

SHEFFIELD RESOURCES (SFX)

Upgrading Price Target to \$1.70

Analyst Stuart McIntyre
Email steuartmcintyre@boeq.com.au
Phone +61 2 8072 2909
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We say

Price

Target

Strategic Target

BUY

0.71 1.70 2.30

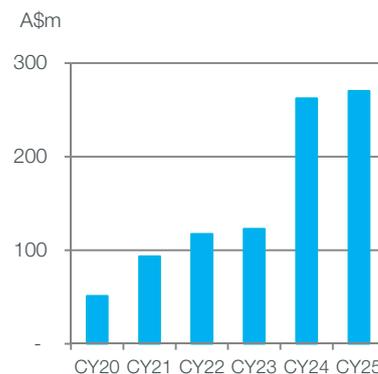
Sheffield is now our top pick in the ASX mining space on a 3-6 month view given the strong macro tailwind for mineral sands and the host of de-risking milestones due near-term (see p5). If the company can successfully sell down a stake in Thunderbird (say ~25% for ~A\$100m) over the next few months, on our forecasts it should be fully funded to begin construction of Thunderbird in early CY18. We upgrade our price target to \$1.70 and maintain our high conviction Buy.

SHARE PRICE CHART



Source: IRESS, Blue Ocean Equities

FORECAST OPERATING CASHFLOW



Source: Company Blue Ocean Equities

COMPANY DATA & RATIOS

Enterprise value	\$136m
Diluted market cap*	\$171m
Diluted shares*	241m
Free float	100%
12 month price range	\$0.41-0.85
GICS sector	Materials
Board & Management hold	~12% (FD)
*Diluted for 13.6m options	

IMPLIED RETURN

Implied all-in return	~140%
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A COMPELLING MACRO OUTLOOK

Over the last 12 months mineral sands prices have staged a major recovery with ilmenite prices more than doubling to US\$180-230/t and premium zircon prices rallying over 35% to US\$1,230/t with more price rises expected in Feb18. [The outlook for zircon is particularly compelling with a ~32% supply deficit being forecast by TZMI over the next few years](#) on mine closures and declining grades.

THUNDERBIRD: A BEST-IN-CLASS PROJECT

In our view Thunderbird has the best combination of world-class scale (3.2bn tonnes), very high grades (0.9% zircon, 3.1% ilmenite) and low strip (0.78:1) that make it arguably one of the most compelling mineral sands projects in the world. When you add the projects proximity to port (140km) and low-risk jurisdiction, we believe it is probably best-in-class.

IMPLIED RETURN OF OVER 140%

We upgrade our price target to \$1.70 (from \$1.40) on reducing our 50% discount to NAV to 30% post confirmation Taurus has been mandated for US\$200m of debt (p2) and now binding offtake agreements are in place for 44% premium zircon. [If key catalysts land in line with our forecast \(p5\), we would reduce our discount further and increase our price target to \\$2.30, more than 3x the current share price.](#)

A\$32M RAISED AT 70c

Around 2 weeks ago, Sheffield completed a A\$30m placement to institutional investors at 70c which included a fully-underwritten A\$2m SPP. The primary use of proceeds is early construction works for the company's 100%-owned Thunderbird mineral sands project in WA, procurement of long-lead items as well as working capital and general corporate purposes.

Accounting for the A\$5.7m cash balance at the end September, we estimate the company now has ~A\$35m in cash and no debt.

US\$200M TAURUS DEBT FACILITY

On 18 October, Sheffield confirmed it has mandated Taurus to arrange and underwrite a US\$200m, 7-year project debt facility comprising:

- Tranche A: US\$75m at US\$-LIBOR + 4.5% = 5.9% (3-month US\$-LIBOR is ~1.35%)
- Tranche B: US\$100m at 8.5%
- Contingent Instruments of US\$25m at 7.75%
- [Total: US\\$200m at average interest of 7.4% \(excl revenue royalty outlined below\)](#)

The debt also includes a revenue royalty comprising:

- 0.5% of revenue for years 1-4, 0.75% of revenue for years 5-22.5
- On BFS prices we estimate this royalty adds ~2% to the cost of debt
- [i.e. Total: US\\$200m at implied average interest of ~9.4% \(incl revenue royalty\)](#)

In our view this is an excellent deal for Sheffield shareholders as it is competitively priced, non-dilutive and does not require cash held in escrow. The cash flows from the revenue royalty are also long-dated and far simpler for investors to understand than many other debt instruments.

