

Sierra Rutile

H1 results & model update: inventory build weighing on cash flow; Area 1 extension boosts TP

Sierra Rutile Holdings Ltd (“Sierra Rutile”; “SRX”) released H1 results showing profitability remained intact despite a tough period operationally, as reported in the July trading update. Sales fell 12% vs H1’22 on a 15% fall in shipments, with realised rutile prices broadly flat. Underlying EBITDA (calculated by H&P) was ~US\$29m, +1.6% YoY, although a ~US\$13.4m inventory build ahead of the Q3 wet season meant H1 operating cash flow was down 80% to US\$7m, with a free cash outflow (post capex) of US\$12m vs US\$2m in H1’22. However, SRX still has a solid US\$32.6m net cash balance and, in spite of a soft rutile market, we expect free cash flow to improve modestly in H2 as stockpiles are worked down. We also now include updated Area 1 Reserves, a single-phase development of Sembahun and a weaker A\$, driving a 22% uplift in our DCF-based target to A\$0.78, ~4x the current share price. SRX remains cheap, in our view, with the market cap roughly 60% covered by net cash and ~2x covered by net current assets.

New production guidance a low bar to clear, with rutile demand the key variable
SRX cut its FY23 rutile guidance from 140kt-144kt to 124kt-126kt on 28th July. We have, therefore, cut our full year estimate by 13% to 124kt. Net unit cost guidance was increased to US\$990/t-US\$1,055/t from US\$950/t-US\$1,025/t (new H&Pe \$1,054/t). However, SRX expects ore and HMC inventories to fall in Q3, as mining slows during seasonal rains and power issues at the mineral separation plant improve. As such, based on historical recovery rates, we believe updated guidance is easily achievable, with the caveat that SRX may throttle back on rutile output if weak market conditions persist. SRX’s near-term pricing outlook was subdued as weakness in global TiO2 pigment demand has impacted downstream capacity utilisation, particularly ex-China. However, we note Iluka recently announced a four-month shutdown of two synthetic rutile kilns, which could help balance rutile markets. Longer-term, a lack of high-quality natural rutile projects suggests an emerging deficit in supply, supporting prices.

Catalysts: Sembahun decision due Q1’24; tax uncertainty delaying Mogbwemo
The Sembahun Definitive Feasibility Study (“DFS”) is on track to be complete in Q4’23, followed by an investment decision during Q1’24. We also expect another Area 1 Reserve update by year end. These two events should be positive catalysts for SRX, in our view, providing evidence of sustainability and potential growth in profits. Post Sierra Leone’s elections in June, we see scope for progress in the renegotiation of Area 1’s tax arrangements (“Third Amendment Agreement”), with dialogue with Government commencing in Q3. Fiscal clarity would unlock opportunities within Area 1, including the Mogbwemo Tailings Project, which could both cut costs and extend mine life by reclaiming historical waste. SRX’s internal study estimated an IRR for Mogbwemo of 40% from initial capex of US\$20m, albeit contingent on market conditions and the revised tax terms.

Changes to H&Pe for FY23E & longer term

Including H1 results, we cut our FY23E underlying EBITDA and EPS by 11% and 64% to US\$58m and US\$2.6/sh, respectively, on the back of lower rutile production guidance and realised prices (see details on pg. 3). Longer-term, we have increased the ore mined at Area 1 following SRX’s Reserve update in March. SRX also announced on 18th May that it would pursue a single phase ramp up instead of a two-phase development at Sembahun, providing a further boost to our DCF, with our unrisks NPV for SRX’s assets rising 70% to US\$218m.

Uplift in target: stock offers deep value on multiple fronts

Partially offsetting the uplift to our NPV, we have reduced our target P/NPVs to 0.8x from 1.0x on Area 1 and 0.6x from 0.7x on Sembahun, to account for increased uncertainty on both timing and funding due to the lack of clarity on fiscal arrangements. Still, combined with a weaker A\$/US\$ exchange rate we see a 22% increase in our risked sum-of-the-parts to A\$0.78/sh, ~4x the current share price. SRX stock continues to offer deep value, in our view, with the current US\$55m market cap sitting at a 44% discount to the book value of cash plus net working capital. This suggests the market currently places negative value on the company’s existing fixed assets, let alone its high-returning growth options. SRX’s current P/BV and EV/invested capital ratios sit at ~0.40x and ~0.19x, respectively. We calculate EV/EBITDAs of 0.3x and 0.4x in FY23 and FY24E, with a cumulative FCF yield over FY23-25E of 250% (excl. Sembahun).

