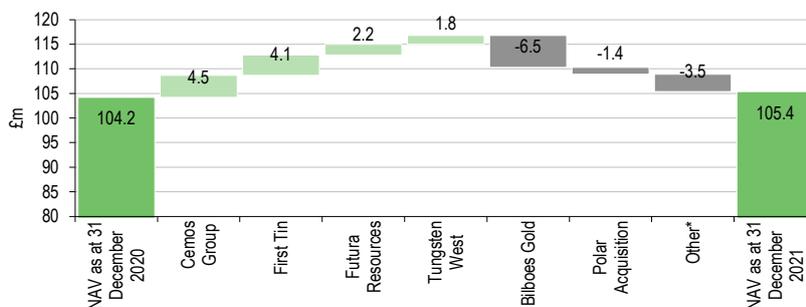


Baker Steel Resources Trust

NAV broadly flat in FY21 after strong FY20

In FY21, Baker Steel Resources Trust (BSRT) reported a modest unaudited NAV total return (TR) of 1.2% (after the strong 31.5% posted in FY20), below the c 11.0% TR recorded by the EMIX Global Mining Index. The positive revaluation of several industrial commodity projects (see chart below), supported by higher price projections and/or development progress, was mostly offset by writing down its precious metals mining investments, which now make up c 25% of BSRT's portfolio vs c 35% at end 2020. We consider BSRT's portfolio to be reasonably mature, providing scope for value uplifts in the medium term as the projects initiate mine construction and then approach first production.

Portfolio NAV development in FY21



Source: BSRT, Edison Investment Research. Assuming no exits and new investments in the period. Note: *Includes revaluation of other investments, as well as income and ongoing charges.

Why consider Baker Steel Resources Trust now?

BSRT offers the opportunity to benefit from the recent favourable environment for commodities through its portfolio of industrial commodities and precious metals projects. At the same time, we note that BSRT is more than a simple beta play on commodity prices, given its focus on value-added project development and investing in projects that offer a solid safety margin in terms of internal rate of return (IRR) based on long-term historical commodity prices. Together with investing through convertibles, this approach provides a certain level of downside protection.

The analyst's view

Following the successful IPO of Tungsten West in October 2021, BSRT now seeks to float three to four holdings this year to fund mine construction (and potentially to recover its initial investment in the case of high investor demand). This may reduce execution risk and in turn facilitate revaluation as these projects move up the development curve and approach first production in the next 24–36 months. As a broad reference point, we estimate that the carrying value of BSRT's unlisted stake in Cemos (a cement production project in Morocco) has been revalued by c 152% since late 2020 following the full ramp-up of its first production line. The expiry of BSRT's lock-ups, agreed as part of the listings, will give it the flexibility to conduct realisations, especially if commodity price inflation continues.

Investment trusts
Metals & mining

4 February 2022

Price Ord. 75p
Market cap £80m
NAV £102.3m

NAV* 95.5p
Discount to NAV 21.5%

*As at 31 January 2022.

Yield 0.0%

Shares in issue** 107.2m

Code/ISIN BSRT/GG00B6686L20

Primary exchange LSE

AIC sector Commodities and Natural Resources

52-week high/low 100.0p 70.5p

NAV high/low 99.8p 94.8p

**Including 700k treasury shares.

Gearing

Net cash at 31 January 2022 0.7%

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 natural resources companies, targeting 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. It focuses primarily on investing in unlisted companies that the manager deems to have strong fundamentals and attractive growth prospects, offering clear valuation upside.

Bull points

- Exposed to project development gains – not a simple beta play on commodity prices.
- Downside protection resulting from use of convertible debt in addition to equity instruments.
- Maturing portfolio, with several projects approaching construction.

Bear points

- Some projects located in high-risk mining jurisdictions.
- High portfolio concentration by project.
- Limited firepower to benefit from potential new market opportunities at present.

