Mineral Commodities

Initiation of coverage

Growing mineral sands producer

Metals & mining

Mineral Commodities (MRC) has successfully transitioned from a mineral sands developer to a producer of small scale at its Tormin project, with scope to emerge as a large player through its Xolobeni ilmenite deposit. After a successful ramp-up, Tormin is being expanded, which will drive significant near-term earnings growth. Our base case NPV is A$0.21/share based on a four-year life at Tormin.

Year end	Revenue (US$m)	PBT* (US$m)	EPS* (c)	DPS (c)	P/E (x)	Yield (%)
12/13	0.2	(1.6)	(0.6)	0.0	N/A	N/A
12/14	35.0	3.9	2.1	0.0	3.6	N/A
12/15e	47.0	8.4	1.4	0.0	5.4	N/A
12/16e	83.5	31.5	5.4	2.4	1.4	32.0

Note: *PBT and EPS are normalised, excluding intangible amortisation, exceptional items and share-based payments. MRC is an ASX company that reports in US dollars.

Successful transition from developer to producer

MRC is an emerging mineral sands producer that developed its Tormin project on South Africa's Atlantic coast on time and budget at a low capital cost of US$16m for initial production capacity of 48ktpa of its main product, a zircon/rutile non-magnetic concentrate (NMC), plus ilmenite and garnet by-products. After a successful ramp-up in 2014 (42.4kt NMC), MRC plans for value-accretive, low-capital cost plant expansions (c US$5m) completed by mid-2016, which should enable NMC production of 62kt that year, climbing to 75kt in 2017, with associated increases in by-product production. The Tormin resource is unique in its beach location, which has resulted in significant resource replenishment of mined blocks due to tidal action. If this phenomenon continues, the Tormin project could extend well beyond its four-year mine life.

Xolobeni – large-scale ilmenite orebody

In addition to Tormin, MRC owns the Xolobeni resource, a large ilmenite orebody on South Africa's east coast. Xolobeni is in the early development and permitting stage, thereby attracting minimal value attribution from the market, despite its potential to be a long-term significant value driver for the company due to its size.

Valuation: DCF analysis points to share price upside

We have used DCF analysis to value the Tormin project, which is in production, and valued Xolobeni on a nominal basis given its early development stage status. Our base case NPV is A$0.21/share, using a 10% discount rate and a four-year life for Tormin. If the resource replenishment that has been experienced since production commenced continues and extends the resource life to, say, eight years, the NPV would increase to A$0.37/share. At the current share price it would appear the market is ignoring any potential for resource life extension at Tormin and is attributing more than a 20% discount rate to cash flows.

13 August 2015

Price	**A$0.10**
Market cap	**A$40m**
	A$/US$0.75
Net debt (US$m) at 30 June 2015	4.98
Shares in issue	404.9m
Free float	100%
Code	MRC
Primary exchange	ASX
Secondary exchange	N/A

Share price performance

%	1m	3m	12m
Abs	0.0	(16.7)	(25.9)
Rel (local)	1.8	(12.2)	(24.0)
52-week high/low		A$0.15	A$0.07

Business description

Mineral Commodities is a growing producer of zircon/rutile non-magnetic concentrate and ilmenite and garnet by-products from its Tormin resource on the Atlantic coast of South Africa. In addition, it owns a large ilmenite deposit, Xolobeni, on the east coast of South Africa, which is at an early development stage.

Next event

Half-year results	August 2015

Analysts

David George	+44 (0)20 3077 5700
Charles Gibson	+44 (0)20 3077 5724

mining@edisongroup.com

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Mineral Commodities is a research client of Edison Investment Research Limited

Investment summary

Company description: Emerging South African mineral sands producer

Mineral Commodities (MRC) is a growing mineral sands producer with two projects located in South Africa. Tormin, already producing, located on the Atlantic coast, is a small but high-grade resource (41% heavy mineral sands) containing 3.4% zircon, 0.7% rutile, 13.6% ilmenite and 18.3% garnet. Xolobeni is located on the east coast and is a large, low-grade resource (5% heavy mineral sands) of 346Mt, containing 9Mt ilmenite, 450kt zircon, 570kt rutile and 450kt leucoxene. Full details of the resources are shown in Exhibits 3 and 4.

Valuation: DCF analysis points to share price upside

We have used a DCF analysis to value the Tormin project, which is in production, and have valued Xolobeni on a nominal basis given its early development stage status. The Tormin resource statement supports a four-year project life, but because of its location on the beach subject to ocean tidal action, the resource depletion since mining commenced has been minimal due to the deposition of fresh resource from offshore. If this phenomenon continues, the Tormin project could extend well beyond its four-year life. Management believes this to be the case, but acknowledges that it will not fully understand this phenomenon until it begins an exploration programme on its offshore tenements. The DCF is A$0.21/share over the stated resource life. If the resource replenishment continues and Tormin's life is extended to eight years, the DCF is A$0.37/share.

