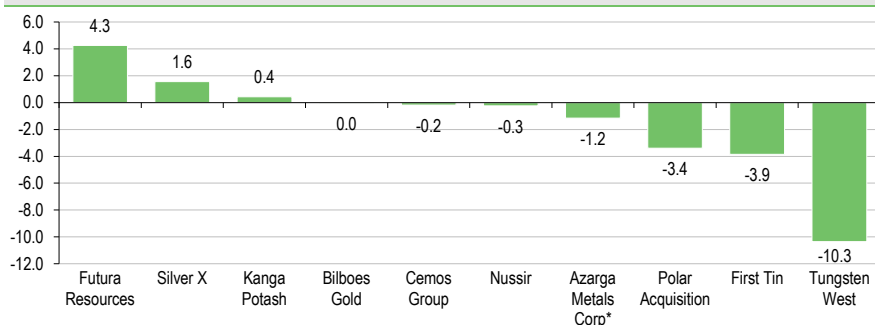


# Baker Steel Resources Trust

## Upside potential from successful project funding

Baker Steel Resources Trust (BSRT) posted an NAV total return of -16.3% in FY22, which was mostly a result of the de-rating of recently floated holdings Tungsten West and First Tin and the impact of Western sanctions against Russia on Polar Acquisition (PAL) and Azarga Metals. However, BSRT also agreed to sell its equity stake in its largest holdings (Bilboes Gold, completed in January 2023) and saw progress across several projects. BSRT's maturing portfolio offers the prospect of attractive income from royalty payments (on production launch of Futura, PAL and Bilboes Gold) and dividends (from Caledonia Mining Corporation, CMCL, and later potentially also Cemos).

### Contributions of key holdings to BSRT's NAV total return in 2022 (pp)



Source: Company data, Edison Investment Research. Note: \*Azarga Metals Corp's contribution to end-May 2022 (last available data).

## Year-end review results in a c 4% NAV increase

Following the year-end (December 2022) portfolio review, BSRT's NAV per share increased by 4.2% versus end-November 2022. Key positive drivers included Cemos (a cement production project in Morocco) and Bilboes Gold (a gold mining company based in Zimbabwe). Cemos saw a 10% positive revaluation versus end-November, translating into a 1% overall decline in 2022, as the fall in multiples of listed peers and lower production volumes in 2022 versus 2021 were largely offset by the first-time recognition of the value attributable to the recently acquired second grinding line (which is yet to be deployed). Bilboes Gold's carrying value went up by 10.6% versus end-November (and was stable in 2022 in sterling terms). It was valued based on the consideration BSRT negotiated as part of the sale agreement with CMCL (see our [previous note](#) for details) consisting of CMCL shares (whose price increased recently alongside other listed gold producers) and a 1% net smelter royalty from Bilboes Gold (which was revalued based on the year-end gold price).

## Risk-reward profile improved as discount widened

BSRT's shares now trade at a wide discount to NAV of 41% (vs a five-year average of c 20%). Moreover, we see potential for an NAV uplift following the successful completion of the currently ongoing fund-raising processes to either initiate mine construction or enable production ramp-up (Futura, Tungsten West, Kanga Investments, Nussir). Also, a meaningful part of BSRT's portfolio (c 27%, according to our estimates) is in listed equities, some of which (First Tin, CMCL) are reflected in BSRT's NAV at a discount due to lock-ups, which will expire later this year.

## Investment trusts Metals and mining

18 January 2023

**Price** 49.0p  
**Market cap** £52.2m  
**NAV** £87.7m

NAV\* 82.4p

\*At end-2022.

Discount to NAV 40.5%

Yield 0.0%

Shares in issue\*\* 107.2m

\*\*Including 700k treasury shares.

Code/ISIN BSRT/GG00B686L20

Primary exchange LSE

AIC sector Commodities & Natural

52-week high/low 76.5p 43.0p

NAV high/low 98.4p 78.3p

### Gearing

Net cash at end-2022 0.2%

### Fund objective

Baker Steel Resources Trust (BSRT) is a closed-ended investment company aiming to achieve long-term capital growth through investing in equity, loans and related instruments issued by private natural resources companies. It targets a global, concentrated portfolio of 15–20 investments. BSRT's objective is to create value through driving the development of investee companies, as well as exploiting market inefficiencies and pricing anomalies.