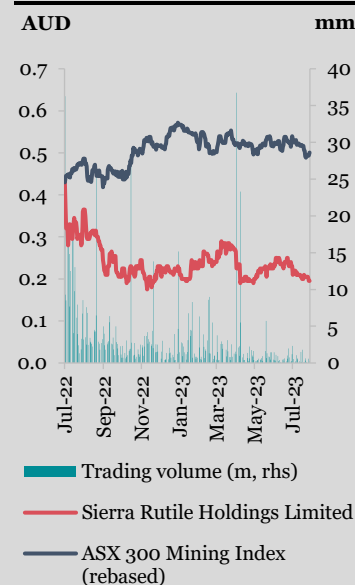
GICS Sector	Materials
Ticker	ASX:SRX
Market cap 24-Aug-23 (A\$m)	84.8
Share price 24-Aug-23 (AUD)	0.20
Target price 31-Dec-23 (AUD)	0.78

+290%

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

>500Mt

Potential rutile resource at Sembahun



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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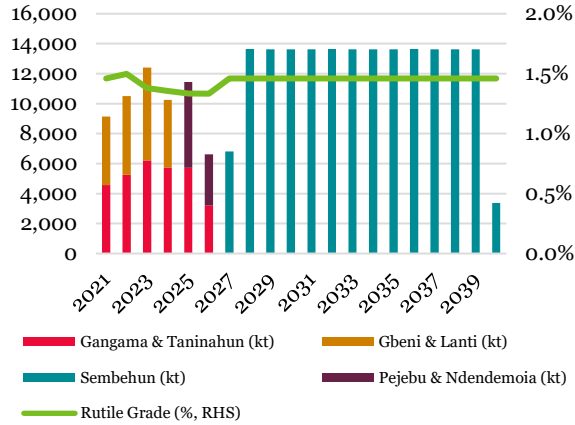
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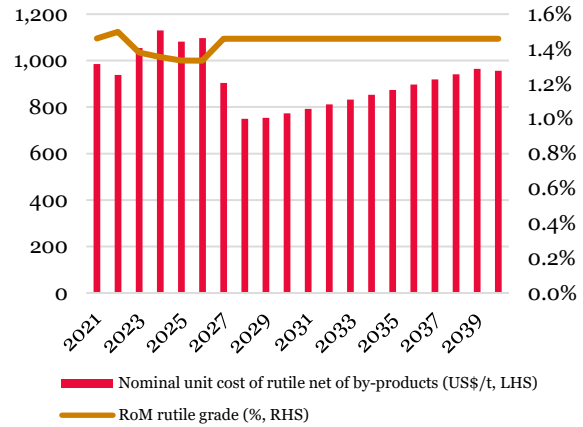
Key Charts