Financials: Maiden profit in 2014, significant earnings growth ahead

MRC reported its maiden profit in 2014 of US$8.4m after tax and US$4.0m before income tax benefit, from product sales revenue of US$33.3m. On commissioning and partial ramp-up of processing plant expansions during 2015 we forecast revenue of US$47.0m and profit before tax to double to US$8.4m. The balance sheet is sound, with end 2014 net debt of US$3.0m forecast to rise to US$5.2m at the close of 2015 after a heavy year of capex of approximately US$14m. At close of 2016 we forecast a net cash position of US$6.9m, on the back of expanded production and higher forecast zircon and rutile prices. This is after the forecast payment of US$9.9m of dividends based on a 45% payout ratio, (Edison estimate based on forecast free cash flow generation).

Sensitivities: Resource life and commodity assumptions, expansion ramp-up risk are key

We identify the following as key sensitivities for earnings and valuation forecasts:

- **Zircon and rutile assumptions:** these commodities, particularly zircon, are the key revenue drivers for MRC. We have assumed a modest recovery in both prices in 2016 to consensus long-term price assumptions, which are c 50% off the peaks seen in 2012;
- **Expansion ramp-up:** the main driver of our forecast revenue, profit and cash flow growth is the planned expansion of the processing plant during 2015 and early 2016. We have assumed successful implementation of the expansion, with full capacity achieved from the start of 2017. We believe this is a reasonable assumption given the small scale of the projects and MRC's success in building and commissioning the initial facilities on time and on budget. However, any significant delay to the expansions would cause negative revisions to earnings and valuation forecasts; and
- **Tormin resource life assumptions:** as discussed in the valuation section, Tormin's resource life could extend beyond its four-year term if resource replenishment by tidal action continues.

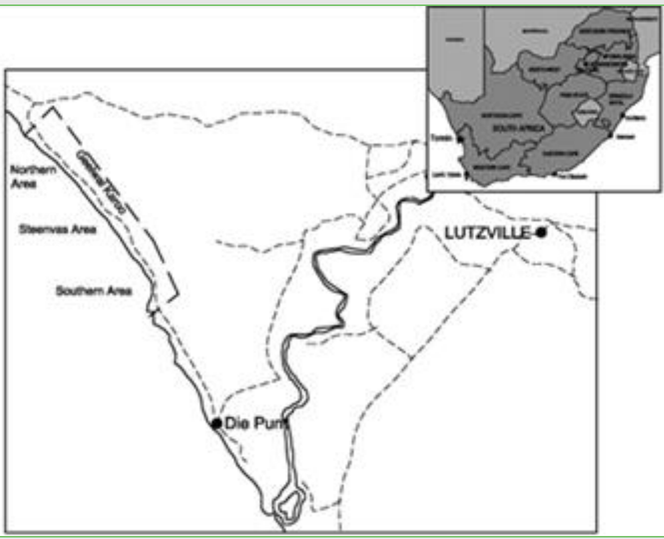
Company description: South African mineral sands

Mineral Commodities (MRC) is a growing mineral sands producer with two projects located in South Africa. Tormin, located on the Atlantic coast, is a small but high-grade resource (41% heavy mineral sands) containing 3.4% zircon, 0.7% rutile, 13.6% ilmenite and 18.3% garnet. Xolobeni is located on the east coast and is a large, low-grade resource (5% heavy mineral sands) of 346Mt, containing 9Mt ilmenite, 450kt zircon, 570kt rutile and 450kt leucoxene. Full details of the resources are shown in Exhibits 3 and 4.

Tormin – a self-replenishing beach sand resource

Tormin is located some 400km north of Cape Town on the Western Cape coastline. The project commenced mining in October 2013 and final product production in January 2014. The plant and mine development were built on time and on budget for US$16m. While it is a small resource, a unique feature is its location on the ocean beach, which exposes the resource to tidal conditions that result in a natural jigging effect. Large proportions of the quartz and light heavies waste material are removed by the ocean tidal action, resulting in a higher ROM grade than was anticipated in the feasibility studies (as high as 86% heavy mineral concentrate [HMC] actual vs 41.3% HMC in the feasibility studies).

Exhibit 1: Tormin location and tenements



Source: Mineral Commodities

This has enabled a significant portion of ROM ore from the beach to be fed directly to the Secondary Concentrator Plant (SCP) and bypassing the Primary Beach Concentrators (PBC), resulting in reduced operating costs. In addition, studies by MRC's resource consultant, AEMCO Pty have shown that the resource replenishes economically around three times that mined, at approximately 80% of the original grade as heavy minerals have been washed in from the ocean by the tides. If this natural replenishment continues at current rates, there is scope for the expected life of Tormin to continue beyond the planned four years. Tormin's primary product is zircon/rutile NMC, comprising 81% zircon and 11% rutile, with by-products being an ilmenite concentrate and a garnet concentrate. Our production forecasts are shown in Exhibit 2.

