

Sierra Rutile

Guidance drop as production slowed on lower prices; shares trade on a 41% discount to cash plus NWC

Sierra Rutile Holdings Ltd (“Sierra Rutile”; “SRX”) has released its Q3 results with operations impacted by an ongoing slump in rutile markets, although the Company continues to operate profitably. Rutile production in Q3 was 27kt, 17% below H&Pe, partly on the back of SRX’s decision to reduce production levels to protect pricing and contain absolute costs. Ore excavation rates in Area 1 were lowered by more than would normally have been expected due to wet season impacts, falling 55% YoY to 1Mt, 62% below H&Pe. Rutile sales were just 11kt, with SRX choosing to stockpile rather than sell finished product. SRX is facing tough market conditions with a hiatus in titanium feedstock demand mainly due to destocking in the downstream pigment sector; however, we believe longer-term fundamentals remain positive with demand linked to global economic growth and a lack of investment in new natural rutile supply. SRX’s shares continue to offer an attractive entry point, in our view, trading at a 41% discount to cash plus net working capital. Updating for new 2023 guidance and a cut in 2024 realised price assumptions, we lower our FY23 and ‘24E EBITDA estimates by 47% and 20%, respectively, as shown on pg.3. Rolling back our target price date to Dec’24, our risked valuation for SRX remains at A\$0.78/share, offering 333% upside.

A slowdown in Q3 results

Mining was intentionally slowed down on Q2, with 1Mt of ore excavated in Area 1, 55% lower than Q3’22. However, rutile production increased 8% QoQ to 27kt (still 17% below H&Pe) as SRX was able to process stockpiled ore after suffering power issues in H1. Rutile sales were 11kt, a reduction of 61% QoQ and 67% YoY, with SRX choosing to stockpile finished product, including 8kt of standard grade rutile (“SGR”) warehoused offshore in Amsterdam in anticipation of improved pricing. SRX’s Q3 realised rutile price came in at US\$1,268/t, 4% lower QoQ, due to demand weakness, as high interest rates, and inflationary pressures, continue to dampen property market activity. Q2 rutile pricing was also positively impacted by a higher proportion of sales going to the better performing titanium sponge market. We note SRX expects shipments to be in-line with production in Q4 and pricing to be similar to Q3. Please see pg.2. for further detail on Q3 results. Guidance for 2023 has also been cut as detailed on pg.3.

Catalysts: Sembehun DFS advances; tax uncertainty delaying Mogbwemo

During the quarter, US\$2.2m was invested in progressing the Sembehun Definitive Feasibility Study (“DFS”), due to complete at the start of 2024. We also expect another Area 1 Reserve update by year end. These events should be positive catalysts for SRX, in our view, providing evidence of sustainability and potential growth in profit. The Mogbwemo Tailings Project, which could both cut costs and extend mine life by reclaiming historical waste, remains pending the resolution of Area 1’s tax arrangements (“Third Amendment Agreement”), although substantial engagement took place in Q3. A US\$25m Revolving Credit Facility from Nedbank Limited was approved at the end of Q3, which would provide SRX greater financial flexibility, enabling it to push forwards with the Mogbwemo Tailings Project, should Third Amendment renegotiations be successful.

Stock offers deep value on multiple fronts; A\$0.78/sh TP offers 333% upside

We believe the long-term market fundamentals for SRX products remain strong, with global rutile supply tightening and growing titanium demand. We update our model for the new 2023 guidance (see pg.3 for summary of changes). SRX remains cheap in the short and long-term, in our view, with cash plus working capital of US\$81.6m versus a market capitalisation of US\$48.1m. This suggests the market currently places negative value on the company’s existing fixed assets, let alone its high-returning growth options. Beyond this, we see potential for a cyclical recovery in rutile prices and other near term catalysts to close the 77% discount to our target price of A\$0.78/sh.

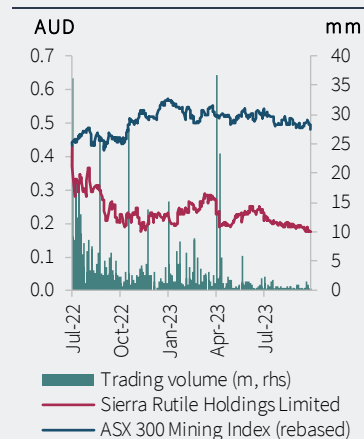
GICS Sector	Materials
Ticker	ASX:SRX
Market cap 26-Oct-23 (A\$m)	76.4
Share price 26-Oct-23 (AUD)	0.18
Target price 31-Dec-24 (AUD)	0.78

+333%

Upside from current share price to our A\$0.78/sh target

>500Mt

Potential rutile resource at Sembehun



The cost of producing this material has been covered by Sierra Rutile Holdings Limited as part of a contractual engagement with H&P Advisory Ltd.