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



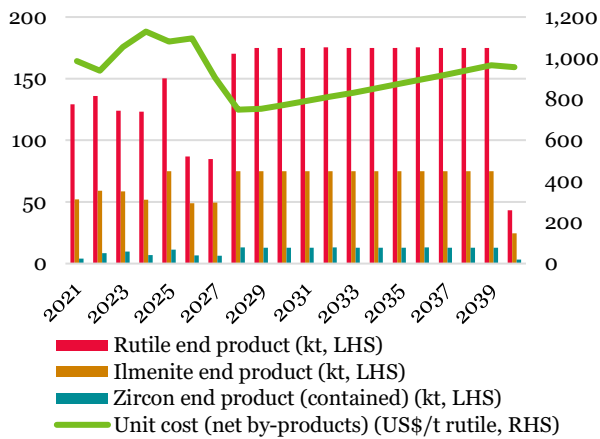
Source: Company reports, H&P estimates

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



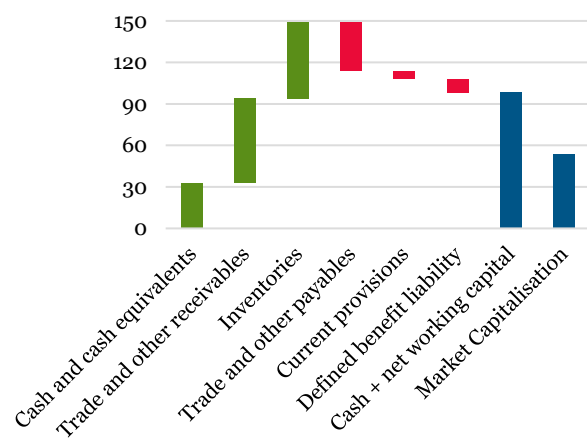
Source: Company reports, H&P estimates

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



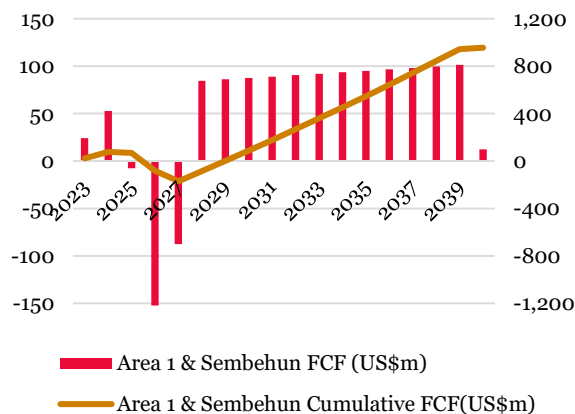
Source: Company reports, H&P estimates

SRX currently trades on very low multiples with cash + NWC of US\$98m vs. market cap of US\$55m



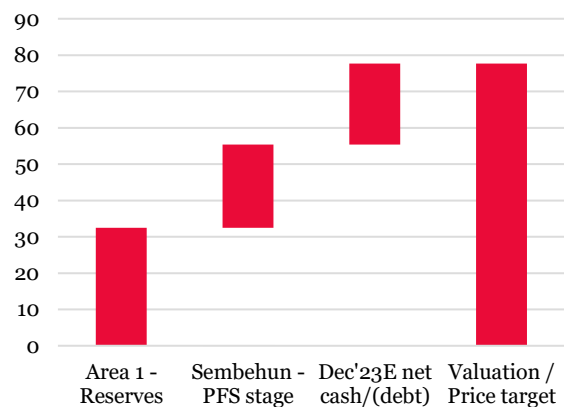
Source: Company reports, H&P estimates, Capital IQ

Area 1 and Sembahun FCF (US\$m)



Source: Company reports, H&P estimates

Price target derivation (A\$c per share)



Source: H&P estimates

Model updates

We have updated our model to incorporate H1'23 results, revised 2023 operational guidance, alignment with recent reserve updates, and the removal of the Phased Sembahun development. The table below details the changes to our estimates for FY23-25E, with cuts in FY23E on downgraded guidance and lower pricing, but increases in FY24-25E post Area 1's updated Reserve. The inclusion of the Pejebu and Ndendemoia zones in the Area 1 Reserve boosts ore excavated and grades in FY25E, significantly adding to production and increasing EBITDA almost five-fold vs our prior estimate to US\$53m. Our headline net income assumption for the full year has been reduced mostly on the back of the US\$28.8m impairment charge against the Area 1 property.