Exhibit 2: Tormin production (000s of tonnes)

Product	2014	2015e	2016e	2017e	2018e	2019-23e
Zircon/rutile NMC	42.7	47.5	62.5	75	75	75
Zircon in NMC	34.5	38.5	50.6	60.7	60.7	60.7
Rutile in NMC	4.9	5.5	7.2	8.6	8.6	8.6
Ilmenite conc	100.4	180	350	350	350	350
Garnet conc	254.8	275	250	240	240	240

Source: MRC 2014 Annual Report and Edison Investment research estimates

In the second half of 2015 MRC plans to expand and optimise the Garnet Stripping Plant (GSP) at an estimated capital cost of US$5.0m and install a Tailings Scavenger Plant (TSP) for an estimated capital cost of US$1m. The TSP will re-process the tailings stream before it is discharged onto the beach and result in an additional 180,000t of HMC feed for the SCP. We have allowed for the production expansions resulting from these projects in our forecasts (Exhibit 2).

In addition to the large increase in revenues that these low-capex projects will deliver (we estimate an uplift of over 139% by 2016 from 2014 levels), unit costs should fall with the greater scale of production. We have allowed for a decline in unit costs per tonne of NMC from an estimated US$600/t in 2014 to US$500/t in 2015 and beyond, although we believe the company has a more ambitious target for cost reductions.

For the quarter ended 30 June 2015, MRC reported the following key results: zircon/rutile concentrate production for the quarter was 11,314 tonnes versus budget of 14,056 tonnes; ilmenite concentrate production was 29,483 tonnes versus budget of 29,316 tonnes, and garnet concentrate production was 61,847 tonnes versus budget of 75,949 tonnes. Q1 revenue was below budget at US$8.37m, driven by 11,622 tonnes of zircon/rutile concentrate shipments, and 66,312 tonnes of garnet concentrate sold as interim stockpile to Garnet International Resources Pty.

In Q115, MRC advised of developments in its work to better understand the deposition of heavy minerals from the tidal action and the potential resource in its offshore prospecting permits (confirmation of the existence of mineralisation offshore was provided by aeromagnetic surveys conducted in early 2014). In that quarter, proposals were received from Jan Du Nul, one of the World's largest dredging companies on methodology for mining the shore break area between the low tide and the wave formation. The studies indicate that material beyond the wave crest formation seaward can be mined by conventional dredging methods and deposited on land.

In addition, the MRC is looking for other placer extensions to the Tormin deposit.

In Q215, further proposals were received by various international and local South African consultants to conduct bathymetric offshore surveys and wave refraction studies, with a view to providing requisite information to identify the best method of undertaking surf zone sampling for offshore resource definition and to investigate mining techniques of the surf zone area that lies between the low tide mark and wave break zone. The company intends to commence studies in Q315. Proposals for sampling the areas seaward of the low tide covered by the Company's Prospecting Permits have also been solicited. The primary purpose of this study is to determine the deposition of heavy minerals, which is known, and develop a sampling and exploration technique which will allow a resource categorization.

Marketing

Until May 2015 MRC sold all its zircon/rutile NMC to Wogen Pacific, a Chinese commodities trading company. In July 2013 MRC announced an offtake and US$2m working capital finance agreement with Wogen (the US$2m was fully repaid by March 2015). Following the agreement, Wogen paid MSR for the concentrate at an FOB level. Thereafter, Wogen funded the shipping and processing of the concentrate until such time as it was sold into the local Chinese market in finished product form, with sale proceeds net of commission, shipping and processing costs then being paid over to MSR. The initial agreement was for three-years.

On 1 May 2015, MRC announced to the ASX that it had served notice of suspension of the marketing agreement on Wogen due to matters pertaining to disputed moisture and quality claims, toll treatment standards, pricing of final product and payment delays, among others, which had had a material adverse effect on the agreement. The notice of suspension was followed up by full termination of the agreement, announced to the ASX on 13 May. MRC could not reach satisfactory agreement with Wogen in respect of the disputed moisture and quality claims etc, and consequently could not reach a marketing agreement for remaining Q215 sales.

MRC is now free to market its Tormin zircon/rutile concentrate directly to processor customers in China and has secured direct customer relationships to ensure there will be no interruption to its sales. We believe this is a better outcome for MRC than selling through a third-party as by having a direct relationship with its customers MRC will be better able to manage any quality disputes that may arise and ensure it minimises any related price discounts.

In the period since the marketing agreement with Wogen was ended, MRC indicates the transition to directly marketing its products to its customers has gone smoothly, with product being sold at pricing above what was achieved under the previous arrangement. MRC's non-magnetic concentrate product is well sought after by converters due to its high content of zircon and rutile which makes it one of the highest grade concentrates imported into the Chinese converter market. The market in China has many converter processing plants seeking feed stock as it gives them the opportunity to add value to the concentrate through cheaper in-country processing costs as opposed to buying finished zircon product which has a higher processing cost.

In respect of garnet marketing, MRC entered into a three-year garnet offtake agreement with GMA Garnet Group of Australia (GMA), the world's largest producer and global distributor of industrial garnet abrasives, which was announced to the ASX on 15 July 2014.

The three-year offtake agreement, with a further two-year buyer's option, provides for a minimum of 150,000tpa but up to 240,000tpa of garnet concentrate to be sold to GMA. Under the agreement, MRC has retained the right to sell up to 60ktpa of garnet concentrate to third parties at its discretion. Garnet is used in abrasive blasting and water jet cutting applications, and is a by-product of the zircon/rutile/ilmenite production process at Tormin. For every tonne of zircon concentrate, approximately five tonnes of garnet concentrate is produced.