### Bull points

- Exposed to project development gains – not a simple beta play on commodity prices.
- Downside protection is provided by BSRT's focus on realising value from project development, valuations based on consensus forecasts for commodity prices and the use of convertible debt.
- Maturing portfolio, with several projects approaching mine construction or production.

### Bear points

- Risk of cost overruns due to the inflationary environment.
- Some projects are located in high-risk mining jurisdictions.
- High portfolio concentration by project.

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## Successful funding of maturing projects are key near-term portfolio catalysts

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### Futura ready to initiate production upon securing funding

Several of BSRT's portfolio companies are currently in the process of securing funding for mine construction/refurbishment or production ramp-up (which could support their valuations through a reduced discount rate associated with project execution risk). This includes **Futura Resources**, BSRT's largest holding (26.7% of end-2022 NAV) and the owner of the Wilton and Fairhill coking coal projects in Australia. Production launches at both sites were previously postponed due to the pandemic outbreak and subsequently the informal Chinese import ban on Australian coal, which adversely affected coal pricing (and led to a period of reorganisation in terms of global coal export/import directions). The projects were awarded mining licences in November 2022, but production launch remains conditional on Futura's ability to secure project funding (which is planned to be primarily debt), which has been pending since 2021. We consider a potential successful fund-raise, followed by production launch (with Wilton likely to come first given limited start-up capex of c A\$25m), as one of the major potential NAV triggers for BSRT in 2023. The company refrained from revaluing Futura upwards during the year-end valuation review (pending the fund-raise), though the holding's carrying value increased earlier in 2022 on the back of the conversion of BSRT's bridging loan to Futura into an additional 0.5% gross revenue royalty (on top of the existing 1.0%).

### Tungsten West targets production launch in Q423

**Tungsten West** (5.2% of NAV at end-2022) has recently published its updated feasibility study (FS) based on the revised plan developed in response to the surge in energy prices (see our [previous note](#) for details). The FS release (which triggered a c 5.5% increase in Tungsten West's share price on the day of the publication) indicates a base-case post-tax NPV<sub>5%</sub> of £297m and an internal rate of return (IRR) of 25%. Last year, the company agreed on a non-binding term sheet for a US\$30m royalty sale with a global mine royalty investment fund. Management expects the funding to close in Q123, which we understand has been tied to the release of the FS. Tungsten West also seeks to secure up to £10m of further funding, which would allow it to commission its Hemerdon project in H123 and launch production in Q423. We note that BSRT (as one of the four founding shareholders) will be awarded 1.65m shares in Tungsten West upon full completion of project fund-raising and another 1.65m on commercial production. These additional shares represent 1.6% of the fully diluted number of shares accounting for all outstanding options and warrants (BSRT currently holds a 16.1% equity stake in Tungsten West, according to BSRT's management).

Tungsten is becoming increasingly important as a strategic metal for the West, especially given that China accounts for c 90% of global reserves and 80% of mine production, according to Tungsten West. The results of the FS position Tungsten West to become the largest tungsten producer in the Western world, according to the management.

### Considering various funding routes for previous IPO candidates

As the sentiment in public markets deteriorated last year, BSRT had to revise plans to list two of its portfolio holdings in 2022. **Kanga Investments** (5.4% of NAV at end-2022), a potash project in the Republic of Congo, completed its FS in September 2020 and recently obtained its mining licence. BSRT is seeking to sell or list the project in H123 to raise funding for mine construction. In this context, we note that muriate of potash prices remain favourable (above US\$500 per tonne), supporting project economics. **Nussir** (4.0% of NAV at end-2022) completed its definitive FS for a fully electrified mine in January 2022 and last year received approval from the Norwegian

authorities to go ahead with the copper project (despite some opposition from the indigenous Sámi community). The project now seeks to obtain financing, with listing being one of the considered options.