Changes to H&P estimates (Dec year-end)										
		2023E			2024E			2025E		
		New	Prev	% ch	New	Prev	% ch	New	Prev	% ch
Total excavated ore	Mt	12.4	11.5	8%	10.3	9.2	12%	11.5	5.7	100%
Rutile Grade	%	1.38%	1.42%	-3%	1.35%	1.42%	-5%	1.33%	1.42%	-6%
HMC Grade	%	2.6%	3.0%	-11%	2.9%	2.9%	-1%	3.1%	2.7%	17%
Total HMC produced	kt	339	351	-3%	304	274	11%	371	159	133%
Total HMC processed	kt	339	351	-3%	304	274	11%	371	159	133%
Rutile recovery from HMC (est)	%	36.6%	40.5%	-10%	40.5%	40.5%	0%	40.5%	40.5%	0%
Ilmenite recovery from HMC (est)	%	17.2%	17.7%	-3%	17.0%	16.4%	4%	20.2%	12.1%	67%
Zircon recovery from HMC (est)	%	2.9%	2.6%	10%	2.2%	2.6%	-13%	3.1%	2.3%	34%
Rutile production	kt	124	142	-13%	123	111	11%	150	64	133%
Ilmenite production	kt	58.5	62.2	-6%	519	44.9	15%	75.0	19.2	290%
ZiC/GiC production	kt	39.4	37.0	6%	27.1	28.0	-3%	45.5	14.6	212%
Rutile shipments	kt	124	142	-13%	123	111	11%	150	64	133%
Ilmenite shipments	kt	58.5	62.2	-6%	519	44.9	15%	75.0	19.2	290%
ZiC/GiC shipments	kt	39.4	37.0	6%	27.1	28.0	-3%	45.5	14.6	212%
Total product shipments	kt	222	241	-8%	202	184	10%	271	98	176%
Rutile realised price	\$/t	1,350	1,481	-9%	1,468	1,460	1%	1,436	1,436	0%
Ilmenite realised price (Est)	\$/t	301	298	1%	255	255	0%	220	220	0%
Zircon realised price (Est)	\$/t	1,837	1,746	5%	1,499	1,505	0%	1,361	1,361	0%
Revenue/t shipped Rutile	\$/t	1,638	1,725	-5%	1,658	1,658	0%	1,649	1,579	4%
Revenue	\$m	203	245	-17%	204	184	11%	248	102	144%
EBITDA	\$m	58	65	-11%	42	38	10%	53	11	371%
EBITDA margin	%	28%	26%	2%	20%	21%	0%	22%	11%	10%
D&A	\$m	17	29	-42%	27	24	12%	30	15	100%
Net finance cost	\$m	3	1	393%	2	1	39%	4	(0)	NM
Tax credit/(expense)	\$m	(4)	(10)	-57%	(4)	(7)	-37%	(7)	(1)	129%
FX/revaluations/other	\$m	(29)	5	NM	-	12	NM	-	6	NM
Net income	\$m	11	31	-64%	13	21	-37%	20	2	129%
EPS	US cps	3	7	-64%	3	5	-37%	5	0	129%
Operating cash flow pre-WC	\$m	57	70	-19%	44	51	-14%	57	17	229%
Dec/(inc) in working cap	\$m	(3)	19	NM	34	23	47%	14	10	45%
Cash flow from operations	\$m	54	89	-39%	78	74	5%	72	27	163%
Interest & tax paid	\$m	(4)	(10)	-58%	(4)	(5)	-20%	(7)	(1)	1039%
Capex	\$m	(29)	(36)	-20%	(18)	(153)	-88%	(68)	(149)	-54%
Other	\$m	2	(6)	NM	(2)	(15)	-86%	(4)	(6)	-35%
Free cash flow	\$m	24	38	-36%	53	(99)	NM	(7)	(128)	-94%
Net cash/(debt) - unadjusted	\$m	62	81	-24%	117	(2)	NM	113	(125)	NM

Source: Company Reports, H&P

Valuation – steep discount to A\$0.78/sh target

We believe SRX offers compelling risk-reward dynamics at the current share price, with FY23/24E EV/EBITDAs of 0.3x/0.4x, despite positive cash flow and a healthy capital buffer. Our sum-of-the-parts valuation is based on a DCF model which incorporates the Area 1 Reserves and the Sembehun PFS mine plan, albeit with a shorter ramp up based on SRX’s revised development approach. We apply a 12.8% WACC and US\$1,223/t long-term rutile price, with Sembehun production assumed to commence in 2027. This generates a NPV of US\$218m, including US\$106m for Sembehun. We apply a P/NPV multiple of 0.8x on the Area 1 and 0.6x on Sembehun, revised from 1.0x and 0.7x previously. This accounts for the Area 1 extension with Pejebu and Ndendemoia, as well as the faster phased Sembehun development now not directly supported by a study, prior to the feasibility study due later this year. We also adjust for forecast net cash to derive a Dec’23E target price of A\$0.78 per share, 290% above the current price.

Estimated Net Present Value per share / Price Target derivation				
	US\$m	P/NPV	US\$m	AUDc/sh
Area 1 - Reserves	112.7	0.8	90.1	33
Sembehun - PFS stage	105.7	0.6	63.4	23
SRX operations - DCF	218.4	0.7	153.5	55
Dec’23E net cash/(debt)	61.9	1.0	61.9	22
Valuation / Price target	280.2		215.4	78

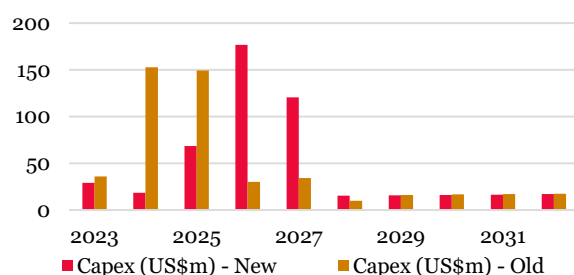
Source: H&P

Sembehun peak funding requirement pushed out and slightly reduced, despite single-phase development approach

SRX announced in May that it has adopted a full development approach for its proposed Sembehun project, to optimise project value and widen debt funding capacity. This is updated from the Pre-Feasibility Study which outlined a two-phase approach with phase 1 lasting two years.