Sales agreements for ilmenite concentrate remain under negotiation at the time of writing. MRC has indicated it has received a number of buyer enquiries due to Tormin's ilmenite concentrate having ideal iron and TiO_2 ratios, which makes it a suitable smelter feed to produce a TiO_2 slag.

Tormin resource and potential for expansion

As noted earlier, the Tormin resource is unique in that since MRC commenced mining it has been evident that natural replenishment of mined blocks by the tidal action depositing heavy minerals from offshore has occurred. In 2014 a total of 1.075Mt was mined including areas that had been mined up to five times. This phenomenon points to the potential for the resource to extend out to sea and in 2012 MRC secured the prospecting right for an area of 12km^2 offshore immediately adjacent to Tormin. This area runs the full 12km length of the existing Tormin tenement and extends 1km out to sea.

MRC is confident that the source of the Tormin beach deposit could extend much further out to sea and has applied for an extension to the prospecting area to a distance of 10km offshore, which will extend the potential resource area to 120km^2. While the application is currently going through the regulatory approval process (including public consultation), MRC is evaluating proposals to drill and sample the 12km^2 offshore area to which it holds the prospecting rights.

MRC is also exploring beyond Tormin for additional resources. Its subsidiary, Mineral Sand Resources, submitted a prospecting application for heavy mineral sands over a 24km stretch of coastline just to the north of its Tormin Mine on 4 June 2015. The Department of Mineral Resources – Western Cape accepted the application (reference number is WC 30/5/1/1/2/10226 PR).

The area under application encompasses approximately 398ha and extends from the northern boundary of the Tormin Mining licence area up to 24km northwards near Jakkalshok – only a few kilometres south of the Tronox heavy mineral sand mine – Namakwa Sands. The area under application is known to host heavy mineral sand deposits and has been the subject of previous exploration work done by Trans Hex.

MSR is currently busy with a scoping-level environmental assessment and a full public participation exercise. This is required as the prospecting application includes bulk sampling, which is a listed activity requiring environmental authorisation under NEMA.

The natural replenishment of the existing beach resource and the planned exploration drilling and sampling of the offshore area indicate the probability that the resource shown in Exhibit 3 could be extended.

Exhibit 3: Reconciliation of Tormin resource

Category	Resource (Mt)	Total (%HM)	Ilmenite (%HM)	Zircon (% HM)	Rutile (% HM)	Garnet (% HM)
Indicated resource – Dec 2013	2.70	49.40	10.60	3.40	0.70	25.30
Tonnes mined	1.07	55.30	16.90	5.02	0.65	32.55
Inferred resource – Dec 2014	2.70	38.14	10.05	2.21	0.46	25.22

Source: Mineral Commodities Q115 Quarterly Report

Xolobeni – potential to be a world-class ilmenite asset

MRC's Xolobeni resource is the tenth largest undeveloped heavy mineral deposit in the world, strategically located on South Africa's east coast with a tenement area of approximately 2,900 hectares. The resource statement is shown in Exhibit 4.

MRC owns prospecting rights to four of the five blocks in Xolobeni and lodged a mining right application for all prospecting permits covering Xolobeni in March 2015. The application for the prospecting rights for the fifth block, Kwanyana, is back at the public consultation stage after the initial application was rejected due to objections. MRC engaged in rounds of political and community consultations during 2014, including with the regional royal family, the Eastern Cape Cabinet, the district municipality, the local municipality and the local Chamber of Commerce.

A full report on the consultations and the necessary regulatory documents has been lodged with the Department of Mineral Resources and MRC is confident it will be awarded the prospecting right over the Kwanyana block in 2015. In the meantime, MRC's project work at Xolobeni has focused on baseline environmental and socioeconomic impact studies and economic modelling in preparation for a scoping study on the project.

Given Xolobeni's early stage, the sensitivities it has encountered with the local communities in respect of the Kwanyana block and the associated delays in being awarded a prospecting right for this block, we have elected not to incorporate Xolobeni into our financial model for MRC. However, as discussed in the valuation section of this report, there is value attributable to shareholders in this potentially large-scale project. Please refer to the valuation section for methodology used.

Exhibit 4: Xolobeni resource statement

Project	Category	Ore (Mt)	HM (%)	Ilmenite (% in HM)
Xolobeni	Measured	224	5.7	54.5
	Indicated	104	4.1	53.7
	Inferred	18	2.3	69.6
	Total	346	5.0	54.0

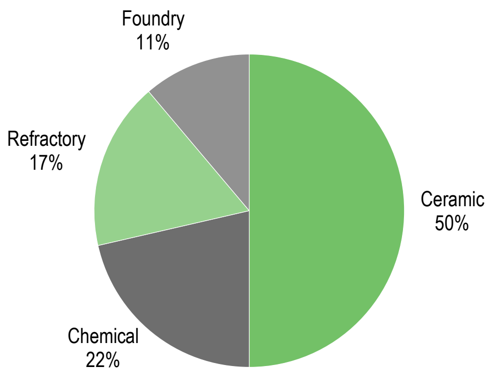
Source: Mineral Commodities Q115 Quarterly Report

Mineral sands markets

Mineral sands markets are different to base and precious metal markets in a number of ways. There is no large volume daily trading market such as the LME for base and precious metals, the supply side is relatively concentrated among three large global mining companies (Rio Tinto, Iluka and Tronox) and the end-user market is dominated by China. To further complicate the picture, the intermediate user market (the direct customer of the mining company) is highly fragmented in the case of zircon, but highly concentrated among about five major producers of titanium pigment sourced from ilmenite and rutile feedstock.