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Q3 results

Production, sales volumes, and prices remained depressed in Q3, impacted by macro conditions and SRX's decision to ship 8kt of Standard Grade Rutile ("SGR") to its overseas warehouse in Amsterdam, in expectation of rutile demand and pricing picking up. Mining performance was intentionally slowed down on Q2, with 1Mt of ore excavated in Area 1, 55% lower than Q3'22 and rutile sales of 11kt, a reduction of 61% QoQ and 67% YoY. Intermediate ore stocks built up ahead of the wet season were intended to be drawdown over the quarter to level out production; however, depletion of stockpiles was lower than anticipated, and so we expect to see ore stocks worked down further in Q4. Along with a rebound in by-product sales, we expect this to help to offset costs in Q4 (H&Pe US\$1,032/t net operating cost in Q4 vs US\$1,147/t in Q3). SRX's Q3 realised rutile price came in at US\$1,268/t, 15% lower QoQ due to weaker pigment markets and a shift in the sales mix away from better performing titanium sponge market.

Q3 Production (27th Oct 2023)		Q3 2023A	Q3 2023E	A vs E %	% ch QoQ	Q3 2022A	% ch YoY
Safety							
TRIFR	/mwhrs	0.77	-	NA	-33%	1.4	-47%
LTIFR	/mwhrs	0.44	-	NA	-24%	0.3	52%
Mining							
Ore Mined	Mt	1.0	2.61	-62%	-71%	2.2	-55%
HMC grade	%	2.30	2.85	-19%	-8%	2.7	-15%
Rutile grade	%	1.40	1.35	4%	0%	1.3	8%
Production							
Rutile	kt	27.0	32.62	-17%	8%	28.0	-4%
Ilmenite	kt	11.0	18.75	-41%	22%	14.0	-21%
ZIC/GIC*	kt	6.0	8.47	-29%	20%	7.0	-14%
Total output of final products	kt	44.0	59.8	88.6%	-13%	49.0	-10%
Sales							
Rutile	kt	11.0	32.12	-66%	-61%	33.0	-67%
Ilmenite	kt	10.0	15.75	-37%	-38%	11.0	-9%
ZIC/GIC*	kt	0.0	7.97	-100%	-100%	-	NA
Total shipments	kt	21.0	55.8	285.7%	-65%	44.0	-52%
Revenue & Cash Costs							
Revenue - Rutile	US\$m	14.0	41.76	-66%	-66%	51.0	-73%
Unit price - Rutile	US\$/t	1,268	1,300.00	-2%	-15%	1,535.0	-17%
Revenue - Ilmenite/ZIC/GIC	US\$m	4.0	7.92	-50%	-73%	2.0	100%
Operating Cash Costs	US\$m	35.0	41.37	-15%	-15%	43.0	-19%
Net Operating Cash Costs - Rutile	US\$m	31.0	33.45	-7%	19%	41.0	-24%
Unit Operating Cash Costs - Rutile	US\$/t	1,295	1,268.17	2%	-21%	1,531.0	-15%
Net Unit Operating Cash Costs - Rutile	US\$/t	1,147	1,025.33	12%	10%	1,464.0	-22%
Capex	US\$m	7.0	7.11	-2%	-13%	8.0	-13%

Source: Company Reports, H&Pe.

Changes to H&P estimates

New production guidance driven by softness in pigment market outlook

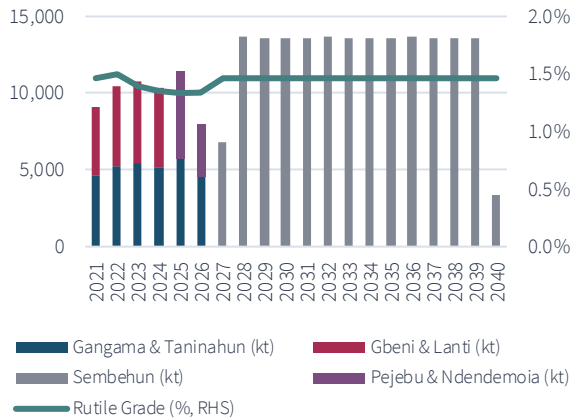
Following the weaker Q3, SRX has cut its FY23 rutile guidance further, from 124kt-126kt to 115kt-120kt (vs initial guidance of 140kt-144kt). This implies increased output in Q4, but we still see a 5% cut in our rutile production estimate to 118.4kt. After higher-than-forecast net unit operating cash costs in Q3 of US\$1,147/t, due to lower rutile output and reduced by-product sales, SRX's cost guidance for the year increased to US\$1,075/t-US\$1,125/t (vs new H&Pe US\$1,096/t). While uncertainty remains in the pigment market, longer-term, a lack of high-quality natural rutile projects suggests an emerging deficit in supply, supporting future prices for SRX's products. The impact of the revised guidance on our estimates is shown below. Our TP is unchanged at A\$0.78/sh, with the rolling back of the target by 12 months to Dec'24E offsetting the downgrades to near-term earnings and cash flow estimates.