FUNDING ASSUMPTIONS TO DEVELOP THUNDERBIRD

Updating our funding assumptions for the above new information, the tables below summarise our view of the most likely funding scenario, assuming the SFX board is comfortable with gearing of ~60%. We assume SFX draws US\$175m of the US\$200m Taurus debt, or A\$233m (at FX of 0.75).

Funding Uses	A\$m	Funding Sources	A\$m
Initial capex	348	Cash	9%
Working capital + other costs	52	Equity	33%
		Debt	58%
Total	400	Total	400

Source: Company, Blue Ocean estimates

[Sheffield is also planning to sell a stake in the project in the next 3-4 months and hoping to realise a price of at least ~A\\$100m.](#) The compelling rationale of this strategy is highlighted in the updated value per share analysis on the following page. Importantly, [if Sheffield is successful with this strategy it should be fully funded to develop Thunderbird.](#)

[i.e. If a partner pays A\\$100m for a 25% stake plus its 25% share of the equity need or A\\$42m \(i.e. 25% of A\\$167m\), this would more than cover the remaining A\\$132m equity need.](#)

RATIONALE OF SALE OF PROJECT STAKE TO A PARTNER (BFS PRICES)

In the table below, we outline three potential scenarios: A “Go-it-Alone” scenario where Sheffield does *not* sell a stake in the project, an extreme case where SFX sells 50% of the project at a huge (bordering on ridiculous) discount, and a scenario somewhere in between, where SFX sells a 25% stake in the project for a more modest discount (the most likely scenario in our view).

Funding Scenarios (Probability in our view)		Go-it-Alone (Least likely)	Sale of 25% (Most likely)	Sale of 50% (Unlikely)
Sale of Stake in Project				
Discount to NPV	%	-	34%	67%
Proceeds from sale of stake	A\$m	-	100	100
Project Debt	A\$m	233	233	233
SFX Cash	A\$m	35	35	35
Partner Equity	A\$m	-	42	83
SFX New Equity	A\$m	132	-	-
Total	A\$m	400	410	452

SFX share of value		Go-it-Alone	Sale of 25%	Sale of 50%
Project post-tax NPV₁₀ (BFS Prices¹)	A\$m	604	604	604
SFX share of Thunderbird	%	100%	75%	50%
SFX share of NPV + sale proceeds + surplus	A\$m	604	563	454

SFX value per share		Go-it-Alone	Sale of 25%	Sale of 50%
Current fully diluted SFX shares	m	241	241	241
New SFX shares @ 80c				
Fully diluted shares post funding	m	405	241	241
SFX share of NPV + sale proceeds	A\$/sh	1.49	2.34	1.88
New SFX shares @ \$1.20				
Fully diluted shares post funding	m	350	241	241
SFX share of NPV + sale proceeds	A\$/sh	1.72	2.34	1.88
New SFX shares @ \$1.50				
Fully diluted shares post funding	m	328	241	241
SFX share of NPV + sale proceeds	A\$/sh	1.84	2.34	1.88

Source: Company, Blue Ocean estimates **¹BFS Prices: Premium Zircon US\$1,282-1,387/t; Sulphate Ilmenite: US\$190/t**

This analysis strongly supports Sheffield’s strategy of selling a stake in the project – in our view it is very unlikely Sheffield will “Go-it-Alone” unless the share price is *much* higher.

In the extreme case, where SFX sells a 50% stake for a 68% discount to NPV of A\$100m... a scenario which would be accretive to the tune of ~A\$200m for the incoming partner, **the value per share in this downside scenario would still be \$1.88, an implied return of ~160%**

In our view, the most likely scenario is SFX sells ~25% of the project for ~A\$100m, which is how we derive our strategic price target of A\$2.30 per share, representing an implied return of ~220%.

RATIONALE OF SALE OF PROJECT STAKE TO A PARTNER (UPSIDE PRICES)

In the table below, we examine exactly the same three scenarios as the previous page... but this time using upside prices for Sheffield's mineral sands products. **On our upside price deck, the NPV for 100% of Thunderbird increases 62% from A\$604m to A\$976m.**

It's also worth highlighting the increase in the discount to NPV implied by the A\$100m sale price in each of the two sell down scenarios.