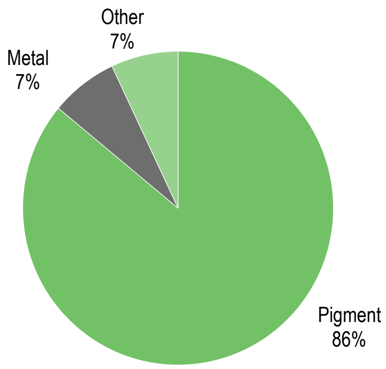
While nearly always occurring together in the same orebody, zircon and ilmenite/rutile have very different applications. Zircon, MRC's main revenue driver, is primarily used in ceramics (tiles, sanitary ware etc) as the source of whiteness, opacity and sheen. Other uses are in the chemical, refractory and foundry industries, as shown in Exhibit 5.

Exhibit 5: Zircon demand by application



Source: TZMI

Exhibit 6: TiO_2 demand by application

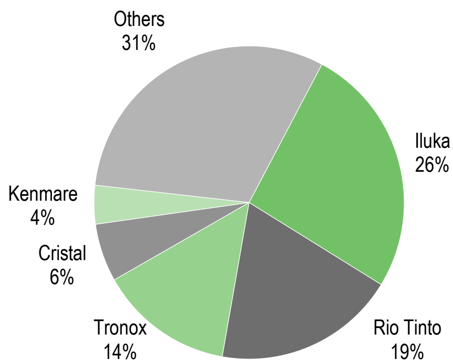


Source: TZMI

Rutile is an almost pure source (c 95% TiO_2) of titanium dioxide, the key ingredient in the manufacture of pigment. Ilmenite is also a source of titanium dioxide, but typically grades 45-48% TiO_2 with the remainder being mainly iron. Pigment provides the opacity to paint, plastics, paper and fillers. TiO_2 applications are shown in Exhibit 6 above.

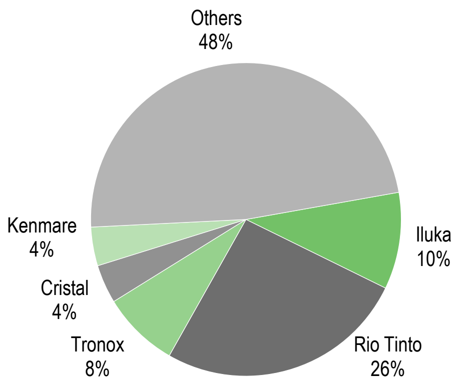
On the supply side the top five largest producers globally account for about 70% of zircon supply and about 50% of TiO_2 supply. In zircon, MRC's main revenue driver, the largest supplier is Iluka Resources with about 26% market share. In recent years Iluka has used its market presence to move the pricing of zircon from long-term (12-24 months) fixed price contracts to three-month fixed price contracts, resulting in larger volatility in zircon pricing than was the case historically.

Exhibit 7: Zircon supply by producer



Source: Iluka Resources

Exhibit 8: TiO_2 supply by producer



Source: Iluka Resources

Mineral sands pricing outlook

Key macro demand drivers for both zircon and rutile are growth in GDP per capita, urbanisation, construction and industrial output. Regionally the performance of these factors in China has the most influence, given it accounts for around 40% of consumption and has demonstrated the largest growth in these parameters for the last decade. The impact this has had on prices is demonstrated in Exhibit 9, which shows recent price history.

Exhibit 9: Recent historical annual weighted average rutile and zircon prices, US$/t

Commodity	2009	2010	2011	2012	2013	2014e
Rutile	510	560	1,170	2,400	1,069	600
Zircon	815	910	1,880	2,080	1,150	1,100

Source: Iluka Resources 2009-2013, Edison estimate 2014

The extreme surge in prices for both zircon and rutile from 2009 to 2012 was due to a combination of a rapid increase in demand from China because of the construction boom resulting from urbanisation and insufficient supply growth. Since 2012 prices have corrected significantly, mainly reflecting reduced apartment construction in China, and a weak European economy, which also accounts for around 35-40% of demand. We believe that with China on a lower growth trajectory than in recent years and the ability to manage the supply side well given the concentration of supply among the top five producers, prices in the future will be less volatile, with the peaks of 2012 unlikely to be achieved in the next few years and the much lower prices of 2009-10 also unlikely. Exhibit 10 shows the pricing assumptions we have used for our analysis of MRC.

Exhibit 10: Zircon and rutile price assumptions, US$/t

Commodity	2014	2015e	2016e	2017e	Long term
Zircon	1,075	1,050	1,250	1,200	1,200
Rutile	450	680	1,000	950	950

Source: Edison investment Research

Directors and management

MRC has a board and senior management team with extensive experience in exploration, mine development and operations, project finance and investment banking.

