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OZ Minerals Ltd (OZL)

Bid highlights quality asset base

Recommendation

Hold (Buy)

Price

\$25.59

Target (12 months)

\$25.00 (previously \$24.45)

GICS Sector

Materials

Expected Return

Capital growth	-2.3%
Dividend yield	0.6%
Total expected return	-1.7%

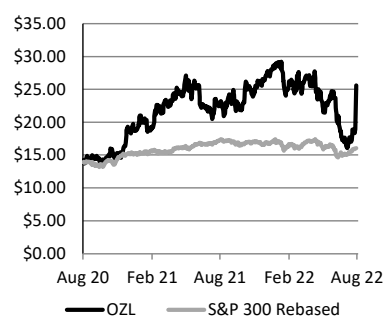
Company Data & Ratios

Enterprise value	\$8,484m
Market cap	\$8,566m
Issued capital	334.7m
Free float	100%
Avg. daily val. (52wk)	\$53.6m
12 month price range	\$15.82-\$29.75

Price Performance

	(1m)	(3m)	(12m)
Price (A\$)	17.45	24.46	22.69
Absolute (%)	46.6	4.6	12.8
Rel market (%)	40.5	8.7	18.9

Absolute Price



SOURCE: IRESS

BHP conditionally offers \$25.00/sh in cash

OZL has received an unsolicited, conditional and non-binding indicative proposal from BHP Group Limited (BHP:AU, not rated), to acquire all shares in OZL for A\$25.00/sh in cash via scheme of arrangement. OZL's Board has determined that it significantly undervalues OZL and is not in the best interests of shareholders. OZL cites factors including: its unique portfolio of high-quality copper and nickel assets in a Tier-1 mining jurisdiction; being the only primary copper producer in the ASX100; its high-quality growth projects, including West Musgrave, the Carrapateena Block Cave and Prominent Hill Extension; the strong long-term outlook for the copper and nickel markets; significant synergies and other benefits to BHP in SA and WA; and the growth and diversification OZL offers to BHP's global copper portfolio.

Premium required to complete, potential for competing bid

In our view this puts OZL completely in play and, with an open register dominated by non-strategic institutional investors, we believe the chances of completion of the acquisition of OZL are high. We also believe this will be seen as an initial offer from BHP and that institutions will want to be compensated for the lack of large-cap investable copper producer options on the ASX. In the first instance, we expect a higher cash bid from BHP as the deal makes strategic sense and offers production growth in a secure jurisdiction. We also believe the scarcity of comparable assets in comparable jurisdictions makes the chances of a competing counter-offer reasonable. Our previous valuation of \$24.45/sh does not include a premium for control or scarcity.

Investment thesis – Hold, TP\$25.00/sh (from Buy, \$24.45/sh)

We view BHP's proposal as offering competitive value but likely to be improved. However, the risk-adjusted potential upside is insufficient for us to maintain a Buy rating and we downgrade to Hold, with a strategy to see through to completion of an all-cash acquisition of OZL by BHP or a competing bidder at the current offer price or higher. We make no changes to our earnings forecasts and increase our valuation by 2% to match the current offer price of \$25.00/sh.

Earnings Forecast

Year end 31 December	2021a	2022e	2023e	2024e
Sales (A\$m)	2,097	1,954	2,110	2,045
EBITDA (A\$m)	1,162	768	886	836
NPAT (reported) (A\$m)	531	345	405	374
NPAT (adjusted) (A\$m)	531	345	405	374
EPS (adjusted) (cps)	159.6	103.0	120.8	111.5
EPS growth (%)	145%	-35%	17%	-8%
PER (x)	16.0	24.9	21.2	22.9
FCF Yield (%)	4%	-5%	-3%	-1%
EV/EBITDA (x)	7.3	11.1	9.6	10.2
Dividend (cps)	34	16	18	23
Yield (%)	1.3%	0.6%	0.7%	0.9%
Franking (%)	100%	100%	100%	100%
ROE (%)	14%	9%	9%	8%

SOURCE: BELL POTTER SECURITIES ESTIMATES

Bid highlights quality asset base

BHP conditionally offers \$25.00/sh in cash

OZL has reported that, on 5 August 2022, it received an unsolicited, conditional and non-binding indicative proposal from BHP Group Limited (BHP:AU, not rated) to acquire all shares in OZL for A\$25.00/sh in cash via scheme of arrangement. OZL has also been advised by BHP that it has accumulated an interest in OZL (via derivative instruments) amounting to an interest of less than 5%. OZL's Board has assessed the Proposal and unanimously determined that it significantly undervalues OZL and is not in the best interests of shareholders. OZL cites factors including:

- its unique portfolio of high-quality copper and nickel assets in a Tier-1 mining jurisdiction with long mine lives and first quartile costs;
- OZL being the only primary copper producer in the ASX100;
- the high-quality nature of OZL's growth projects which include the West Musgrave nickel-copper Project (FID scheduled for 2HCY22), the Carrapateena Block Cave and Prominent Hill Extension projects which together are expected to generate significant production growth over the next 5 years;
- the strong long-term outlook for the copper and nickel markets, underpinned by increasing geological scarcity, global electrification and decarbonisation;
- significant synergies and other benefits to BHP including operational synergies in South Australia (between Olympic Dam, Carrapateena and Prominent Hill) and in Western Australia (between Nickel West and West Musgrave); and
- the growth and diversification OZL offers to BHP's global copper portfolio.

In its proposal, BHP has made the case that its offer represents a significant premium to the market value of OZL shares and delivers immediate value to OZL shareholders for projects that are in various stages of development and subject to development and financing risks.

Premium required for completion, potential for competing bid

In our view this offer puts OZL completely in play and, with a wide-open register dominated by non-strategic institutional investors, we believe the chances of completion of the acquisition of OZL are high. OZL's Board will have to act in the interests of its (effectively institutional) shareholders and for institutional investors every asset has a price.

Whilst BHP's offer premium is attractive (32.1% to OZL's closing price of \$18.92/sh on 5 August 2022 and 41.4% to OZL's 30-day VWAP of A\$17.67/sh), we also believe this will be seen as an initial offer from BHP and that institutions will want to be compensated for the lack of large-cap investable copper producer options on the ASX. As such, in the first instance, we expect a higher cash bid from BHP.

We also believe the scarcity of these types of assets in Tier-1 jurisdictions makes OZL's portfolio increasingly attractive and we wouldn't be surprised to see a counter-offer from the likes of Rio Tinto (RIO:AU, not rated), Freeport McMoran (FCX:US, not rated) or even First Quantum (FM:CN, not rated). Given the location of OZL's assets however, BHP is the most natural owner, knows how to operate in that jurisdiction, is the best placed to extract the most value from operational synergies and therefore able to pay the highest price.

Proposal makes strategic sense

The operational synergies noted above are helpful but equally or more important are other strategic factors, such as BHP securing copper production growth in a Tier-1 jurisdiction.

BHP currently produces ~1.6Mtpa of copper, of which ~1Mtpa comes from the Escondida copper mine in Chile, a jurisdiction facing significant negative risks related to policies and fiscal terms being considered by a newly elected Government. BHP is reportedly re-evaluating US\$10 billion (A\$14.3 billion) of operational re-investment to maintain production as a result.

The offer price for OZL of \$25.00/sh equates to A\$8.4 billion and would increase BHP's copper production by ~140ktpa (~8.5%), potentially establishing BHP as the world's largest copper producer. It would also double BHP's Australian-sourced copper production to ~280ktpa (16% of expanded production), de-risking its asset base.

Valuation

In terms of valuation, the offer price aligns closely with our previous target price of \$24.45/sh, so we see it as a competitive starting point.

BHP argues that its offer brings forward the value of potential cash flows from development projects and brings certainty to OZL shareholders in an uncertain operating and economic environment. This is true, but we believe our previous valuation also reflects these factors. It was recently lowered to reflect a higher risk, higher cost and more challenging operating environment. Our valuation is forward looking and includes risk-adjusted Discounted Cash Flow (DCF) valuations for OZL's development projects, such as West Musgrave, i.e. reflecting the fair value of future cash flows and the risks associated with realising them.

Our valuation does not reflect either a scarcity premium or a premium for control and it is here where we see a higher offer may be justified by either BHP or a competitor.

Theoretically, the offer is dilutive for BHP trading on a ~9.0x trailing P/E ratio compared with OZL trading on ~16.0x, but OZL's production and earnings growth profile is stronger and the relative size of OZL as a target largely mitigates this aspect.

Changes to our forecasts

There are no operational updates that require us to change our forecasts made with the June 2022 quarterly report. We make no material changes to our modelled assumptions.

