HANNAM&PARTNERS

Sierra Rutile

FY22 results: solid cash flow with more to come in FY23 as Area 1 extension & Sembehun take shape

Sierra Rutile Holdings Ltd ("Sierra Rutile"; "SRX") has announced its maiden set of annual results as a newly demerged entity on the ASX, with free cash flow for the year coming in at a solid US$23.5m, implying a ~34% FCF yield. SRX had pre-reported rutile production of 142kt and a year-end cash balance of US$37.7m, making deviations vs H&Pe on the P&L of negligible importance. That said, costs were slightly higher than expected, leading to modestly lower than expected EBITDA, even after stripping out a non-cash inventory movement. Nonetheless, lower D&A and tax expenses led to underlying* net profit of US$52.2m, 46% better than H&Pe, and implying a trailing PE ratio of just 1.3x. Looking forward, we expect profitability to remain strong in FY23E (H&Pe EBITDA of US$65m) based on SRX's unchanged production and cost guidance for the year, despite our expectation of slightly lower rutile prices. More importantly, we see significant positive catalysts in the form of a near term Reserve and Resource update which should show extensions to the life of the Area 1 operations, to be followed later this year by a Definitive Feasibility Study (DFS) on the development of a new mining area at Sembehun. Both should provide further evidence of the sustainability of profits from SRX, in turn closing the 63% discount to our A$0.64 target price.

FY23E guidance reiterated

With management now focused on optimising output from a single asset, and several target areas for productivity improvements, SRX expect a 3% to 6% increase in rutile production in FY23E. However, reductions in ore grades as Area 1 moves toward the end of its mine life will require increased ore mining and processing to sustain rutile product output, plus greater haulage between mining, WCP and MSP units. This is expected to increase unit operating costs by up to 6.4% YoY and net-unit costs (post by-product credits) by up to 9.2% per tonne of rutile. Opex is expected to be H1-weighted, as SRX also plans to build stockpiles during H1'23 in order to avoid the impacts seen in Q3'22 caused by the wet season. Offsetting this, SRX anticipates some reversal in the 40% YoY increase in fuel costs encountered in FY22A. Similarly, capital expenditure is likely to be weighted to H1'23, partly due to seasonality as well as a catch up in works originally planned for 2022.

Opportunity to grow value through Reserve uplift and transition to Sembehun

A Reserve update for Area 1, to be released during Q1'23, is expected to extend the mine life, providing a positive near-term catalyst. SRX also outline the potential for a further LoM update in the medium term which could bridge the gap to production coming from Sembehun, on which a DFS is expected by year end. The synergies between these assets and the opportunity to recycle its current positive cash flow into a high-returning, NPV-enhancing project, justify a price to earnings multiple increase, in our view (See our Initiation report for details). The PFS, released in June 2022, showed solid economics, with an $NPV_{8\%}$ of US$318m and IRR of 24%, based on capex (over two phases) totalling US$337m, for which we believe debt funding should be available. Even based on Area 1 alone, beyond 2023, as Reserves decline, we estimate average EBITDA of US$31m over the remaining ~3.5 years of mine life, implying an average EV/EBITDA multiple of <1.4 for FY23-25E. SRX also benefits from a healthy US$45m of restricted funds placed at demerger into an independent environmental rehabilitation trust.

Valuation – steep discount to A$0.64/sh target

We believe SRX continues to offer a cheap entry point, with a FY23E EV/EBITDA of 0.48x, despite solid rutile prices, positive cash flow and a healthy capital buffer. Our sum-of-the-parts valuation is based on a DCF model including SRX's current Reserves, and Sembehun production assumed to commence in 2026. Using a 12.8% WACC and US$1,223/t long-term rutile price, this generates an asset NPV of US$129m, with Sembehun contributing US$65m (and an IRR of 15%). We apply a target P/NPV multiple of 1.0x on the Area 1 operations and 0.7x on the PFS-stage Sembehun project. After adjusting for net cash, this delivers a Dec'23E target price of A$0.64 per share, 167% above the current price.

**Excluding US$23.4m impairment reversal*

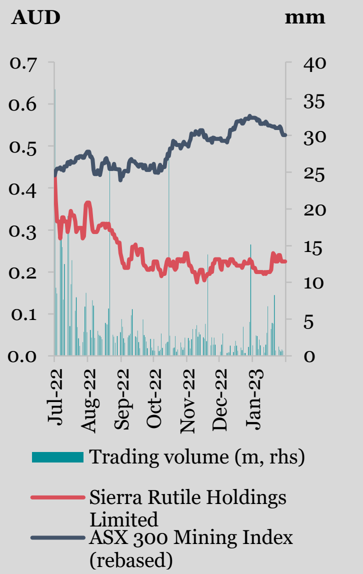
GICS Sector	Materials
Ticker	ASX:SRX
Market cap 27-Feb-23 (A$m)	101.8
Share price 27-Feb-23 (AUD)	0.24
Target price 31-Dec-23 (AUD)	0.64

+167%

Upside from current share price to our A$0.64/sh target

>500Mt

Potential rutile resource at Sembehun



H&P Advisory Ltd is a Retained Advisor to Sierra Rutile Holdings Limited. The cost of producing this material has been covered by Sierra Rutile Holdings Limited as part of a contractual engagement with H&P; this report should therefore be considered an "acceptable minor non-monetary benefit" under the MiFID II Directive.