Mark Victor Caruso, executive chairman: Mark has extensive experience in mining, earthmoving and civil engineering. Most recently he served as chairman of Allied Gold, a Pacific Ring gold producer, where he raised over US$550m to develop its operations in Papua New Guinea and the Solomon Islands and oversaw the successful sale of Allied Gold in September 2012.

Tony Sheard, CFO: Tony has held senior financial roles in the resources & engineering sector for over 20 years. He holds a B. Comm, MBA and graduate diploma in Applied Finance & Investment and is a Fellow of CPA Australia and the Financial Services Institute of Australasia.

Guy Walker, non-executive director: Guy is a highly accomplished director and senior investment management executive with over 20 years' financial markets experience. He currently sits on the boards of several mining companies including exploration, development and production companies.

Peter Torre, non-executive director and company secretary: Peter was appointed company secretary of MRC in July 2006 and a director in April 2010. He is a chartered accountant, a chartered secretary and a member of the Australian Institute of Company Directors.

Joe Anthony Caruso, non-executive director: Joe is a director of Zurich Bay Holdings Pty and construction manager of Simto Australia Pty, both of which are involved in mining, earthmoving, civil engineering and construction. He has considerable experience in the management and administration of engineering, mining, raw materials production operations, earthmoving and related infrastructure and services contracts. Joe has been a director of MRC since September 2000 and served as chairman until August 2012.

Ross Hastings, independent non-executive director: Ross is a geologist with over 30 years' international experience of working in the minerals industry, with a majority of that time working in Papua New Guinea at Ok Tedi copper mine in the roles of geotechnical superintendent and manager of mining, and at Misima gold mine as chief geologist. From 1996 to 2014, he was involved with Allied Gold's Simberi Gold Project, where his roles included management of exploration and the feasibility and pre-development studies for mine construction. He progressed to general manager, resource development, and concluded his tenure at St Barbara subsequent to its merger between with Allied Gold Mining. He is currently a director of Perpetual Resources.

Sensitivities: Resource life and commodity assumptions, expansion ramp-up risk are key

We identify the following as key sensitivities for earnings and valuation forecasts:

- **Zircon and rutile assumptions:** these commodities, particularly zircon, are the key revenue drivers for MRC. We have assumed a modest recovery in both prices in 2016 to consensus long-term price assumptions, which are c 50% of the peaks seen in 2012.
- **Expansion ramp-up:** the main driver of our forecast growth is the planned expansion of processing plant during 2015 and early 2016. We have assumed commissioning in Q216, with full capacity achieved from the start of 2017. We believe this is a reasonable assumption given the small scale of the projects and MRC’s success in building and commissioning the initial facilities on time and on budget. However, any significant delay to the expansion would cause negative revisions to earnings and valuation forecasts.
- **Tormin resource life assumptions:** as discussed in the valuation section, Tormin's resource life could extend beyond four years if the resource replenishment by tidal action continues.
- **Local communities:** MRC has implemented proactive initiatives in managing its relationships with local communities at Tormin and Xolobeni. It works with its Black Economic Empowerment (BEE) partner, Blue Bantry Investments 255, to manage the expectations of local communities and other parties affected by its operations. The local communities are among South Africa’s poorest and MRC has several programmes in place to provide assistance, including a structured investment loan to Tormin BEE partners to provide investment in community projects and road upgrades; direct employment opportunities at Tormin; preferential procurement opportunities resulting in >40% of Tormin capital expenditure being spent in the immediate project area; recruitment, training and development programmes enabling over 80% of the workforce and over 50% of management positions to be people from the local communities; and support for a number of new businesses such as taxis, logistics and maintenance.

Valuation methodology and sensitivities

Exhibit 11 shows our base case valuation for MRC. We have used a DCF analysis as the base valuation methodology for Tormin and a nominal valuation for the early-stage Xolobeni project.

Exhibit 11: Mineral Commodities base case valuation

Item	Value
Tormin (DCF over four-year life @ 10% discount rate, US$m)	58.6
Xolobeni resource (nominal, US$m)	10.0
Net debt 2015e	5.2
No. of shares (m)	404.5
NPV US$/sh	0.16
NPV A$/sh	0.21

Source: Edison estimates. Note: A$/US$0.75 assumed.

Our base case valuation for MRC shares is A$0.21/share, which allows for a four-year life for Tormin in line with the stated resources, well above the current share price of A$0.1/share. Exhibit 12 displays a range of valuations for MRC shares for commodity price sensitivities of 10% higher and lower than our base case assumptions; 10%, 15% and 20% discount rates; and four-year and eight-year life scenarios. The eight-year life scenario is examined to test the valuation potential of MRC shares if the rate of resource replenishment that has already been experienced continues.

From Exhibit 12 it would appear that the market is currently valuing MRC shares using more than a 20% discount rate, 10% lower mineral sands prices than our base case, is assuming Tormin's life is limited to four years and is not attributing any value to a potential extension of its resource life.