Table 1 - Changes to our earnings estimates

Year ending 31 Dec	Previous			New			Change		
	2022e	2023e	2024e	2022e	2023e	2024e	2022e	2023e	2024e
Prices & currency									
Copper (US\$/lb)	4.10	3.90	4.00	4.10	3.90	4.00	0%	0%	0%
Gold (US\$/oz)	1,850	1,900	1,925	1,850	1,900	1,925	0%	0%	0%
US\$/A\$	0.71	0.69	0.70	0.71	0.69	0.70	0%	0%	0%
Production & costs									
Copper (kt)	123	138	137	123	138	137	0%	0%	0%
Gold (koz)	209	209	206	209	209	206	0%	0%	0%
C1 cost (US\$/lb)	1.23	0.97	1.02	1.23	0.97	1.02	0%	0%	0%
Total costs (US\$/lb)	2.24	1.76	1.81	2.24	1.76	1.81	0%	0%	0%
Earnings									
Revenue (A\$m)	1,954	2,110	2,045	1,954	2,110	2,045	0%	0%	0%
EBITDA (A\$m)	768	886	836	768	886	836	0%	0%	0%
EBIT (A\$m)	512	603	559	512	603	559	0%	0%	0%
NPAT (adjusted) (A\$m)	345	405	374	345	405	374	0%	0%	0%
EPS (adjusted) (cps)	103	121	112	103	121	112	0%	0%	0%
PER (x)	16.5	14.1	15.2	24.9	21.2	22.9	8.3	7.1	7.7
EPS growth (%)	-35%	17%	-8%	-35%	17%	-8%	0%	0%	0%
Free cash flow (A\$m)	(448)	(234)	(95)	(448)	(234)	(95)	na	na	na
DPS (reported) (cps)	16	18	23	16	18	23	0%	0%	0%
Yield	1.8%	1.3%	1.4%	0.6%	0.7%	0.9%	-1.1%	-0.6%	-0.5%
Valuation (sum of parts) (\$/sh)	23.96	24.45	24.89	23.96	24.45	24.89	0%	0%	0%
Price Target (\$/sh)		24.45			25.00			2%	

SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

We view BHP's proposal as offering competitive value but likely to be improved. However, the risk-adjusted potential upside is insufficient for us to maintain a Buy rating and we downgrade to Hold, with a strategy to see through to completion of an all-cash acquisition of OZL at the current offer price or higher.

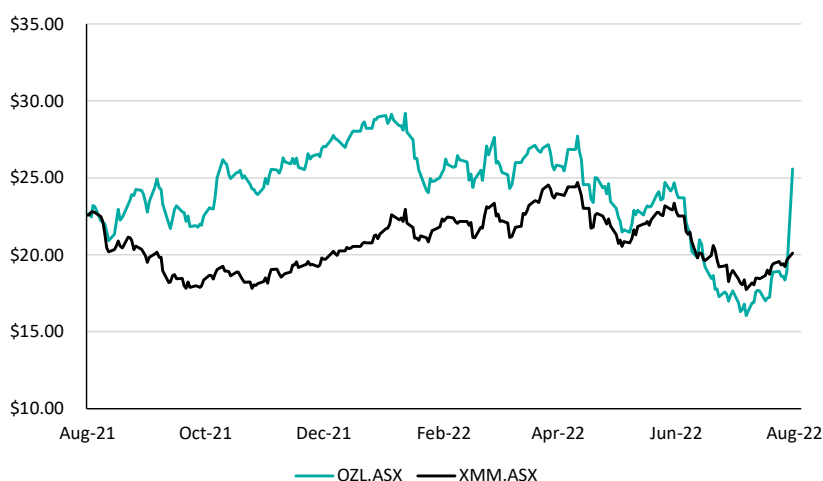
Upcoming catalysts

Key near term catalysts for OZL include:

- The progression of BHP's offer for OZL, including the potential for a higher bid in order to secure the acquisition of OZL. We also view the chances of a competing bid from a third party as reasonable, given the scarcity of comparable assets in comparable jurisdictions globally;
- The release of OZL's 1HCY22 financial results, expected in August 2022;
- Approval of the Kalkaroo option agreement by HAV shareholders, which is expected to be voted on in August 2022;
- The September 2022 quarter production report, expected in late October 2022;
- The ramp-up of underground mining production at Prominent Hill to 5Mtpa through CY22, and at Carrapateena to 5Mtpa from CY23;
- The final investment decision for the West Musgrave project in 2HCY22, including updated Resource and Reserve Statements and the results of the nickel Mixed Hydroxide Product (MHP) study;
- Progress updates on the Prominent Hill shaft expansion project, including headframe installation in Q1CY23 and completion in late CY24; and
- Completion of the Santa Lucia PFS in Q4CY22, part of the Carajas hub in Brazil.