Funding Scenarios (Probability in our view)		Go-it-Alone (Least likely)	Sale of 25% (Most likely)	Sale of 50% (Unlikely)
Sale of Stake in Project				
Discount to NPV	%	-	59%	80%
Proceeds from sale of stake	A\$m	-	100	100
Project Debt	A\$m	233	233	233
SFX Cash	A\$m	35	35	35
Partner Equity	A\$m	-	42	83
SFX New Equity	A\$m	132	-	-
Total	A\$m	400	410	452

SFX share of value		Go-it-Alone	Sale of 25%	Sale of 50%
Project post-tax NPV₁₀ (Upside Prices¹)	A\$m	976	976	976
SFX share of Thunderbird	%	100%	75%	50%
SFX share of NPV + sale proceeds + surplus	A\$m	976	842	640

SFX value per share		Go-it-Alone	Sale of 25%	Sale of 50%
Current fully diluted SFX shares	m	241	241	241
<u>New SFX shares @ 80c</u>	m	164	-	-
Fully diluted shares post funding	m	405	241	241
SFX share of NPV + sale proceeds	A\$/sh	2.41	3.50	2.66
<u>New SFX shares @ \$1.20</u>	m	110	-	-
Fully diluted shares post funding	m	350	241	241
SFX share of NPV + sale proceeds	A\$/sh	2.79	3.50	2.66
<u>New SFX shares @ \$1.50</u>	m	88	-	-
Fully diluted shares post funding	m	328	241	241
SFX share of NPV + sale proceeds	A\$/sh	2.97	3.50	2.66

Source: Company, Blue Ocean estimates. ¹**Upside Prices: Premium Zircon US\$1,500/t; Sulphate Ilmenite: US\$250/t**

In our most likely scenario (SFX sells ~25% of the project for ~A\$100m), using upside mineral sands prices, our potential value per share for Sheffield increases to \$3.50, representing an implied return from the current share price of ~400% or 5x!

NEAR-TERM CATALYSTS

In our view the key near term de-risking milestones for Sheffield are:

- **More Binding Offtake Agreements:** In the last ~2 months Sheffield has signed 3 binding offtake agreements representing 44% of its Premium Zircon production for Stage 1. The company is aiming to have 90% of Stage 1 production under binding offtake agreement over the next few months and we expect more positive news flow on this front near term.
- **Environmental Approval:** We expect this to be forthcoming by end Nov 2017
- **Native Title Agreement:** We expect agreement on native title by Dec 2017 / Jan 2018
- **Potential sale of stake in project to Partner (if required):** We expect any deal with a potential partner to be finalised by Jan / Feb CY18. We include updated analysis on the rationale of this option on pages 3&4.

HIGHLY LIKELY TO BE A TAKEOVER TARGET IN OUR VIEW

As discussed in our initiation report, we also continue to believe that Sheffield is highly likely to be a takeover target given:

- **Supply shortages in Premium Zircon:** The significant ~30% supply deficit being predicted by TZMI over the next few years (~62% of Thunderbird's revenue is from zircon on BFS prices). The zircon market is tight and prices have already begun to rally. There is also a distinct lack of other projects which could fill this forecast supply shortfall.
- **Compelling valuation:** SFX's relatively modest ~A\$170m fully diluted market cap, relative to the A\$604m NPV for Thunderbird on BFS prices.
- **Thunderbird's world class attributes:** Thunderbird is a large scale project (42 year mine life and will be 6-7% of zircon market), very high grade and low strip and is located in a safe jurisdiction (in Western Australia).

Sheffield has already invited a number of potential strategic partners into its data room in connection with the planned sell down of a stake in Thunderbird. After conducting detailed due diligence, we believe there is a chance one (or more) of these potential strategic partners may decide they'd prefer to own 100% of Thunderbird, rather than a minority stake.

And given where Sheffield is currently trading, the rationale for a potential acquirer is potentially compelling at present:

- At 71c, SFX's fully-diluted market cap is ~A\$170m vs. our NPV₁₀ of Thunderbird of A\$604m
- A 35-40% premium would represent a potential purchase price of ~A\$230-240m (96-98c)
- ...an opportunistic price potentially accretive to the acquirer by a substantial A\$365-375m! (or over A\$700m if we use our upside price deck which yields an NPV₁₀ of A\$976m!)

If there is a potential suitor out there planning to bid for Sheffield, we believe the most likely time would be post environmental and native title approvals, both of which we expect within ~3 months.