**Exhibit 1: BSRT portfolio summary**

	% of end-2022 NAV	Commodity	Location	Next development step
Futura Resources	26.7%	Coking coal	Australia	Production launch in 2023 subject to funding
Cemos Group	22.0%	Cement	Morocco	Capacity expansion, clinker line being considered
Bilboes Gold	15.6%	Gold	Zimbabwe	Restarting oxide mining operations in 2023
Kanga Investments	5.4%	Potash	Republic of Congo	Funding of mine construction
Tungsten West	5.2%	Tungsten	UK	Funding for mine refurbishment, project commissioning in H123, production launch planned for Q423
Silver X Mining Corporation	5.2%	Silver, lead, zinc	Peru	Resource update and expanding production
Polar Acquisition	4.9%	Silver	Russia	First production in 2023, production ramp-up in 2024
First Tin	4.6%	Tin	Germany, Australia	Definitive Feasibility Study for Taronga and Tellerhäuser completion in Q423
Nussir	4.0%	Copper	Norway	Funding of mine construction
Prism Diversified	1.4%	Lithium, iron, vanadium	Canada	N/A
Listed precious metal shares	2.4%	Gold, silver	Various	-
Other investments	2.4%	-	-	-
Net cash, equivalents and accruals	0.2%	-	-	-

Source: Baker Steel Resources Trust, Edison Investment Research

## Carrying value of second-largest holding stable, supported by expansion prospects

Production volumes at Cemos (22.0% of end-2022 NAV) declined by c 11% y-o-y in 2022 (according to management estimates), affected by clinker availability in the first half of the year and subsequently a decrease in demand for cement from the local construction sector amid an overall economic slowdown in Morocco. The carrying value of the project was also affected by the decline in earnings multiples of public peers. For example, the current EV/EBITDA multiples for FY22e of LaFarge Holcim Maroc and Ciments du Maroc stand at 10.2x (based on Refinitiv consensus), versus EV/EBITDA FY21 multiples of c 13.5x for both at the time of publishing our [February 2022 note](#).

However, the above effects were largely offset by the first-time recognition of the value associated with the project's planned expansion. Cemos acquired a second production line in late 2022 and is now identifying a suitable location to install it, with an ongoing geological exploration program evaluating pozzolan deposits, which Cemos would like to utilise to reduce the amount of consumed clinker. Upon the launch of the second line (which BSRT expects in 2025), Cemos will have a total capacity of 570k tonnes pa, with a cost of expansion of only c €7m (which can be funded internally by Cemos). The company is still evaluating the construction of its own clinker line and expects to complete the associated technical work in H223.

## Growing income potential from maturing portfolio

We believe that BSRT's portfolio offers an attractive potential for future recurring income from royalties upon successful production ramp-up. A key contributor in this respect may be Futura Resources, in which BSRT holds a 1.5% gross revenue royalty (on top of a c 26% equity stake). For illustrative purposes, at the current spot price for Australian coking coal (free on board, FOB) of US\$280 per tonne and at full capacity utilisation of both projects of 2.3m tonnes pa, the annual pre-tax royalty income potential would be around c US\$10m pa, or 7.4p per BSRT share (vs end-2022 NAV per share of 82.4p). This does not account for any discounts (eg related to an off-take

agreement or impurities). BSRT's management is cautiously indicating a royalty income potential from the project of at least US\$3m pa.

Further income may come from the 0.8% to 1.9% net smelter royalty over the Prognoz silver project (first production scheduled for 2023), with BSRT's management suggesting an income potential of at least US\$1.5m pa (based on the annual output of 6.5m ounces implied by the revised development plan). However, we acknowledge that there are certain risks related to BSRT's ability to collect the royalty given that the project is located in Russia. Polymetal International (Jersey-domiciled), which is the owner of this project, is considering breaking up its operations into two entities (one of which would hold Polymetal's Russian assets). Finally, BSRT received a 1% net smelter royalty from Bilboes Gold as part of the sale agreement with CMCL (with management guiding to an annual income potential of at least US\$2m).

BSRT now also holds 800k shares of CMCL, which has been a regular dividend payer with US\$0.56 per share distributed in total in 2022. This level would translate into a dividend for BSRT of c US\$0.45m pa. Here, we note that BSRT is likely to sell down its CMCL holdings over the medium term to deploy the proceeds into unlisted junior mining projects, in line with its core strategy. BSRT has a six-month lock-up from the date of Bilboes deal completion on half of the held shares.

While the near-term cash flows of Cemos may be affected by the cyclical macroeconomic slowdown and the start-up costs of the second line (and potentially also the clinker line), it should become an important earnings contributor for BSRT and a potential source of dividend income in the longer run.

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