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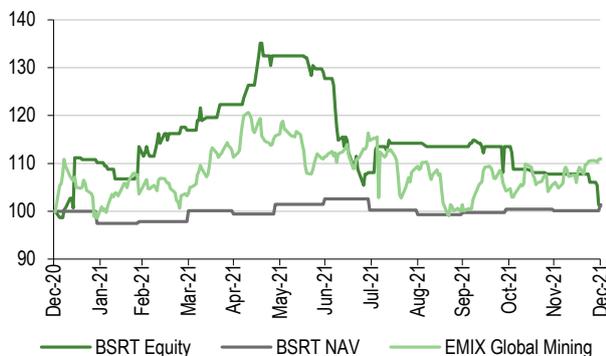
Baker Steel Resources Trust is a research client of Edison Investment Research Limited

Performance: Muted NAV TR in FY21, but medium-term returns remain intact

Following a particularly strong FY20 with NAV TR of 31.5%, BSRT recorded a NAV TR of 1.2% in FY21, which fell short of the EMIX Global Mining Index's 11.0% total return in sterling terms. BSRT's portfolio NAV expanded to £105.5m as at end-December 2021 from £104.2m a year earlier, according to our calculations. It was assisted by the healthy upward revaluations of industrial commodity projects, including Cemos (adding £4.5m), First Tin (£4.1m) and Futura Resources (£2.2m). This was due to a combination of commodity price movements and organic project developments. Moreover, Tungsten West was revalued on the back of a pre-IPO funding round in May 2021 (the IPO price of 60p was in line with the pre-IPO valuation), adding another £1.8m. However, valuation tailwinds were largely offset by the reduced carrying value of precious metals projects, primarily Bilboes (-£6.5m) and, to a lesser extent, Polar Acquisition (-£1.4m, see below for details). Nevertheless, we note that BSRT's NAV TR over the last three and five years to end-2021 remains solid at 19.1% pa and 15.5% pa, respectively, broadly in line with the EMIX Global Mining Index at 19.7% and 14.3%, respectively. BSRT's NAV fell in January 2022 by 2.9%, primarily on the back of a decline in the share price of listed holdings, mostly notably Tungsten West.

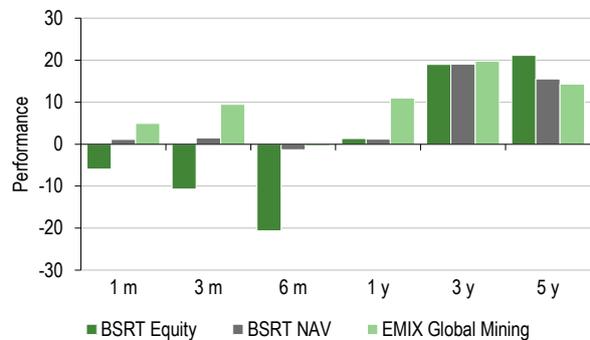
After reaching its peak of 100p on 18 May 2021, BSRT's share price significantly declined to just 75p on 31 December 2021, resulting in a mere 1.4% return in FY21. Currently, BSRT's share price is 75.00p (3 February 2022), which represents a c 21.5% discount to its last reported NAV, broadly in line with the five- and 10-year averages of c 19% and 25%, respectively.

Exhibit 1: Price, NAV and index total return performance, one-year rebased



Source: Refinitiv, Edison Investment Research at 31 December 2021

Exhibit 2: Price, NAV and index total return performance (%)



Source: Refinitiv, Edison Investment Research. Note: Three-year and five-year performance figures annualised.

Higher multiple applied to Cemos following a strong year

Cemos (BSRT's largest holding as at end-January 2022 making up 19.0% of NAV) reported the second straight profitable year and slightly exceeded the FY20 results (supported by a particularly strong H121). As a result, BSRT decided to reduce the discount to listed Moroccan cement companies at which it values the business, now assuming a 7x 2021 EBITDA multiple (compared to 5.1x blended 2020 actual and 2021 estimated EBITDA previously), driving a more than 35% increase in carrying value in sterling terms according to our calculations. At present, the two cement companies listed on the Casablanca Stock Exchange (LafargeHolcim Maroc and Ciments Du Maroc) both trade at an EV/EBITDA 2021e multiple of c 13.5x (based on Refinitiv consensus). BSRT's investment remains a combination of equity and a convertible loan, as it decided to extend the latter in November 2021 for a further two years to provide the business with the flexibility to pursue the construction of a second production line (which would double its capacity) and a clinker

plant (with the final decision regarding this capital expenditure in H222 at the earliest). Cemos is considering a listing on the Casablanca Stock Exchange to raise funding for the above-mentioned clinker plant and to provide liquidity for current shareholders. However, based on our discussion with BSRT's management, we understand that this is unlikely to materialise in the near term, as shareholders may prefer the site to build a longer production track record to achieve a higher IPO valuation. Hence, Cemos may decide to conduct a private funding round before listing.