Exhibit 12: A$/share valuation sensitivities – discount rates, commodities, project life

Commodity price sensitivity	10% disc. rate, four-year life	15% disc. rate, four-year life	20% disc. rate four-year life	10% disc. rate, eight-year life	15% disc. rate, eight-year life	20% disc. rate, eight-year life
+10%	28	26	24	48	42	37
Base case	21	19	18	37	32	28
-10%	14	13	12	26	22	19

Source: Edison estimates. Note AU$/US$0.75c assumed.

Financials

MRC reported its maiden profit in 2014 of US$8.4m after tax and US$4.0m before income tax benefit, from product sales revenue of US$33.3m. On commissioning and partial ramp-up of 2015 processing plant expansions, we forecast revenue increases to US$47.0m and pre-tax profit doubles to US$8.4m. The balance sheet is sound, with end-2014 net debt of US$3.0m forecast to rise to US$5.2m by end 2015 after a heavy year of capex of c US$14m. For end 2016 we forecast net cash of US$6.9m, on the back of expanded production and higher forecast zircon and rutile prices. This is after the forecast payment of US$9.9m of dividends based on a 45% payout ratio.

MRC's June 2015 Quarterly Report indicated sales of US$8.37m were below budget (US$11.91m), with sales of 11,622 tonnes of zircon/rutile concentrate and 66,312 tonnes of garnet sold to stockpile under an offtake agreement with GMA.

MRC cited the key reason for sales missing budget as lower zircon/rutile concentrate production, a carry-over of zircon/rutile concentrate quality claims from Q1 and a revised interim price for Garnet stockpile sales to GMA.

In its June Quarterly Activities Report, MRC confirmed it is currently assessing a dividend policy, which it expects to finalise in the second half of FY15. To be conservative, we have allowed for the maiden dividend declaration to occur in 2016 when earnings are forecast to have gained significant momentum. As is typical for most mining companies, we expect MRC to declare dividends on a payout ratio of earnings basis rather than a fixed dividend per share basis. A notional payout ratio of 45% provides an attractive return to shareholders (c 32% yield for 2016e at the current share price level) while enabling sufficient cash retention for future growth options.

Apart from zircon and rutile prices themselves, a key driver of MRC's revenue is the level of discount it receives for selling its product as a concentrate rather than separate processed products. The former marketing agreement with Wogen should have enabled MRC to achieve about 75% of the prevailing zircon and rutile prices, but was eroded due to further quality discounts Wogen imposed on delivered product.

As discussed in the marketing section above, MRC disputed the quality claims and has terminated the marketing agreement with Wogen, and will sell its product direct to its customer base. This should enable it to attain the targeted 75% zircon and rutile price level, and this increase is assumed in our forecasts.

Other options MRC is seeking to further enhance revenue include adding final processing of all non-magnetic concentrate and ilmenite concentrate through a standalone Magnetic Separation Plant (MSP). MRC is in discussions with third-party downstream processors with a view to forming joint ventures to enable magnetic separation. At this stage we do not allow for this in our forecasts.

MRC is in discussions with traditional providers regarding financing options for its planned expansion to the Garnet Separation Plant and the Tailings Scavenger Plant, which should enable production of NMC to increase to c 75ktpa from current levels of c 48ktpa which we have incorporated into our forecasts. Note that MRC effectively receives all its revenue in US$, while the majority of its costs are denominated in rand. Similarly, its reporting currency is also in US dollars.

It is important to note that while MRC has a 50% interest in its projects and its BEE partner Blue Bantry owns the remaining 50%, there are mechanisms under intercompany and shareholder agreements that, in effect, give MRC 100% of the economic benefits for at least the first five years of the operation and an c 80% interest in subsequent years (incorporated into our calculations in Exhibit 12).