OZL vs the ASX Metals and Mining Index

Figure 1 - OZL relative share price performance vs ASX Metals and Mining Index (XMM)



SOURCE: IRESS

OZ Minerals Ltd (OZL)

Company description: Australian copper producer

OZL's 100% owned Prominent Hill copper-gold operation is located 130km northwest of BHP Billiton's Olympic Dam operation in the Gawler Craton, South Australia. Shipments of concentrate began in April 2009. It currently produces ~60tpa copper and ~130kozpa gold in concentrate sourced from its underground mining operations.

OZL's Carrapateena Copper Mine, also in South Australia, successfully ramped up to nameplate production during CY20 and is targeting production of ~70ktpa Cu and 90kozpa Au from its underground caving operations. Expansion to a Block Caving mining method was approved in CY21, targeting a lift in mining rates from 4-5Mtpa to up to 12Mtpa from CY26. Copper production will increase to 110-120ktpa.

OZL has also built out an extensive pipeline of development assets in Australia and overseas. This includes a suite of assets in Brazil, centred on the Carajas Hub, where production from the Pedra Branca underground mine is ramping up.

Investment thesis – Hold, TP\$25.00/sh (from Buy, \$24.45/sh)

We view BHP's proposal as offering competitive value but likely to be improved. However, the risk-adjusted potential upside is insufficient for us to maintain a Buy rating and we downgrade to Hold, with a strategy to see through to completion of an all-cash acquisition of OZL at the current offer price or higher. We make no changes to our earnings forecasts and increase our valuation by 2% to match the current offer price of \$25.00/sh.

Valuation & target price

Our OZL target price is based on our 12-month forward sum of parts NPV valuation for the Prominent Hill mine and Carrapateena development project.

Our 12-month forward valuation incorporates:

- A discounted cash flow valuation of OZL's Prominent Hill copper-gold mine;
- A discounted cash flow valuation of the Carrapateena copper-gold mine;
- A discounted cash flow valuation of the Carajas copper operations in Brazil;
- An estimation of the value of OZL's exploration and development assets, including a risk-adjusted discounted cash flow valuation of the West Musgrave Project;
- The market value of OZL's listed investments; and
- Estimated valuations of OZL's corporate costs and net cash position.

Risks

Risks to OZL include, but are not limited to:

- **Operating and development risks:** Mining companies' assets are subject to risks associated with their operation and development. Risks for each company can be heightened depending on method of operation (e.g. underground versus open pit mining) or whether it is a single mine company. Development of mining assets may be subject to receiving permits, approvals timelines or weather events, causing delays to commissioning and commercial production.
- **Operating and capital cost fluctuations:** The cost and availability of exploration, development and mining inputs can fluctuate widely and cause significant differences between planned and actual operating and capital costs. Key operating costs are linked to energy and labour costs as well as access to, and availability of, technical skills, operating equipment and consumables.
- **Commodity price and exchange rate fluctuations:** The future earnings and valuations of exploration, development and producing Resources companies are subject to fluctuations in underlying commodity prices and foreign currency exchange rates.
- **Resource growth and mine life extensions:** The viability of future operations and the earnings forecasts and valuations reliant upon them may depend upon resource and reserve growth to extend mine lives, which is in turn dependent upon exploration success, of which there are no guarantees.
- **Funding and capital management risks:** Funding and capital management risks can include access to debt and equity finance, maintaining covenants on debt finance, managing dividend payments and managing debt repayments. Exploration and development companies with no sales revenues are reliant on access to equity markets and debt financing to fund the advancement and development of their projects.
- **Corporate/M&A risks:** Risks associated with M&A activity including differences between the entity's and the market's perception of value associated with completed transactions.
- **Regulatory changes risks:** Changes to the regulation of infrastructure and taxation (among other things) can impact the earnings and valuation of mining companies.
- **Sovereign risks:** Mining companies' assets are subject to the sovereign risks of the jurisdiction within which they are operating.
- **Geopolitical risks:** Mining companies' assets are subject to geopolitical risks, arising from events in, and outside, the jurisdictions they operate in.
- **COVID-19 risks:** Mining companies' rely on freedom of movement of workforces, functioning transport routes, reliable logistics services including road, rail, aviation and ports in order to maintain operations and get their products to market. They also rely on liquid, functioning markets to sell their products. Measures being put in place to combat the COVID-19 pandemic are posing risks to these conditions.