PRICE TARGET & RATING

We increase our price target for Sheffield by 21% to \$1.70 (from \$1.40) based on:

- A 2% lower NPV for Thunderbird of A\$604m using BFS mineral sands prices (as outlined on p7 of our initiation report¹) and a 10% nominal discount rate. The only change is an A\$15m reduction in NPV due to the inclusion of the royalty on the Taurus debt (see p2).
- We also reduce our discount to NPV to 30% (from 50%) to account for Sheffield successfully completing a number of key de-risking milestones:
 - Signing 3 binding offtake agreements representing 44% of Stage 1 production of Premium Zircon
 - Mandating Taurus on a US\$200m debt finance facility

It is important to flag that we intend to continue to reduce our 30% discount to NPV as Sheffield ticks off its key de-risking milestones, i.e. environmental approvals, native title approvals, etc.

We rate Sheffield Resources a high conviction Buy and our \$1.70 Price Target represents an implied return of ~140%.

We also continue believe that Sheffield is highly likely to be a takeover target given its relatively modest ~A\$170m fully diluted market cap, relative to the A\$604m NPV for Thunderbird, the significant ~30% supply deficit being predicted by TZMI over the next few years as well as the project's combination of world-class scale, very high grades and safe jurisdiction (in Western Australia). We outline the rationale of this possibility in more detail on p5.

STRATEGIC TARGET

We derive our \$2.30 Strategic Target for Sheffield Resources based on our view of the most likely potential partner funding scenario outlined on p3 – which assumes Sheffield is able to sell a 25% stake in Thunderbird for ~A\$100m in early CY18.

Our \$2.30 Strategic Target represents an implied return of ~220%. It is important to note that our Strategic Target does *not* account for upside mineral sands pricing scenarios *or* for further exploration success at the company's other mineral sands projects.

KEY RISKS

Sheffield Resources is exposed to all the normal risks associated with developing and operating mining projects, including permitting, funding and construction risk.

Assuming Sheffield makes the transition into production, its revenues will be derived from the sale of premium zircon (43% of revenue on BFS assumptions), zircon concentrate (19% of revenue), sulphate ilmenite (29% of revenue), Hi-Ti88 leucoxene (4% of revenue) and titano-magnetite (5% of revenue). Fluctuations in the prices of these products as well as the Australian dollar could impact the company's reported cash flow (in A\$), profitability and share price.

As Sheffield's Thunderbird project is based in Western Australia, an investment in Sheffield also carries Australian sovereign risk. However, it is worth noting that Australia is considered materially lower sovereign risk than many of the other jurisdictions which host mineral sands mines like South Africa (Rio Tinto), Mozambique (Kenmare) and Kenya (Base Resources).

¹ Our initiation report on Sheffield Resources is available here: <http://cm.boeq.com.au/files/SFX-2017-Sep-12-2612.pdf>

MODEL SUMMARY: FINANCIALS & VALUATION

Stock Details					Enterprise Value	\$136m
Recommendation:	BUY				Diluted MCap	\$171m
Target	\$1.70	Share Price	\$0.71		Diluted Shares	241m
NAV	\$1.74	52 Week High	\$0.85		Free Float	100%
Implied Return	139%	52 Week Low	\$0.41		Avg Daily Value	\$0.1m

Macro Assumptions	% of Rev	FY17E	FY18E	FY19E	FY20E	FY21E
Exchange Rate (A\$/US\$)		0.75	0.76	0.75	0.74	0.73
Premium Zircon	43%	1,025	1,150	1,241	1,250	1,279
Zircon Concentrate	19%	513	575	621	625	638
Ilmenite	29%	135	180	180	183	183
	91%					

Profit & Loss (A\$m)	FY17E	FY18E	FY19E	FY20E	FY21E
Revenue	-	-	-	82	194
Operating Costs	-	-	-	(57)	(124)
Operating Profit	-	-	-	25	71
Corporate & Other	(7)	(6)	(6)	(6)	(6)
Exploration Expense	(2)	-	-	(0)	(1)
EBITDA	(9)	(6)	(6)	19	64
D&A	(0)	(0)	(0)	(4)	(8)
EBIT	(9)	(6)	(6)	15	56
Net Interest Expense	0	0	1	(8)	(17)
Pre-Tax Profit	(9)	(6)	(5)	6	38
Tax Expense	1	-	-	(3)	(11)
Underlying Profit	(8)	(6)	(5)	4	27
Significant Items (post tax)	(2)	-	-	-	-
Reported Profit	(9)	(6)	(5)	4	27

