

Sierra Rutile

Sembahun development plan updated to full development approach for a greater debt capacity

Sierra Rutile Holdings Ltd (“Sierra Rutile”; “SRX”) announced it has adopted a full development approach for its proposed Sembahun 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. The Definitive Feasibility Study (“DFS”) timeline remains unchanged and is anticipated to be completed by year end, followed by a Final Investment Decision (“FID”) early next year. Alongside the DFS, we expect another Area 1 Reserve update by year end. These two events should provide further evidence of the sustainability of both operations, and as such profits from SRX, in turn closing the 69% discount to our A\$0.64 target price.

Adoption of full development approach at Sembahun project

As outlined in the Jun’22 Pre-feasibility study (“PFS”), the Sembahun project was set to follow a two-phase approach, with two years in Phase 1, expanding to double the capacity in Phase 2. SRX commenced the Sembahun DFS in Sep’22, in line with the phased approach; however, SRX has today announced adjustments to the DFS basis. The company has moved away from the phased approach to full development, with the aim of maximising project NPV and improving debt funding capacity. The DFS timeline remains unchanged and is anticipated to be completed by year end, with an FID expected in early 2024.

Equity dilution risk reduced

While the project’s value should be boosted by accelerating the production ramp up and through capex efficiencies, the peak external funding requirement is likely to increase as construction capital will no longer be spread over several years. However, the Company expects that the increase in debt-carrying capacity should more than offset the increase in funding requirement, implying less equity will need to be contributed to finance the build. SRX has appointed a global mining finance advisor to advise on future debt financing. A simplified funding structure with more debt capital raised upfront should also leave the Company less reliant upon suboptimal, lower-margin Phase 1 output. Residual cash flows from Area 1 are also subject to a higher degree of uncertainty as grades naturally fall and as the Government of Sierra Leone recently announced that it was seeking to renegotiate the fiscal arrangements for its current operations.

Rutile prices fell going into Q1, coinciding with lower sales

SRX had maintained a steady increase in realised rutile prices from 2017 to 2022 as they became a more prominent supplier known for quality and reliability. However, realised rutile price in Q1 came in at US\$1,427/t, 4% below H&Pe US\$1,481/t for 2023 and 8% lower QoQ, as downstream customers were squeezed by weaker pigment demand, particularly in Europe. While there were some endogenous factors, we believe pigment maker [Venator’s filing for Chapter 11 Bankruptcy protection](#) on 15th May is illustrative of the wider stress currently being felt downstream, especially in western markets. We expect this slack in demand to continue, exacerbated by recessionary fears, and we note SRX anticipates the slump in rutile markets is likely to persist for “some months” on demand weakness, with similar dynamics for sales to welding applications. Notwithstanding weaker product markets and lower shipments, SRX still delivered strong free cash flow of US\$38m in Q1’23.

Valuation – steep discount to A\$0.64/sh target

We believe SRX offers compelling risk-reward dynamics at the current share price, with a FY23E EV/EBITDA of 0.48x, despite positive cash flow and a healthy capital buffer. Our sum-of-the-parts valuation is based on a DCF model which matches the PFS mine plan, and uses a 12.8% WACC and US\$1,223/t long-term rutile price, with Sembahun production assumed to commence in 2026. This generates an asset NPV of US\$129m, including US\$65m for Sembahun. We apply a P/NPV multiple of 1.0x on the Area 1 and 0.7x on Sembahun, and adjust for forecast net cash, to derive a Dec’23E target price of A\$0.64 per share, 167% above the current price.

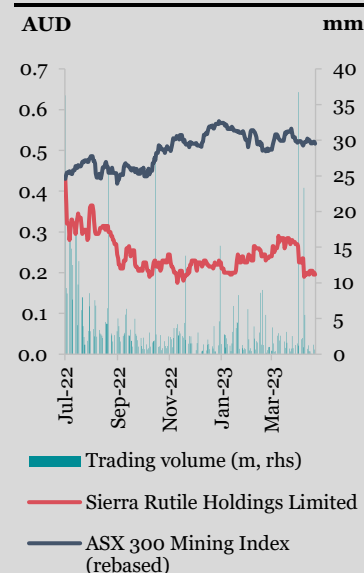
GICS Sector	Materials
Ticker	ASX:SRX
Market cap 18-May-23 (A\$m)	82.7
Share price 18-May-23 (AUD)	0.20
Target price 31-Dec-23 (AUD)	0.64

+220%

Upside from current share price to our A\$0.64/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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