Table 2 - Financial summary

PROFIT AND LOSS						FINANCIAL RATIOS							
Year ending 31 Dec	Unit	2020a	2021a	2022e	2023e	2024e	Year ending 31 Dec	Unit	2020a	2021a	2022e	2023e	2024e
Revenue	\$m	1,342	2,097	1,954	2,110	2,045	VALUATION						
Expense	\$m	(685)	(878)	(1,131)	(1,155)	(1,139)	NPAT (underlying)	\$m	213	531	345	405	374
Exploration	\$m	(51)	(56)	(55)	(70)	(70)	EPS (underlying, diluted)	c/sh	65	160	103	121	112
EBITDA	\$m	606	1,162	768	886	836	EPS growth	%	29%	145%	-35%	17%	-8%
Depreciation & amortisation	\$m	(283)	(367)	(256)	(282)	(277)	PER	x	39.2x	16.0x	24.9x	21.2x	22.9x
EBIT	\$m	323	796	512	603	559	DPS	c/sh	25	34	16	18	23
Net interest expense	\$m	(27)	(39)	-	-	-	Franking	%	100%	100%	100%	100%	100%
PBT	\$m	296	757	512	603	559	Yield	%	1.0%	1.3%	0.6%	0.7%	0.9%
Tax expense	\$m	(83)	(226)	(166)	(198)	(185)	FCF/share	c/sh	9	102	(134)	(70)	(29)
NPAT (continuing operations)	\$m	213	531	345	405	374	P/CFPS	x	276.2x	25.0x	-19.0x	-36.6x	-89.6x
Profit/(loss) from discontinued ops	\$m	-	-	-	-	-	EV/EBITDA	x	14.1x	7.3x	11.1x	9.6x	10.2x
Reported NPAT	\$m	213	531	345	405	374	EBITDA margin	%	45%	55%	39%	42%	41%
Non-underlying items	\$m	-	-	-	-	-	EBIT margin	%	24%	38%	26%	29%	27%
Adjusted NPAT	\$m	213	531	345	405	374	Return on assets	%	4%	10%	6%	6%	5%
Less: Non-controlling interest	\$m	-	-	-	-	-	Return on equity	%	7%	14%	9%	9%	8%
NPAT attributable to OZL equity	\$m	213	531	345	405	374	LIQUIDITY & LEVERAGE						
PROFIT AND LOSS						LIQUIDITY & LEVERAGE							
Half years	Unit	Dec-20a	Jun-21a	Dec-21a	Jun-22e	Dec-22e	Net debt (cash)	\$m	(32)	(215)	333	610	775
Revenue	\$m	767	986	1,111	997	957	ND / E	%	-1%	-6%	8%	14%	17%
Expense	\$m	(386)	(401)	(477)	(524)	(607)	ND / (ND + E)	%	-1%	-6%	8%	12%	14%
Exploration expensed	\$m	(26)	(24)	(32)	(28)	(28)	EBITDA / Interest	x	22.4	29.7	0.0	0.0	0.0
EBITDA	\$m	355	561	601	445	322	ASSUMPTIONS - Prices						
Depreciation & amortisation	\$m	(156)	(173)	(194)	(66)	(190)	Year ending 31 Dec	Unit	2021a	2022e	2023e	2024e	LT real
EBIT	\$m	199	388	408	380	132	Metals						
Net interest expense	\$m	(15)	(21)	(19)	-	-	Copper	US\$/lb	4.22	4.10	3.90	4.00	4.19
PBT	\$m	184	368	389	380	132	Gold	US\$/oz	1,800	1,850	1,900	1,925	1,968
Tax expense	\$m	(51)	(99)	(127)	(120)	(46)	Silver	US\$/oz	25.20	22.87	22.35	22.65	23.21
NPAT (continuing operations)	\$m	133	269	262	259	86	CURRENCY						
Profit/(loss) from discontinued ops	\$m	-	-	-	-	-	AUD/USD	US\$/A\$	0.75	0.71	0.69	0.70	0.72
Reported NPAT	\$m	133	269	262	259	86	ASSUMPTIONS - Production & costs						
Non-underlying items	\$m	-	-	-	-	-	Year ending 31 Dec	Unit	2020a	2021a	2022e	2023e	2024e
Adjusted NPAT	\$m	133	269	262	259	86	Production						
Less: Non-controlling interest	\$m	-	-	-	-	-	Copper	kt	98	125	123	138	137
NPAT attributable to OZL equity	\$m	133	269	262	259	86	Gold	koz	258	237	209	209	206
CASH FLOW						Costs							
Year ending 31 Dec	Unit	2020a	2021a	2022e	2023e	2024e	C1 costs	US\$/lb	-0.04	0.64	1.23	0.97	1.02
OPERATING CASHFLOW							Total costs	US\$/lb	0.81	1.44	2.24	1.76	1.81
Receipts	\$m	1,253	2,043	2,017	2,090	2,056	Valuation						
Payments	\$m	(589)	(830)	(1,292)	(1,230)	(1,212)	Issued capital						