Roger Bell
Director, Mining Research
T +44-207-907-8534
E rb@hannam.partners

Oscar Norris
Research Analyst
T +44-207-907-8500
E on@hannam.partners

Jay Ashfield
Director, Mining Sales
T +44-207-907-2022
E ja@hannam.partners

H&P Advisory Limited
3rd Floor, 7-10 Chandos Street,
London W1G 9DQ

FY22 results confirm strong progress as newly demerged entity

Shipments and realised prices were pre-reported on 25th Jan, and as such FOB revenues came in broadly in-line with expectations at US$245m for the year. Cash costs of US$165m were broadly in-line with the pre-reported figure of US$163m, but did not include a ~US$13m reduction in inventory accruing to costs in FY22A and a further ~US$19m in S,G&A and other costs; we calculate costs ~7% above H&Pe on a like-for-like basis. Reported EBITDA of US$58m was therefore ~24% below H&Pe, but up 206% YoY.

Underlying net profit after tax of ~US$52m more than quadrupled the FY21 result, and comfortably beat H&Pe due to D&A (US$2.5m) and tax (US$1.3m) respectively 90% and 89% below our estimates.

Despite variances on the P&L, free cash flow of ~US$23m was only slightly below H&Pe, impacted by a larger than forecast increase in working capital as receivables increased due to shipments booked at year end, which should reverse in FY23E. As previously reported, SRX ended the year with a comfortable ~US$38m cash balance.

2022 Financial Results

		2022 Actual	2022 H&Pe	% Diff.	FY21A	% YoY
Production Results						
Rutile	kt	136	136	0%	127	7%
Ilmenite	kt	59	59	-1%	52	12%
Zircon	kt	34	34	0%	26	30%
Financial Results						
Revenue (FOB)	US$m	245.0	238.6	3%	177.3	38%
Revenue (Freight)	US$m	9.5	0.0	Na	6.9	36%
Cost of Sales (Cash)	US$m	-165.3	-154.4	7%	-137.5	20%
Inventory movement included in CoGS	US$m	-12.6	0.0	Na	-1.0	1170%
S,G&A and Other	US$m	-18.8	-8.6	119%	-27.8	-32%
EBITDA	US$m	57.8	75.6	-24%	18.9	206%
D&A	US$m	-2.5	-25.9	-90%	-27.4	-91%
Impairment Reversal	US$m	23.4	0.0	Na	-4.7	-598%
Net Interest & Other	US$m	-1.8	0.0	Na	-9.5	-81%
Tax	US$m	-1.3	-12.0	-89%	-3.4	-62%
NPAT	US$m	75.6	35.9	111%	7.5	908%
Underlying NPAT*	US$m	52.2	35.9	46%	12.2	328%
Cashflow						
Operating Cashflow (Excl. WC movement)	US$m	60.7	61.8	-2%	13.6	346%
WC Movement	US$m	-17.4	-13.7	27%	-9.6	81%
Capex & exploration	US$m	-19.8	-20.0	-1%	0.0	Na
Free cash flow	**US$m**	**23.5**	**28.1**	**-16%**	**4.0**	**486%**
Debt repayment to ILU**	US$m	-11.6	0.0	Na	0.0	Na
Other	US$m	0.0	0.2	-100%	6.2	-100%
Movement in Cash	US$m	11.9	28.3	-58%	10.2	16%
Final Cash Balance	US$m	37.7	37.7	0%	26.0	45%

Source: Company Reports, H&P estimates. Notes: *Excluding US$23.4m impairment reversal; **H&Pe for 2022 cash flow reflects proforma figures already adjusted for repayment internal debt, resulting in differences in movement in cash balance vs reported figure

Disclaimer

This Document has been prepared by H&P Advisory Limited ("H&P"). It is protected by international copyright laws and is for the recipient's use in connection with considering a potential business relationship with H&P only. This Document and any related materials are confidential and may not be distributed or reproduced (in whole or in part) in any form without H&P's prior written permission.

By accepting or accessing this Document or any related materials you agree to be bound by the limitations and conditions set out herein and, in particular, will be taken to have represented, warranted and undertaken that you have read and agree to comply with the contents of this disclaimer including, without limitation, the obligation to keep information contained in this Document and any related materials confidential.

This Document does not represent investment research for the purposes of the rules of the Financial Conduct Authority ("FCA Rules"). To the extent it constitutes a research recommendation, it takes the form of NON-INDEPENDENT research for the purposes of the FCA Rules. As such it constitutes a MARKETING COMMUNICATION, has not been prepared in accordance with legal requirements designed to promote the independence of investment research and is not subject to any prohibition on dealing ahead of dissemination of investment research.

The information contained herein does not constitute an offer or solicitation to sell or acquire any security or fund the acquisition of any security by anyone in any jurisdiction, nor should it be regarded as a contractual document. Under no circumstances should the information provided in this Document or any other written or oral information made available in connection with it be considered as investment advice, or as a sufficient basis on which to make investment decisions. This Document is being provided to you for information purposes only.

