We view this as a positive development, as the Shanghai listed US$4.9b rare earths company has mining, smelting, separating, and processing capacity, and brings practical downstream expertise and demand for concentrate.
- Shenghe clearly has international ambition which has played out with stakes in the recently revived MP Materials (MP.NYSE, 8% holding), Greenland Minerals (GGG.ASX, 9%), and Vietnam Rare Earth Co. Ltd (90%). Shenghe's 15ktpa separation and 12ktpa processing capacity requires ore and concentrate feedstock, supplemented by international sources. While Shenghe is not currently deemed a SOE, we note the Chinese sector has undergone recent consolidation; we think the situation remains dynamic.
- The high grade, long life, massive resource of PEK's Ngualla is likely the attraction for Shenghe in our view. With its peer leading reserve and resource grades, Ngualla is a very attractive alternative high grade long life feedstock for Shenghe, even as its other existing stakes throw up queries. Shenghe's choice of Ngualla makes strategic sense, given the lower grade at MP's Mountain Pass as well as its historical processing queries, and the licencing issues at GGG's Kvanefjeld.
- PEK has reiterated its own unchanged downstream strategy at Teesside, and will seek to monetise its Ngualla resource fully by pursuing a separator at Teesside. Shenghe is a ready made offtake partner, at least for mineral concentrate, should PEK elect to pursue this option. Shenghe's involvement presents an interesting quandary for PEK. We think the answer lies in the orebody: a tier one resource is likely to provide PEK with development options, and Ngualla is sufficiently large to accommodate both Shenghe and PEK's concentrate demand. We see the potential for the company to investigate development at Ngualla for concentrate to sate Shenghe and enable early cash flow, to support the later development of the Teesside capacity. We anticipate these options will be addressed in the near term, but for now we note PEK has reiterated its own unchanged downstream strategy.

PRICES GO FROM STRENGTH TO STRENGTH

- The RE sector continues to enjoy strong NdPr prices, which continue to go from strength to strength, with the NdPr oxide price already up 20% for CY22, and having enjoyed an almost fourfold increase since January 2020. The reference price has just broken US$160/kg, an 11 year high, a level not seen since June 2011.
- The recent sector consolidation among Chinese SOEs is likely to give greater pricing power to fewer players in what was already a powerful oligopoly, and which already controlled a supermajority of global RE mining, separating, and processing.

Figure 1: NdPr oxide price, 2020 to date – almost 4x increase over two years



Source: Asian Metals.

VALUATION – INCREASED TO $2.46/SHARE, RISKED (PRIOR $1.80)

- We derive a risked valuation of $2.46/share for PEK (prior $1.80/share). Our valuation is underpinned by NPV_{10} DCF of $771M for the Ngualla Project and Teesside Refinery. Our unrisked valuation is $3.07/share for PEK.
- We have an increased long term price for NdPr 99% oxide of US$80/kg ex VAT (prior US$70/kg). We continue to consider only the Reserve estimate in our valuation; we further note the Reserve represents only 22% of the existing Resource. We see future upside potential for the company to convert Resource to Reserve, with some 90% of the Resource in the Measured or Indicated categories, however we do not include these in our present valuation.
- The company underwent a 10 to 1 consolidation in December. We now assume a fully diluted share number of 302M shares with no changes to 33% equity assumption and an unchanged US$365M capex, or US$121M, however we do note the current cost inflationary environment.

Figure 2: PEK Valuation

Company Valuation	Unrisked A$M	Unrisked, A$/sh	Risked, A$M	Risked, A$/sh	1-Risk Factor
Ngualla and Teesside	771	2.55	617	2.04	80%
Corporate	-24	-0.08	-19	-0.06	80%
Cash	15	0.05	15	0.05	100%
Cash from equity raise	161	0.53	128	0.43	80%
Cash from options, ITM at valuation	4	0.01	3	0.01	80%
Valuation DCF, WACC 10%, nominal	**$926**	**$3.07**	**$744**	**$2.46**	**80%**
Ordinary shares, M*	199				
Options, M	13				
Shares from equity raise, M	89				
Fully diluted shares, M	**302**				

Source: Company, Foster Stockbroking estimates.

MAINTAIN SPECULATIVE BUY, PRICE TARGET $2.50 (PRIOR $1.80)

- We continue to recommend PEK as a Speculative Buy with an increased price target of $2.50/share (prior $1.80 post consolidation; 0.8x P/NPV). We view the Shenghe investment as a positive, with PEK's long life, high grade Ngualla asset the main attraction, while Shenghe is an active RE participant with technical expertise. PEK's proposed vertically integrated rare earth project should allow it to maximise its value capture from downstream RE processing. The company continues to target framework agreement in 1Q22 and FID at CY22 end.
- We see a number of milestones for PEK in the near term, including:
    - Formal grant of the Special Mining Licence by the Tanzanian government;
    - Framework agreement negotiation to finalise fiscal regime governing Ngualla;
    - Financing;
    - BFS update with target release mid CY22.
    - Offtake agreements; and
    - FID target of CY22 end and two year construction period.

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Specific disclosure: The analyst does not owns PEK securities at the time of this report. Diligent care has been taken by the analyst to maintain honesty and fairness in writing the report and making the recommendation.

Specific disclosure: Foster Stockbroking acted as Joint Lead Manager to the $30M placement of 333.3M PEK shares at $0.09 in September 2021, and provides equity capital markets and corporate advice to PEK. Foster Stockbroking has received fees for these services.

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