Danakali’s share price far below value estimates: Investors Chronicle

Danakali Ltd (ASX:DNK) (LON:DNK) has a massive ore reserve of 1.1 billion tonnes grading 10.5% potassium oxide at the Colluli Potash Project in Eritrea.

UK-based Investors Chronicle, a weekly magazine published by the Financial Times Group, has recommended Danakali as a speculative buy in its Tip of the Week article published last Friday.

Following is an extract from the Investors Chronicle article:

As Sirius Minerals, Berkeley Energia and SolGold have shown in the past year, backing early-stage mining projects can be a frustrating, volatile yet sometimes exciting business. Investing in an unfinanced potash project in Eritrea, less than half a year after the country emerged from UN sanctions, certainly fits the volatile category.

But in Danakali (DNK), which joined London’s main market last summer, we think prospective backers have reason for genuine optimism, as well as potential drama. That’s because the group’s Colluli project has already ticked enough boxes to have a better-than-even chance of success. Ahead of debt project financing later this year, investors still have a chance to get in on the ground floor of a world-class (if high-risk) mining project.

That project centres on a deposit of sulphate of potash (SOP) - used as a low-chloride, premium fertiliser on high-value crops - in the Danakil Depression region of Eritrea, some 75km from the Red Sea coast. As last year’s defined feasibility study showed, Colluli is a simple and fully-permitted project, which has world-leading grades, extremely large reserves and logistical advantages over major producers in Russia, Belarus and Canada. Its overheads are lower than anywhere else, meaning it should occupy the bottom 15 per cent of the global cost curve for SOP, once complete.

Start-up costs should also be low. Danakali predicts that for an initial outlay of $302m (£236m), Colluli will be able to mine 472,000 tonnes of SOP a year. Against a long-term price forecast of $600 a tonne, broker Numis believes Danakali could generate a gross profit of $170m in 2022, when the mine reaches initial capacity. Based on a slightly lower price and cost assumptions, Danakali's bosses believe the miner's stake has a net present value of $242m, even after adjustments for debt funding, joint ownership of the project with the Eritrean state, and a 10 per cent discount rate on future cash flows.

These credentials haven't gone unnoticed. A 10-year off-take agreement has already been struck with Swiss fertiliser giant EuroChem for between 87 and 100 per cent of output, while a non-indicative term sheet for $200m of debt funding has already been signed with Afreximbank and Africa Finance Corporation. The project also has a vote of approval from the United Nations’ Development Programme, which funded an independent report that found...
Colluli could support Eritrea's sustainable development goals, economy, agricultural productivity, training and employment.

Until recently, a partnership with the desperately poor and historically isolated East African nation was an extremely high-risk proposition. But that all changed last year, when Eritrea signed a peace treaty with its long-time adversary, Ethiopia, and UN sanctions on the country were finally lifted. As such, the country has every incentive to make Colluli work.

Danakali's bosses also believe the project is the only known sulphate of potash greenfield development to have completed front-end engineering design. It's shovel-ready and unlikely to be leapfrogged. But things do go awry, and it's sensible to assume setbacks will occur and, if so, the shares are likely to prove illiquid. Applying a generous 8 per cent discount rate and a cautious 'target multiple' of 0.6 times net asset value, Numis arrives at a target price of 70p.

That seems appropriate considering the risks, although this year is likely to present plenty of catalysts for short-term punters. Speculative buy.
Before you act on any general advice we provide, please consider whether it is appropriate for your personal circumstances.