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An unusual miner, an unusual mineral

IPO watch

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Nothing beats a hot theme to excite investors about a float. Growth in China and India is boosting demand for crop fertiliser ingredients – a trend Potash West wants to capitalise on.

The explorer is seeking up to $6 million to develop glauconite deposits near Perth. Potassium can be extracted from glauconite to produce potash, which is used in fertilisers.

Investors had a crash course in potash last year when BHP Billiton made a failed $US40 billion takeover bid for Canadian miner Potash Corporation of Saskatchewan.

Potash prices soared from $US200 a tonne in 2007 to more than $US800 in late 2008 as China became a net importer. Prices fell to about $US350 in early 2010 and have risen slightly since.

Potash West believes high potash prices make its glauconite deposits feasible. Glauconite is an unusual potash source due to the mineral's low grades and shallow depth.

Traditional potash sources typically have grades many times higher than glauconite, are mined one or more kilometres underground in Canada and Eastern Europe, and have billion-dollar capital costs.

No glauconite deposit in the world is commercially producing potash.

The nearest comparable explorer is Amazon Mining Holding, listed on the Toronto Stock Exchange. Amazon is developing the Cerrado Verde glauconite project in Brazil.

Amazon shares soared in the fourth quarter of 2010, capitalising the company at $C231 million.

Potash West's indicative valuation at listing is $15 million.

Amazon has a defined resource and is well into its drilling program. Potash West is an early-stage explorer relying on decade-old exploration results, and is months away from a full drilling program.

The company was formed in November 2010 to combine the potash and phosphate exploration assets of four tenement holders: ASX-listed Image Resources and three private companies.

Potash West is as much a processing company as an explorer. Although yet to drill or define a resource, the company knows glauconite is there. The question is, at what grade? And can it be extracted economically? Up to $2 million of funds raised in the float will help determine the best way to proceed.

Potash West is targeting an initial resource of at least 50 million tonnes that complies with the Joint Ore Reserves Committee Code.

Rough calculations suggest Potash West could process 5 million tonnes of low-grade ore annually over 10 years, for about 200,000 tonnes production each year. Production is at least six years away, if Potash West gets that far. Exploration is needed this year and next before Potash West commits to a bankable feasibility study over 12 to 18 months.

Assuming project economics stack up, Potash West would have to raise up to $200 million to finance plant construction, depending on the resource size.

Investors must be confident potash prices will remain high. Lower prices would damage the economics of this low-grade deposit.

Another issue is Potash West's capital structure. At the full subscription, 30 million 20¢ shares will be issued, with 75 million shares outstanding. Of that, 15 million "contingent entitlement" shares are held in trust for investors with at least 10,000 shares at the listing date, and who still own at least one Potash share when restricted securities provisions are lifted.

This complex arrangement, a variation of a loyalty option scheme, was needed because Image Resources has many small shareholders who will receive unmarketable parcels of Potash shares (less than $2000).

The contingent entitlement shares allow these investors to lift their shareholding to a marketable parcel – provided they retain their shares during the escrow period, expected to be two years.

The upside is Image shareholders may not sell their Potash West shares when it lists.

The downside is potential selling pressure two years after escrow provisions cease.

The prospectus describes the entitlement as "innovative", but does not explain it well. Some shareholders may struggle to understand their potential entitlement.

The unusual capital structure adds to an unusual company with an unusual mineral.

Still, Potash West's offer is well timed. Higher demand for fertiliser ingredients is expected as developing nations industrialise, giving potash attractive long-term fundamentals.

Potash West secured a chunk of its maximum subscription within days of its offer opening. The issue is whether the $15 million valuation is appropriate for such an early-stage explorer with a commodity that has never been produced commercially for potash.

If it succeeds, Potash West's valuation will be many times higher – the company's targeted annual production is about 40 per cent of Australia's total potash imports, and it has a ready-made market in Western Australia.

Excess production could be exported to China or India.

But Potash West is arguably among the riskier offers in recent years.

Float facts

Company	Potash West NL
Operations	Glauconite exploration, West Australia
Minimum subscription	$4.5 million
Maximum subscription	$6 million
Issue price	20¢
Market capitalisation at listing	$15 million
Offer closes	April 4
Expected listing date	April 18
Lead manager	Patersons Securities
Website	www.potashwest.com.au

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