Changes to H&P estimates (Dec year-end)										
		2023E			2024E			2025E		
		New	Prev	% ch	New	Prev	% ch	New	Prev	% ch
Total excavated ore	Mt	10.8	12.4	-13%	10.4	10.3	1%	11.5	11.5	0%
Rutile Grade	%	1.39%	1.38%	1%	1.35%	1.35%	0%	1.33%	1.33%	0%
HMC Grade	%	2.6%	2.6%	-3%	2.8%	2.9%	-1%	3.1%	3.1%	0%
Total HMC produced	kt	286	339	-16%	305	304	0%	371	371	0%
Total HMC processed	kt	286	339	-16%	305	304	0%	371	371	0%
Rutile recovery from HMC (est)	%	41.3%	36.6%	13%	40.5%	40.5%	0%	40.5%	40.5%	0%
Ilmenite recovery from HMC (est)	%	17.5%	17.1%	3%	17.9%	18.3%	-2%	20.2%	20.2%	0%
Zircon recovery from HMC (est)	%	2.4%	2.9%	-16%	2.2%	2.2%	-2%	3.1%	3.1%	0%
Rutile production	kt	118	124	-5%	123	123	0%	150	150	0%
Ilmenite production	kt	50.1	57.9	-13%	54.4	55.8	-2%	75.0	75.0	0%
ZIC/GIC production	kt	27.9	39.4	-29%	26.7	27.1	-2%	45.5	45.5	0%
Rutile shipments	kt	103	124	-17%	138	123	12%	150	150	0%
Ilmenite shipments	kt	55.1	57.9	-5%	49.4	55.8	-11%	75.0	75.0	0%
ZIC/GIC shipments	kt	31.9	39.4	-19%	22.7	27.1	-16%	45.5	45.5	0%
Total product shipments	kt	190	221	-14%	211	206	2%	271	271	0%
Rutile realised price	\$/t	1,347	1,350	0%	1,330	1,468	-9%	1,401	1,436	-2%
Ilmenite realised price (Est)	\$/t	338	301	12%	290	254	14%	245	220	11%
Zircon realised price (Est)	\$/t	2,001	1,837	9%	1,712	1,499	14%	1,394	1,361	2%
Revenue/t shipped Rutile	\$/t	1,679	1,636	3%	1,504	1,666	-10%	1,629	1,649	-1%
Revenue	\$m	174	203	-14%	208	205	1%	245	248	-1%
EBITDA	\$m	30	58	-47%	34	43	-20%	39	53	-28%
EBITDA margin	%	18%	28%	-11%	16%	21%	-4%	16%	22%	-6%
D&A	\$m	13	17	-26%	26	27	-1%	30	30	-2%
Net finance cost	\$m	3	3	0%	1	2	-30%	3	4	-26%
Tax credit/(expense)	\$m	(1)	(4)	-80%	(2)	(5)	-48%	(3)	(7)	-56%
FX/revaluations/other	\$m	(29)	(29)	0%	(0)	-	NM	0	-	NM
Net income	\$m	(8)	11	NM	7	14	-48%	9	20	-56%
EPS	US cps	(2)	3	NM	2	3	-48%	2	5	-56%
Operating cash flow pre-WC	\$m	30	57	-48%	36	45	-20%	42	57	-27%
Dec/(inc) in working cap	\$m	(1)	(3)	-70%	29	34	-14%	15	14	5%
Cashflow from operations	\$m	29	54	-47%	65	78	-18%	57	72	-21%
Interest & tax paid	\$m	(0)	(4)	-88%	(2)	(5)	-48%	(3)	(7)	-56%
Capex	\$m	(26)	(29)	-11%	(19)	(18)	1%	(68)	(68)	0%
Other	\$m	2	2	0%	(1)	(2)	-30%	(3)	(4)	-26%
Free cash flow	\$m	5	24	-78%	42	53	-21%	(18)	(7)	138%
Net cash/(debt) - unadjusted	\$m	43	62	-30%	87	117	-26%	72	114	-37%