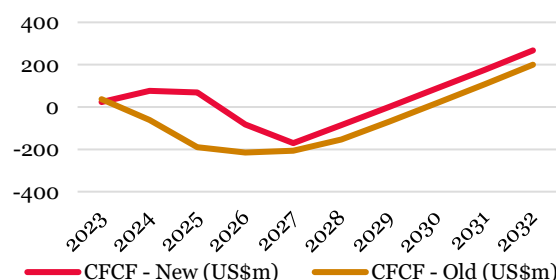
This implies the estimated ~US\$340m initial capex budget will be spent over a compressed time-frame, increasing the Company’s peak funding requirement, all else equal. However, with a final investment decision expected around the end of Q1’24, we do not expect the company to start incurring capex until after the 2024 wet season, effectively pushing the timeframe for first production back by ~12 months. Combined with the extension of the Area 1 operations on the back of SRX’s updated Reserves, this should allow the Company to build a larger cash buffer from its existing operations. Overall, this suggests a smaller funding gap to be bridged for the Sembehun development in our updated model, as shown in the chart on the right below.

Area 1 and Sembehun Capex update (US\$m)



Source: H&P estimates

Area 1 and Sembehun cumulative FCF update (US\$m)



Source: H&P estimates

Financial Summary

Income statement						
Year end December		2021A	2022A	2023E	2024E	2025E
Revenue	US\$m	184.2	254.5	209.4	204.4	247.9
Cost of Sales	US\$m	(148.0)	(186.1)	(141.4)	(162.6)	(194.5)
Depreciation	US\$m	(27.4)	(2.5)	(16.8)	(26.6)	(30.5)
Gross profit/(loss)	US\$m	8.8	65.9	51.1	15.2	22.9
Other income	US\$m	1.8	0.2	0.6	-	-
Other operating costs	US\$m	5.2	12.5	(39.7)	-	-
Operating profit/(loss)	US\$m	15.8	78.6	12.1	15.2	22.9
Unwinding of discount on rehabilitation and mine closure p:	US\$m	(0.8)	(0.5)	-	-	-
Other finance costs	US\$m	(4.0)	(1.3)	3.4	2.1	3.9
Profit/(Loss) before tax	US\$m	11.0	76.9	15.5	17.3	26.9
Tax credit/(expense)	US\$m	(3.4)	(1.3)	(4.4)	(4.3)	(6.7)
Net profit/(loss)	US\$m	7.5	75.6	11.1	13.0	20.1

EBITDA	US\$m	19.0	57.7	57.7	41.8	53.4
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Ratios and per share data						
Year end December		2021A	2022A	2023E	2024E	2025E
Yr end shares in issued	m	424.2	424.2	424.2	424.2	424.2
Revenue growth	%	Na	38%	-18%	-2%	21%
EBITDA margin	%	10%	23%	28%	20%	22%
ROCE	%	160%	57%	49%	37%	0%
ROE	%	143%	54%	8%	8%	0%
EPS	US¢/sh	1.3	17.4	2.6	3.1	4.7
EPS growth	%	Na	1216%	-85%	17%	55%
Free cash flow	US\$m	8.7	(7.6)	24.0	52.9	(7.5)
FCF/share	US¢/sh	2	(2)	6	12	(2)
Net cash/(debt)	US\$m	10.0	37.7	61.9	116.9	113.4
Current EV / EBITDA	x	0.9	0.3	0.3	0.4	0.3
Current EV / Sales	x	0.1	0.1	0.1	0.1	0.1

Production volumes						
		2021A	2022A	2023E	2024E	2025E
Rutile	kt	129	136	124	123	150
Ilmenite	kt	52	59	59	52	75
Zircon	kt	4	9	10	7	11

Shipment volumes						
		2021A	2022A	2023E	2024E	2025E
Rutile	kt	129	142	124	123	150
Ilmenite	kt	52	62	59	52	75
ZIC	kt	16	48	39	27	46