Exhibit 13: Financial summary

US$000	2013	2014	2015e	2016e	2017e	2018e	2019e
31-December	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS							
Revenue	225	34,960	46,968	83,512	90,530	90,530	90,530
Cost of Sales	(1,382)	(27,233)	(32,000)	(44,750)	(50,600)	(50,600)	(50,600)
Gross Profit	(1,157)	7,728	14,968	38,762	39,930	39,930	39,930
EBITDA	(1,157)	7,728	14,968	38,762	39,930	39,930	39,930
Operating Profit (before amort. and except.)	(1,309)	4,457	9,289	33,070	34,376	34,486	34,575
Intangible Amortisation	0	0	0	0	0	0	0
Share based payments	0	0	0	0	0	0	0
Other	(95)	(30)	(30)	(30)	(30)	(30)	(30)
Exceptionals	0	0	0	0	0	0	0
Operating Profit	(1,404)	4,427	9,259	33,040	34,346	34,456	34,545
Net Interest	(166)	(478)	(906)	(1,564)	344	1,041	1,748
Profit Before Tax (norm)	(1,570)	3,949	8,353	31,475	34,689	35,497	36,293
Profit Before Tax (FRS 3)	(1,570)	3,949	8,353	31,475	34,689	35,497	36,293
Tax	0	4,427	(2,506)	(9,443)	(10,407)	(10,649)	(10,888)
Profit After Tax (norm)	(1,570)	8,376	5,847	22,033	24,283	24,848	25,405
Profit After Tax (FRS 3)	(1,570)	8,376	5,847	22,033	24,283	24,848	25,405
Minority Interest	0	0	0	0	0	0	0
Net income (normalised)	(1,570)	8,376	5,847	22,033	24,283	24,848	25,405
Net income (FRS3)	(1,570)	8,376	5,847	22,033	24,283	24,848	25,405
Average Number of Shares Outstanding (m)	251.8	404.9	404.9	404.9	404.9	404.9	404.9
EPS - normalised (USc)	(0.6)	2.1	1.4	5.4	6.0	6.1	6.3
EPS - normalised and fully diluted (USc)	(0.6)	2.0	1.4	5.4	6.0	6.1	6.3
EPS - (IFRS) (USc)	(0.6)	2.1	1.4	5.4	6.0	6.1	6.3
Dividend per share (Ac)	0.0	0.0	0.0	2.4	2.7	2.8	2.8
Gross Margin (%)	-514.5	22.1	31.9	46.4	44.1	44.1	44.1
EBITDA Margin (%)	-514.5	22.1	31.9	46.4	44.1	44.1	44.1
Operating Margin (before GW and except.) (%)	-581.8	12.7	19.8	39.6	38.0	38.1	38.2
BALANCE SHEET							
Fixed Assets	30,383	34,986	43,057	43,115	42,560	42,117	41,762
Intangible Assets	0	4,037	4,037	4,037	4,037	4,037	4,037
Tangible Assets	30,383	30,949	39,020	39,078	38,523	38,080	37,725
Investments	0	0	0	0	0	0	0
Current Assets	3,548	13,488	12,370	28,873	44,661	58,800	73,158
Stocks	772	6,123	8,226	14,626	15,856	15,856	15,856
Debtors	1,178	3,085	4,144	7,369	7,988	7,988	7,988
Cash	1,503	4,216	0	6,877	20,817	34,957	49,314
Other	94	64	0	0	0	0	0
Current Liabilities	(8,548)	(17,191)	(11,532)	(16,126)	(18,235)	(18,235)	(18,235)
Creditors	(2,522)	(9,956)	(11,532)	(16,126)	(18,235)	(18,235)	(18,235)
Short term borrowings	(6,026)	(7,235)	0	0	0	0	0
Long Term Liabilities	0	(77)	(5,214)	0	0	0	0
Long term borrowings	0	0	(5,214)	0	0	0	0
Other long term liabilities	0	(77)	0	0	0	0	0
Net Assets	25,382	31,206	38,682	55,861	68,986	82,683	96,686
CASH FLOW							
Operating Cash Flow	(2,209)	8,440	14,968	38,762	39,930	39,930	39,930
Net Interest	56	(932)	(906)	(1,564)	344	1,041	1,748
Tax	0	0	(2,506)	(9,443)	(10,407)	(10,649)	(10,888)
Capex	(20,517)	(5,414)	(13,750)	(5,750)	(5,000)	(5,000)	(5,000)
Acquisitions/disposals	0	18	0	0	0	0	0
Financing	10,492	(3)	0	0	0	0	0
Dividends	0	0	0	(9,915)	(10,927)	(11,182)	(11,432)
Net Cash Flow	(12,177)	2,108	(2,194)	12,091	13,940	14,140	14,357
Opening net debt/(cash)	(8,057)	4,523	3,019	5,214	(6,877)	(20,817)	(34,957)
HP finance leases initiated	0	0	0	0	0	0	0
Other	(403)	(604)	0	0	0	0	0
Closing net debt/(cash)	4,523	3,019	5,214	(6,877)	(20,817)	(34,957)	(49,314)

Source: Company accounts, Edison Investment Research

Contact details	Revenue by geography
40 Murray Road North Welshpool Perth - 6106 Australia +61 8 6253 1100 www.mineralcommodities.com	Not disclosed

Management team

Executive Chairman and CEO: Mark Caruso	Chief Financial Officer: Tony Sheard
Mr Caruso has extensive experience in mining, earthmoving and civil engineering construction earthworks. He has been a director of the company since September 2000.	Tony has held senior financial roles in the resources and engineering sector for over 20 years. He holds a B. Comm, MBA and Graduate Diploma in Applied Finance and Investment and is a Fellow of both Certified Public Accountant Australia and Financial Services Institute of Australasia.
Non-executive director: Guy Walker	**Non-executive director & company secretary: Peter Torre**
Guy is a highly accomplished director and senior investment management executive with over 20 years' financial markets experience. He currently sits on the boards of several mining companies including exploration, development and production companies.	Peter was appointed company secretary of MRC in July 2006 and a director in April 2010. He is a chartered accountant, a chartered secretary and a member of the Australian Institute of Company Directors. He was previously a partner of an internationally affiliated firm of chartered accountants and is currently the company secretary of several ASX-listed companies.

Principal shareholders	(%)
AU Mining	23.61
HSBC Custody Nominees (Australia)	21.68
Citicorp Nominees	14.57
Zurich Bay Holdings Pty	12.35
Zurich Bay Holdings Pty (Minesite Construction A/C	6.36
JP Morgan Nominees Australia	2.98
Miss Kathryn Yule	1.57

Companies named in this report

Iluka ILU; Rio Tinto RIO; Tronox, Cristal, Kenmare