Higher price assumptions for Futura Resources, but production launch still on hold

In the year-end portfolio review, BSRT also updated the royalty model for both the coking coal mines held by Futura Resources, applying new production forecasts as well as higher medium- and long-term coking coal price projections based on the current forward curve, assisted by the price rally in H221. Consequently, the carrying value of the project increased by c 13.6%. Nevertheless, we note that the application for a mining licence and production launch for the projects remains on hold despite current favourable mining economics (all-in sustaining cost (AISC) at a mere US\$80/t for Futura's Wilton project vs current coking coal prices above US\$400/t), which we understand (based on our discussion with BSRT's management) is due to prolonged debt financing negotiations (equity funding has already been agreed but is conditional on the debt raise). Consequently, there is limited visibility at present in terms of the start of production, which was previously postponed due to the pandemic outbreak and subsequently the informal Chinese import ban on Australian coal. BSRT forecasts Futura's FY23 EBITDA at A\$100m.

Carrying value of precious metals projects marked down

As part of the end-year revaluations, BSRT decided to cut the carrying value of Bilboes Gold by 34%, due to falling market valuations of its African gold mining peers, as well as the failed sale to a strategic investor (the termination of negotiations was announced in early August 2021). Interestingly, in BSRT's revised NAV statement as at end-2020 (published in early April 2021), it removed Bilboes' valuation discount related to execution risk associated with the deal as it considered the offer price of US\$114m for its 24.2% stake as the best reflection of the project's carrying value (regardless of the outcome of negotiations). The net impact of these valuation movements in 2021 is a c 19% reduction, which represents the main drag on BSRT's 2021 NAV TR. This illustrates that the carrying value of BSRT's holdings can be quite volatile at times. We note that Bilboes has just completed an updated definitive feasibility study (DFS, the original was completed in 2020) ahead of the fund-raising planned in Q222. The AISC estimate for the project went up by 4.4% to US\$826/oz versus the original DFS, but at the same time BSRT now assumes an average production of 167,000oz per year (versus 152,000oz previously) which reflects a higher gold price (now US\$1,650/oz versus US\$1,500/oz previously), arriving at a post-tax NPV of US\$323m at a 10% discount rate (versus US\$236m previously).

In the above-mentioned revised NAV statement for end-2020, BSRT also adjusted the discount rate used in the royalty model for the Prognoz silver mine held through Polar Acquisition (PAL) to match the rate used by Polymetal (owner of the mine) across all its mining assets. Together with falling silver prices, this translated into a 16% downward revaluation of BSRT's holdings in PAL throughout FY21, according to our calculations. BSRT expects the project's first payable concentrate production in Q323.

Raising project funding through IPOs

On 28 October 2021, **Tungsten West** (BSRT's fourth-largest holding at end-January 2022 with a 12.8% share of NAV) was listed on AIM to raise financing for mine construction. The IPO price was

set at 60p per share, well above the acquisition cost of BSRT's equity position in November 2019 of c 20.3p per share (£5m investment via a convertible loan which was converted on IPO). The share price reached its peak of 85.5p on 3 November 2021, but retraced to 62.5p at end-2021 and now stands at c 50p. Based on our conversation with BSRT's management, we understand that BSRT recognizes its 16.1% equity stake in Tungsten West at a 20% discount given the lock-up agreed as part of the listing process. The change in the project's carrying value after the year-end revaluations was limited, as the IPO price was in line with the valuation of the previous private funding round completed in May 2021.

As one of the four founders of Tungsten West, BSRT was granted options over almost 5m shares, exercisable in three equal tranches on achieving certain project milestones. The first was the successful IPO and therefore BSRT has already exercised the first tranche. The second tranche will be available once the Hemerdon mine is fully financed to production, which should occur in H122 on fulfilment of the conditions agreed for the 3% royalty and senior loan facility (£36m) from Orion Resource Partners (Orion). The last tranche will be available on the launch of commercial production, which is scheduled for 2023. The outstanding options are valued at a discount reflecting the risk of these milestones not being achieved.

