Atlas Iron Limited (AGO) – BUY, PT $0.04

Monetising infrastructure with PLS DSO agreement

Recommendation				Buy
Previous				Buy
Risk				High
Price Target				$ 0.040
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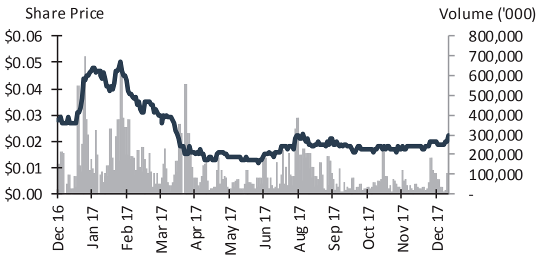
Share Price (A$)				**$ 0.022**
ASX Code				AGO
52 week low - high (A$)				0.012-0.05
Capital structure				
Shares on Issue (M)				9,280
Market Cap (A$M)				**204**
Net Cash/(Debt) (A$M)				11
EV (A$m)				**193**
Options on issue (M)				0
12mth Av Daily Volume ('000)				105,417
Y/e Jun earning A$M	**2017a**	**2018e**	**2019e**	**2020e**
Sales	871.1	624.2	727.6	552.6
EBITDA, adj	135.1	98.4	92.5	92.6
NPAT, adj	48.0	23.2	18.3	17.5
EPS, adj c	0.51	0.25	0.19	0.19
Board				
Eugene Davis				Non-Executive Chairman
Cliff Lawrenson				Managing Director
Daniel Harris				Non-Executive Director
Alan Carr				Non-Executive Director
Cheryl Edwardes, AM				Non-Executive Director
Major Shareholders				
Legg Mason Inc.				10.2%
Bain Capital Credit LP				6.2%

Share Price Graph



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The analyst does not own AGO securities.

Foster Stockbroking and associated entities (excluding Cranport Pty Ltd) do not own AGO securities.

Cranport Pty Ltd owns 26,869,043 AGO shares.

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Event:

- **DSO agreement with Pilbara Minerals (PLS); revised assumptions.**

Analysis:

- **DSO agreement reached with Pilbara Minerals (PLS):** AGO will purchase a minimum of 1Mt of 1.5% lithium DSO from Pilbara Minerals, and up to 1.5Mt over the next fifteen months.
- **Monetising AGO's existing infrastructure:** AGO will purchase the ore at PLS' Pilgangorora mine gate, and crush the ore at Mt Dove, transport and load to ship for export using its existing capacity at Utah Point.
- **$30M EBITDA contribution from Lithium DSO opportunity**: AGO expect an operating margin of A$15-20/t lithium DSO. We have assumed 1.5Mt of DSO from April 2018e, and a price of US$120/t for Li 1.5% DSO.
- **Altura Mining (AJM) royalties to bolster cash flow in FY19e:** 5% gross sales royalty to AGO from AJM's Pilgangoora production expected to generate ~$5M cash per year from FY18e onwards. We estimate ~A$50M value from the royalty stream.
- **Delivering on growth options, preview of further deals to come:** as previously flagged, AGO was keen to monetise its existing infrastructure, and in particular its crushing, transport, and port capacity. We are now seeing the first fruits of that revenue diversification pivot. AGO continue to work on deals for ~2.5Mtpa remaining Utah Point capacity.
- **Additional cash likely to allow for continued headway into debt reduction**. Term Loan B was A$103M at 30 September, while cash was A$114M. Proceeds from AJM royalty stream likely to be applied to debt.
- **Growth options:** the company continue to consider future iron ore opportunities including bespoke low alumina iron ore product, Corunna Downs development, DSO from Davidson Creek Hub and Miralga Creek, and magnetite from the Ridley Project. Outside of iron ore, the company has flagged further lithium (Pancho, Cisco JV) and gold opportunities.

Earnings and Valuation:

- We now forecast FY18e and FY19e EBITDA of $98M and $93M (previously $108M and $78M).
- We have an unchanged valuation of $0.04 based on our DCF valuation. The inclusion of lithium DSO, AJM royalties, and updated iron ore forecasts was offset by updated currency forecasts and persistent iron ore discounts. **We view AGO as a leveraged opportunity for a constructive view of underlying commodity prices, with increased revenue diversification from lithium DSO and monetising existing infrastructure.**

Recommendation:

- We maintain a **Buy recommendation** on AGO with an unchanged **price target of $0.04**, in line with our DCF valuation. Revenue diversification through mining services is a welcome addition to the portfolio. We see positive catalysts for the stock include 1) further lithium DSO agreements; 2) updates on Corunna Downs development; 3) further debt reduction; 4) development updates on further growth opportunities in iron ore and other commodities.