Cash Flow (A\$m)	FY17E	FY18E	FY19E	FY20E	FY21E
Operating Cashflow	(3)	(6)	(6)	19	65
Tax	-	-	-	-	(5)
Net Interest	0	0	1	(8)	(17)
Net Operating Cash Flow	(3)	(6)	(5)	11	42
Exploration	(10)	-	-	(2)	(4)
Capex	(0)	(76)	(169)	(101)	(14)
Acquisitions / Disposals	1	-	-	-	-
Other	-	-	-	-	-
Net Investing Cash Flow	(10)	(76)	(169)	(103)	(18)
Equity Issue	16	164	2	3	2
Borrowing / Repayments	-	-	117	117	-
Dividends	-	-	-	-	-
Other	-	-	-	-	-
Net Financing Cash Flow	16	164	118	119	2
Change in Cash Position	3	82	(56)	27	26
FX Adjustments	-	-	-	-	-
Cash Balance	8	90	35	62	88

Balance Sheet (A\$m)	FY17E	FY18E	FY19E	FY20E	FY21E
Cash	8	90	35	62	88
Other Current Assets	0	0	0	0	0
PP&E	0	76	245	341	347
Exploration & Development	39	39	39	40	44
Other Non Current Assets	-	-	-	-	-
Total Assets	47	205	318	444	479
Debt	-	-	117	233	233
Other Liabilities	2	2	2	4	10
Net Assets	46	204	200	206	235

Ratio Analysis		FY17E	FY18E	FY19E	FY20E	FY21E
Diluted Shares	m	196	423	425	432	437
EPS - Diluted	Ac	(4.1)	(2.2)	(1.2)	0.8	6.2
P/E	x	n.m.	n.m.	n.m.	87.3x	11.5x
CFPS - Diluted	Ac	(1.7)	(2.2)	(1.2)	2.5	9.6
P/CF	x	n.m.	n.m.	n.m.	28.5x	7.4x
FCF - Diluted	Ac	(1.8)	(19.4)	(41.1)	(18.9)	10.3
P/FCF	x	n.m.	n.m.	n.m.	n.m.	6.9x

Dividends	Ac	-	-	-	-	-
Dividend yield	%	-	-	-	-	-
Payout Ratio	%	-	-	-	-	-
Franking	%	-	-	-	-	-
Enterprise Value	A\$m	163	81	253	342	316
EV/EBITDA	x	(17.8x)	(13.4x)	(42.1x)	18.1x	4.9x
ROE	%	(17%)	(3%)	(3%)	2%	11%
ROA	%	(16%)	(3%)	(2%)	1%	6%
Net Debt / (Cash)		(8)	(90)	82	171	145
Gearing (ND/(ND+E))	%	n.m.	(80%)	29%	45%	38%
Gearing (ND/E)	%	n.m.	(44%)	41%	83%	62%

	Reserves & Resources					
	Valuable HM Grade					
	mt	HM	Zircon	Ilmenite	Hi-Ti	Lcx Leucos
Proved	236	13.3	1.00	3.55	0.29	0.26
Probable	445	10.2	0.80	2.85	0.26	0.26
Reserve	681	11.3	0.87	3.10	0.27	0.26
Measured	220	14.5	1.07	3.90	0.31	0.27
Indicated	640	11.8	0.90	3.30	0.28	0.25
Inferred	180	10.8	0.87	3.00	0.27	0.26
Resource	1,050	12.2	0.93	3.30	0.28	0.26

Earnings Sensitivity			FY20E	FY21E	FY20E	FY21E
			A\$m	A\$m	%	%
Premium Zircon Price	US\$/t	+10%	3	8	n.m.	29%
Ilmenite Price	US\$/t	+10%	2	4	n.m.	15%
Exchange Rate	A\$/US\$	-10%	6	15	n.m.	57%

Valuation	Discount	Stake	A\$m	A\$/sh
Thunderbird (unrisked)		100%	605	2.52
Thunderbird (risk-adjusted)	30%	100%	424	1.76
Exploration & Other Projects			30	0.12
Corporate & Other			(74)	(0.31)
Debt			-	-
Cash			35	0.14
Option Strikes			3	0.01
Risk adjusted NAV			418	1.74
				0.41