According to BSRT, during the IPO of Tungsten West, additional investor applications were accepted to provide a further liquidity buffer for cost overruns. This brought the total volume of the issue to £39m, significantly exceeding the targeted amount of £25m. Together with the above-mentioned financing from Orion, the project will have sufficient resources to cover the £44.6m capex estimated in the bankable feasibility study, released in March 2021 (see our [previous note](#) for more detail). Currently, ramp-up production at the Hemerdon mine should start in Q422, and the mine should reach a steady-state production level within eight months (Q323).

Further listings planned for H122

BSRT is expecting to list First Tin (previously Anglo Saxony Mining) on the London Stock Exchange (LSE) in late Q122 or early Q222, which is one of the conditions for completing the sale and purchase agreement related to the Taronga tin mine signed with Aus Tin in November 2021. Aus Tin (listed on the ASX) will receive A\$1.35m and 60m shares in First Tin (or a minimum 22.6% stake) once the listing has closed, bringing the total acquisition price to c A\$34m. During the IPO, First Tin targets raising c £20m at a minimum price of 30p per share (significantly above BSRT's acquisition cost). BSRT, which holds a c 25% stake in First Tin, has increased its carrying value by c 50% at the year-end revaluation to reflect the minimum price per share in the upcoming listing, which we understand is adjusted for a 25% discount attributable to execution risk.

Based on the pre-feasibility study (PFS) completed in 2014 by Aus Tin, the Taronga mine holds c 22m tonnes of resources with 0.16% tin content, translating into 35.6k tonnes of tin, which was later revised to 57.2k tonnes. The mine remains inactive since 2019 and First Tin plans its own DFS as early as 2022. It will be run parallel to the DFS and drilling programme on its primary Tellerhäuser project located in Germany. According to International Tin Association figures, both projects combined represent the fourth largest undeveloped (non-producing) tin resource worldwide. The AISC of the Tellerhäuser project stands at US\$16,600/t compared with the current spot tin price on the LSE of more than US\$40,000/t.

Meanwhile, Nussir is finalising the revised DFS reflecting full electrification of the mine and is considering an IPO in mid-2022 to finance the construction works. Similarly, Kanga Potash, which completed its DFS in September 2020, is planning to list on AIM in H122. Kanga's AISC stands at US\$75.9/t compared to the current potash price of c US\$800/t.

Risks from Russian-Ukrainian tensions are moderate

BSRT currently has exposure to two companies with projects in Russia – PAL (7.8% of BSRT's NAV at end-January 2022) with its Prognoz silver mine (located 444km north of Yakutsk) and Azarga Metals (2.6%) with its Unkur copper/silver project in far eastern Russia. Given that both mines are at the pre-production stage, there seems to be little short-term disruption risk associated with the potential sanctions imposed on Russia by Western countries if Russia invaded the Ukraine.

Moreover, there are a number of potential alternative end-markets for the output produced by these projects beyond North America and Europe, most notably China, which is unlikely to impose any sanctions on Russia.

Exhibit 3: Summary of BSRT's key portfolio holdings (with a more than 3% share of NAV)

Company	% of NAV at end-January 2022	Form of investment	Resources	Current development stage	Next stage
Cemos Group	19.0%	Convertible loan + equity	Cement	First production line fully ramped up	Decision regarding construction of a second line and a clinker plant (H222 at the earliest)
Futura Resources	18.3%	Equity + 1% gross revenue royalty	Coking coal	Debt financing negotiations	Acquisition of mining licence and production launch (H122)
Tungsten West	12.8%	Equity	Tungsten, tin	Successful IPO to raise financing for mine construction	Debt financing (Q222), mine construction (to be completed by Q323)
Bilboes Gold	13.6%	Equity + loan notes	Gold	Updated DFS (January 2022)	Potential IPO or trade sale (Q222)
First Tin	7.9%	Equity	Tin	Tellerhäuser PFS completed in April 2020	Tellerhäuser DFS and IPO (H122)
Polar Acquisition	7.8%	Royalty in the Prognoz mine*	Silver	Accelerated development plan	First production (Q323)
Kanga Potash	4.2%	Equity	Potash	DFS (September 2020)	IPO (H122)
Nussir	3.7%	Equity	Copper	DFS (March 2020)	Updated DFS incorporating full electrification of the mine (Q122), IPO (H122)

Source: Baker Steel Resources Trust, Edison Investment Research. Note: *Held indirectly through an equity stake in PAL.

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