Mineral sands price assumptions (nominal)						
		2021A	2022A	2023E	2024E	2025E
Rutile - spot	US\$/tonne	1,382	1,500	1,481	1,460	1,436
Rutile - realised	US\$/tonne	1,334	1,500	1,350	1,468	1,436
Ilmenite - spot	US\$/tonne	283	350	313	269	232
Ilmenite - realised	US\$/tonne	150	261	301	255	220
Zircon - spot	US\$/tonne	1,613	2,102	1,838	1,584	1,432
Zircon - realised	US\$/tonne	931	1,571	1,837	1,499	1,361

Cash Costs						
		2021A	2022A	2023E	2024E	2025E
Cash costs/t finished product (net of by-products)	US\$/tonne	985	938	1,054	1,129	1,081
Total Cash Cost	US\$m	139	163	167	163	195
Cost of sales (P&L)	US\$m	175	189	158	189	225

Source: H&Pe

Cash flow statement						
Year end December		2021A	2022A	2023E	2024E	2025E
Profit/(loss) before tax	US\$m	11.0	76.9	15.5	17.3	26.9
Depreciation	US\$m	27.4	2.5	16.8	26.6	30.5
Other non-cash items/adjustments	US\$m	(21.0)	(17.8)	24.7	-	-
Operating cash inflow/(outflow)	US\$m	17.4	61.6	57.1	43.9	57.3
Working capital change	US\$m	(6.5)	(16.1)	(2.6)	33.9	14.3
Net interest (paid)/received	US\$m	0.0	0.7	0.8	-	-
Tax (paid)/received	US\$m	(3.8)	(1.6)	(4.9)	(4.3)	(6.7)
Other	US\$m	(3.1)	(1.2)	0.0	0.0	-
CFO	US\$m	4.0	43.3	50.4	73.5	64.9
Sustaining capex	US\$m	-	(20.0)	(24.2)	(10.5)	(12.0)
Growth capex	US\$m	-	-	(5.0)	(8.0)	(56.5)
Other	US\$m	-	(44.8)	3.0	-	-
CFI	US\$m	-	(64.8)	(26.3)	(18.5)	(68.5)
CFF	US\$m	6.2	33.4	-	-	-
Net change in cash	US\$m	10.2	11.9	24.2	55.0	(3.6)
Beginning cash & equivalents	US\$m	16.6	26.0	37.7	61.9	116.9
Ending cash & equivalents	US\$m	26.0	37.7	61.9	116.9	113.4

Balance sheet						
Year end December		2021A	2022A	2023E	2024E	2025E
Cash	US\$m	26.0	37.7	61.9	116.9	113.4
Receivables	US\$m	43.4	53.9	47.3	29.1	24.7
Inventory	US\$m	40.5	35.0	40.0	29.1	24.7
Other	US\$m	-	2.5	-	-	-
Current Assets	US\$m	109.9	129.2	149.2	175.1	162.8
PPE	US\$m	3.5	53.4	36.4	28.3	66.3
Other	US\$m	0.1	40.9	42.0	42.0	42.0
Fixed Assets	US\$m	3.6	94.3	78.4	70.3	108.3
Payables	US\$m	22.8	29.0	24.7	29.5	35.1
Other	US\$m	24.0	6.3	5.9	5.9	5.9
Current Liabilities	US\$m	46.8	35.3	30.6	35.4	41.0
Non Current Liabilities	US\$m	61.9	53.2	51.4	51.4	51.4
Total Equity	US\$m	4.8	135.0	145.6	158.6	178.7

Market cap, net debt & enterprise value						
Year end December		2021A	2022A	2023E	2024E	2025E
Market Cap (Yr end)	US\$m	54.9	54.9	54.9	54.9	54.9
Net Debt/(Cash)	US\$m	(10.0)	(37.7)	(61.9)	(116.9)	(113.4)
EV	US\$m	44.9	17.2	(7.0)	(62.0)	(58.5)

Estimated Net Present Value per share / Price Target derivation					
		US\$m	P/NPV	US\$m	AUDc/sh
Area 1 - Reserves		\$112.7	0.8X	\$90.1	33
Sembehun - PFS stage		\$105.7	0.6X	\$63.4	23
SRX operations - DCF		\$218.4	0.7X	\$153.5	55
Dec'23E net cash/(debt)		\$61.9	1.0X	\$61.9	22
Valuation / Price target		\$280.2		\$215.4	78

Source: H&Pe

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