The distribution of this Document or any information contained in it and any related materials may be restricted by law in certain jurisdictions, and any person into whose possession this Document or any part of it comes should inform themselves about, and observe, any such restrictions.

The information in this Document does not purport to be comprehensive and has been provided by H&P (and, in certain cases, third party sources) and has not been independently verified. No reliance may be placed for any purposes whatsoever on the information contained in this Document or related materials or in the completeness of such information.

The information set out herein and in any related materials reflects prevailing conditions and our views as at this date and is subject to updating, completion, revision, verification and amendment, and such information may change materially. H&P is under no obligation to provide the recipient with access to any additional information or to update this Document or any related materials or to correct any inaccuracies in it which may become apparent.

Whilst this Document has been prepared in good faith, neither H&P nor any of its group undertakings, nor any of its or their respective directors, members, advisers, representatives, officers, agents, consultants or employees makes, or is authorised to make any representation, warranty or undertaking, express or implied, with respect to the information or opinions contained in it and no responsibility or liability is accepted by any of them as to the accuracy, completeness or reasonableness of such information or opinions or any other written or oral information made available to any party or its advisers.

Without prejudice to the foregoing, neither H&P nor any of its group undertakings, nor any of its or their respective directors, members, advisers, representatives, officers, agents, consultants or employees accepts any liability whatsoever for any loss howsoever arising, directly or indirectly, from use of this Document and/or related materials or their contents or otherwise arising in connection therewith. This Document shall not exclude any liability for, or remedy in respect of, fraudulent misrepresentation.

All statements of opinion and/or belief contained in this Document and all views expressed and all projections, forecasts or statements regarding future events or possible future performance represent H&P's own assessment and interpretation of information available to it as at the date of this Document.

This Document and any related materials may include certain forward-looking statements, beliefs or opinions. By their nature, forward-looking statements involve risk and uncertainty because they relate to events and depend on circumstances that will occur in the future. There can be no assurance that any of the results and events contemplated by the forward-looking statements contained in the information can be achieved or will, in fact, occur. No representation is made or any assurance, undertaking or indemnity given to you that such forward looking statements are correct or that they can be achieved. Past performance cannot be relied on as a guide to future performance.

This Document is directed at persons having professional experience in matters relating to investments to whom Article 19 of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 ("FPO") applies, or high net worth organisations to whom Article 49 of the FPO applies. The investment or investment activity to which this communication relates is available only to such persons and other persons to whom this communication may lawfully be made ("relevant persons") and will be engaged in only with such persons. This Document must not be acted upon or relied upon by persons who are not relevant persons.

This Document is not intended for distribution to, or use by any person or entity in any jurisdiction or country where such distribution or use would be contrary to local law or regulation. In particular, the information contained in this Document is not for publication, release or distribution, and may not be taken or transmitted into: (i) the United States or its territories or possessions, or distributed, directly or indirectly, in the United States, its territories or possessions or to any U.S. person as such term is defined in Regulation S of the Securities Act; or (ii) Australia, Canada, Japan, New Zealand or the Republic of South Africa. Any failure to comply with this restriction may constitute a violation of United States, Canadian, Japanese, New Zealand or South African securities law. Further, the distribution of this document in other jurisdictions may be restricted by law, and persons into whose possession this Document comes are required to inform themselves about, and observe, any such restrictions.

H&P may from time to time have a broking, corporate finance advisory or other relationship with a company which is the subject of or referred to in the Document.

This Document may contain information obtained from third parties, including ratings from credit ratings agencies such as Standard & Poor's. Reproduction and distribution of third party content in any form is prohibited except with the prior written permission of the related third party. Third party content providers do not guarantee the accuracy, completeness, timeliness or availability of any information, including ratings, and are not responsible for any errors or omission (negligent or otherwise), regardless of the cause, or for the results obtained from the use of such content. Third party content providers give no express or implied warranties, including, but not limited to, any warranties of merchantability or fitness for a particular purpose or use. Third party content providers shall not be liable for any direct, indirect, incidental, exemplary, compensatory, punitive, special or consequential damages, costs, expenses, legal fees or losses (including lost income or profits and opportunity costs or losses caused by negligence) in connection with any use of their content including ratings. Credit ratings are statements of opinions and are not statements of fact or recommendations to purchase, hold or sell securities. They do not address the suitability of securities or the suitability of securities for investment purposes, and should not be relied on as investment advice.

In H&P's view this material is considered as "acceptable minor non-monetary benefit" under MiFID II as it is either: (i) "non-substantive short-term market commentary"; and/or (ii) making a brief reference to existing H&P research and, as such, is in-and-of-itself non-substantive; and/or (iii) paid for by a corporate issuer or potential corporate issuer as part of a contractual engagement with H&P.

H&P Advisory Ltd is registered in England No.11120795. Registered Office: 3rd Floor, 7-10 Chandos Street, London W1G 9DQ. H&P Advisory Ltd is authorised and regulated by the Financial Conduct Authority (Firm Reference Number 805667).