Source: H&Pe

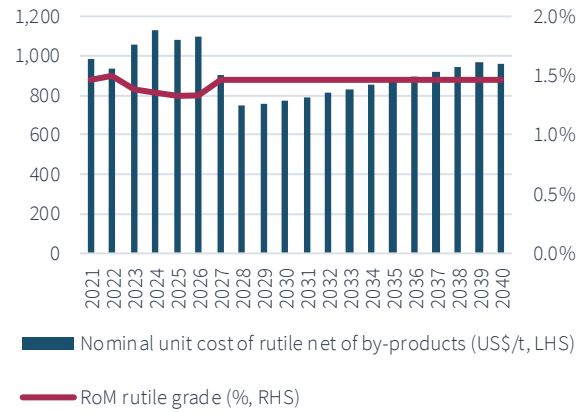
Key Charts

Area 1 and Sembehun ore mined mine plan; potential for Mogbwemo extension to fill the gap as Sembehun ramps up



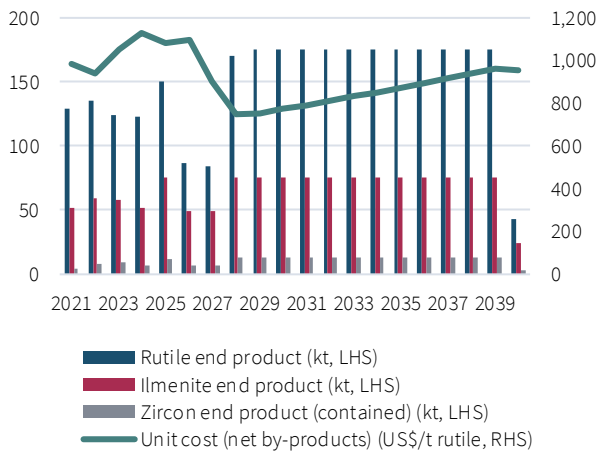
Source: Company reports, H&P estimates

Rutile end product output with unit cost for rutile, net of ilmenite and zircon by-products



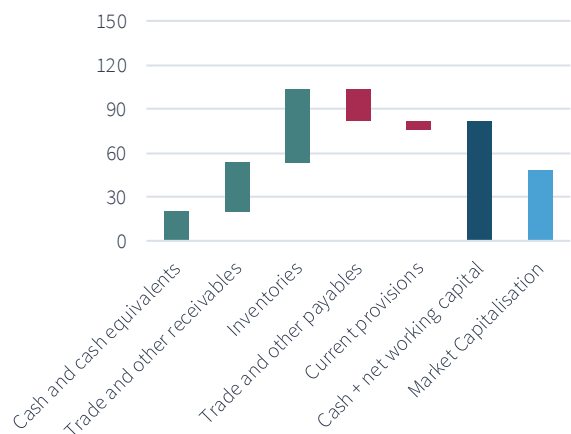
Source: Company reports, H&P estimates

Rutile end product output with unit cost for rutile, net of ilmenite and zircon by-products



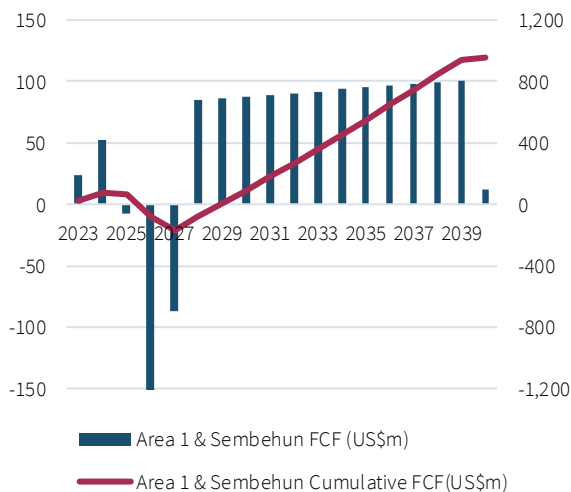
Source: Company reports, H&P estimates

SRX currently trades on very low multiples with cash + NWC of US\$82m vs. market cap of US\$48m



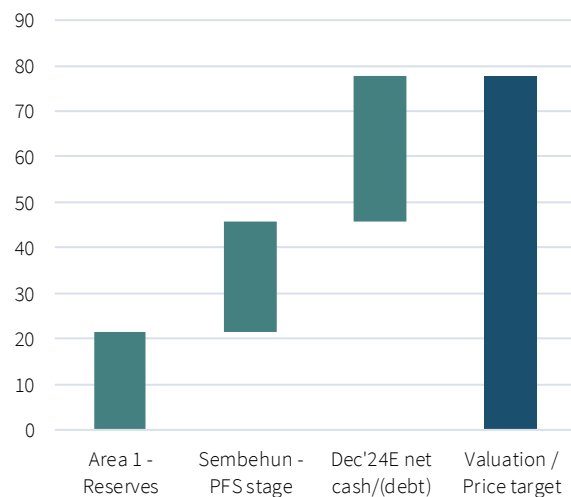
Source: Company

Area 1 and Sembehun FCF (US\$m)



Source: Company reports, H&P estimates

Price target derivation (A\$0.78/share); 333% upside



Source: H&P estimates

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