Tax	\$m	(44)	(146)	(166)	(198)	(185)	Shares on issue	m					
Net interest	\$m	(23)	(40)	-	-	-	Options/Perf. Rights						
Other	\$m	(47)	(56)	(18)	-	-	Total diluted shares on issue						
Operating cash flow	\$m	550	971	542	661	660	Current						
INVESTING CASHFLOW						Sum of parts valuation							
Capex incl. deferred mining	\$m	(546)	(572)	(855)	(785)	(685)	A\$m	\$/sh	A\$m	\$/sh	A\$m	\$/sh	
Exploration & evaluation	\$m	(17)	(72)	(135)	(110)	(70)	Prominent Hill	1,446	4.32	1,723	5.15	1,916	5.72
Investments	\$m	-	-	-	-	-	Carrapateena	5,788	17.29	6,124	18.29	6,359	19.00
Other	\$m	43	14	-	-	-	Carajas	146	0.44	120	0.36	70	0.21
Investing cash flow	\$m	(520)	(630)	(990)	(895)	(755)	Other Exploration	770	2.30	770	2.30	770	2.30
Free cash flow	\$m	30	341	(448)	(234)	(95)	Corporate	(266)	(0.80)	(223)	(0.67)	(176)	(0.53)
FINANCING CASHFLOW						Subtotal							
Share issues/(buy-backs)	\$m	-	-	-	-	-	7,884	23.55	8,514	25.43	8,939	26.70	
Debt proceeds/(repayments)	\$m	100	(100)	375	350	100	Net cash	132	0.39	(333)	(1.00)	(610)	(1.82)
Dividends	\$m	(73)	(81)	(100)	(43)	(70)	Investments	4	0.01	4	0.01	4	0.01
Other	\$m	(55)	(76)	-	-	-	Total	8,019	23.96	8,185	24.45	8,332	24.89
Financing cash flow	\$m	(28)	(257)	275	307	30	Substantial holders						
Change in cash	\$m	2	84	(174)	73	(65)	Shareholder						
BALANCE SHEET						Substantial holders							
Year ending 31 Dec	Unit	2020a	2021a	2022e	2023e	2024e	BlackRock Group					5.4%	18.1
ASSETS							Dimensional					5.0%	16.6
Cash & short term investments	\$m	132	215	42	115	50	Cooper Investors					4.8%	16.2
Accounts receivable	\$m	160	237	191	212	201	State Street Global Advisors					4.8%	16.0
Inventory	\$m	519	409	409	409	409	Total					20.0%	66.9
Property, plant & equipment	\$m	2,914	3,350	3,949	4,452	4,860	SHAREHOLDER'S EQUITY						
Other	\$m	1,032	1,086	1,221	1,331	1,401	Share capital	\$m	2,371	2,400	2,400	2,400	2,400
Total assets	\$m	4,756	5,297	5,812	6,519	6,920	Reserves	\$m	(34)	14	14	14	14
LIABILITIES							Retained earnings	\$m	874	1,316	1,561	1,922	2,226
Accounts payable	\$m	190	232	127	122	119	Total equity	\$m	3,211	3,730	3,975	4,337	4,641
Borrowings	\$m	100	-	375	725	825	Weighted average shares	m	326	333	334	334	334
Other	\$m	1,255	1,335	1,335	1,335	1,335	SOURCE: BELL POTTER SECURITIES ESTIMATES						
Total liabilities	\$m	1,545	1,567	1,837	2,182	2,279							

Recommendation structure

Buy: Expect >15% total return on a 12 month view. For stocks regarded as 'Speculative' a return of >30% is expected.

Hold: Expect total return between -5% and 15% on a 12 month view

Sell: Expect <-5% total return on a 12 month view

Speculative Investments are either start-up enterprises with nil or only prospective operations or recently commenced operations with only forecast cash flows, or companies that have commenced operations or have been in operation for some time but have only forecast cash flows and/or a stressed balance sheet.

Such investments may carry an exceptionally high level of capital risk and volatility of returns.

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