Source: Company data, Blue Ocean Equities

MODEL SUMMARY: OPERATIONAL INPUTS & FREE CASH FLOW

Operational Summary						Macro Assumptions									
		FY18E	FY19E	FY20E	FY21E	FY22E	A\$/US\$ FX		FY18E	FY19E	FY20E	FY21E	FY22E		
Thunderbird							x		0.76	0.75	0.74	0.73	0.73		
Mining								% of revenue							
Ore Mined	mt	-	-	3.7	7.8	8.4		Premium Zircon	43%	US\$/t	1,150	1,241	1,250	1,279	1,327
Strip Ratio	x	-	-	0.52	0.52	0.52		Zircon Concentrate	19%	US\$/t	575	621	625	638	663
Production								LTR Ilmenite	29%	US\$/t	180	180	183	183	183
Premium Zircon	kt	-	-	18	44	54		Hi-Ti88	4%	US\$/t	500	500	500	500	500
Zircon Concentrate	kt	-	-	21	46	50		Titano-Magnetite	5%	US\$/t	58	58	48	48	48
LTR Ilmenite	kt	-	-	102	242	283									
Hi-Ti88 Leucoxene	kt	-	-	4	11	14									
Titano-Magnetite	kt	-	-	61	144	168									
Total Production Volume	kt	-	-	207	487	570									
Costs															
Opex incl royalties	A\$/t ore	-	-	15.34	15.83	15.92									
Sustaining capex	A\$/t ore	-	-	0.73	0.80	0.64									
Opex+Royalties+Sustaining	A\$/t ore	-	-	16.07	16.63	16.56									
Operating Cash Margins	A\$/t ore	-	-	6.07	8.25	11.76									
Operating Cash Margins	%	-	-	27%	33%	42%									
Revenue															
Premium Zircon											31	77	99		
Zircon Concentrate											18	40	46		
LTR Ilmenite											26	61	71		
Hi-Ti88 Leucoxene											3	7	10		
Titano-Magnetite											4	9	11		
Total Revenue	A\$m	-	-	82	194	236									
Revenue per tonne ore	A\$/t	-	-	22.14	24.89	28.32									
Opex incl royalties											57	124	133		
Sustaining Capex											3	6	5		
Opex+Royalties+Sustaining	A\$m	-	-	59	130	138									
Operating Cash Margins	A\$m	-	-	22	64	98									
Operating Cash Margins											27%	33%	42%		
Growth Capex										76	169	98	8	31	
Exploration										-	-	2	4	4	
Corporate Overheads										6	6	6	6	6	
All-in Cash Margin	A\$m	(82)	(175)	(84)	47	57									
All-in Cash Margins											-	-	n.m.	24%	24%
Corporate															
Cash Tax													5	18	
Other Items													-	-	
FCF pre Debt Service											(82)	(175)	(84)	41	39
Net Interest											(0)	(1)	8	17	17
Debt Drawdown / (Repayment)											-	117	117	-	-
FCF post Debt Service											(82)	(57)	25	24	23
New Equity/Dividends															
Proceeds from Shares/Options											164	2	3	2	-
Dividends Paid											-	-	-	-	-
Change in Cash											82	(56)	27	26	23
Cash Balance											90	35	62	88	111

Source: Company data, Blue Ocean Equities

CONTACTS

ANALYST

Steuart McIntyre

Senior Resource Analyst

P +61 2 8072 2909

E steartmcintyre@boeq.com.au

AUTHORITY

David O'Halloran

Executive Director

P +61 2 8072 2904

E doh@boeq.com.au

Philip Pepe

Senior Industrials Analyst

P +61 2 8072 2921

E philpepe@boeq.com.au

Stuart Turner

Senior Industrials Analyst

P +61 2 8072 2923

E stuartturner@boeq.com.au

Justin Pezzano

Research Associate

P +61 2 8072 2926

E justinpezzano@boeq.com.au

Michael Gerges

Investment Analyst

P +61 2 8072 2935

E michaelgerges@boeq.com.au

Mathan Somasundaram

Market Portfolio Strategy

P +61 2 8072 2916

E mathan@boeq.com.au

Josie Nicol

Dealing Associate

P +61 2 8072 2931

E josienicol@boeq.com.au

Adam Stratton

Institutional Dealing

P +61 2 8072 2913

E adamstratton@boeq.com.au

Scott Calcraft

Institutional Dealing

P +61 2 8072 2920

E scottcalcraft@boeq.com.au

Doc Cromme

Institutional Dealing

P +61 2 8072 2925

E doccromme@boeq.com.au

Scott Hildebrand

Institutional Dealing

P +61 2 8072 2933

E shildebrand@boeq.com.au

Tim Potts

Institutional / HNW Dealing

P +61 2 8072 2906

E tim@boeq.com.au

HEAD OFFICE

Blue Ocean Equities Pty. Ltd.

AFSL No. 412765

ABN 53 151186935

P +61 2 8072 2988

E info@boeq.com.au

W blueoceanequities.com.au

Level 29, 88 Phillip Street

Sydney NSW 2000

Australia

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Steuart McIntyre does not own shares in Sheffield Resources.