

Ticker: SVM AU **Net cash:** ~A\$8.9m **Project:** Kasiya / Nsaru, Malingunde
Market cap: A\$319m **Price:** A\$0.77/sh **Country:** Malawi
RECOMMENDATION: BUY **TARGET (up):** A\$1.20/sh **RISK RATING:** SPECULATIVE

We 'stopped counting' in 3Q20 at SCPe 275Mt @ 0.96% rutile with 935Mt total undrilled potential. Today's resource of 644Mt @ 1.0% is over double our estimate, a phenomenal result. With only 49km² of 114km² drilled to date, simple pro-rating the existing resource suggests upside potential for 1.5Bt. Mineral sands projects aren't cheap to build, and infrastructure will cover the large deposit area, so the 'repay the mill' early-years grade is critical; the 59Mt @ 1.6% rutile does just that, beating our own 1.5% estimate. In fact, at 10Mtpa (~150ktpa rutile, or ~5% market size), 1.5% is sustainable for a remarkable 14 years, or 60 years at 1% once infrastructure is repaid, hence we see sizing options of up to 20Mtpa over time. Sovereign noted today that spot rutile prices have lifted to ~US\$1,800/t CIF China, well over 1Q21 contract prices in line with our LT US\$1,200/t with inventory-restocking compounding the potential shut down of Iluka's Sierra Leone mine. The 10-20Mtpa ROM feed above would support 150-300ktpa of rutile even at US\$1,200/t a gross margin of 50% should be beatable, implying simplistic EBITDA of US\$90-180m or >US\$350m at spot CIF china prices net of transport. Looking to next steps, the appointment of a lead Study Manager and a Technical Manager experienced in the African mineral sands space speaks to engineering momentum into a year-end Scoping Study, with an indirect vote of support from those that know mineral sands well. On valuation we previously applied a nominal 5% of US\$1,300/t in-situ to 500Mt @ 0.96%. In due course, we anticipate moving to a DCF valuation, with a key pending input being graphite credits, which should be quantified in 2H20 ahead of the year-end PEA.

For now, **we maintain our BUY rating, lifting our PT from A\$0.95/sh to A\$1.20/sh** based on 5% in-situ valuation (ie US\$65/t rutile vs. ~US\$1,300/t spot) over 644Mt rather than the prior nominal 500Mt. Big picture – this is beyond world-class to what we would call 'disruptive'. Being in the form of 'ESG compliant' low-CO₂ rutile, with EV-feedstock graphite credit, it just doesn't get better than this. With respect to social licence, the clean slate allows the asset to pull away from South African operations on coal-grid power that have sadly seen a recent loss of life, Sierra Leone operations giving notice of shut-downs to drive cost reductions and productivity increases, and even full project suspensions in Madagascar. Malawi has existing on-licence rail to an existing deepwater port. While there is plenty to do next as the shift moves to engineering, including mining methods, mine layout, TMF and settling pond design, met work including variability, and ESG studies, we see no fatal flaws, but quite the opposite with the best metallurgy, grade profile and size of any asset globally.

Table 1. Maiden SVM MRE against SCP estimate, and SCP potential upside from undrilled areas

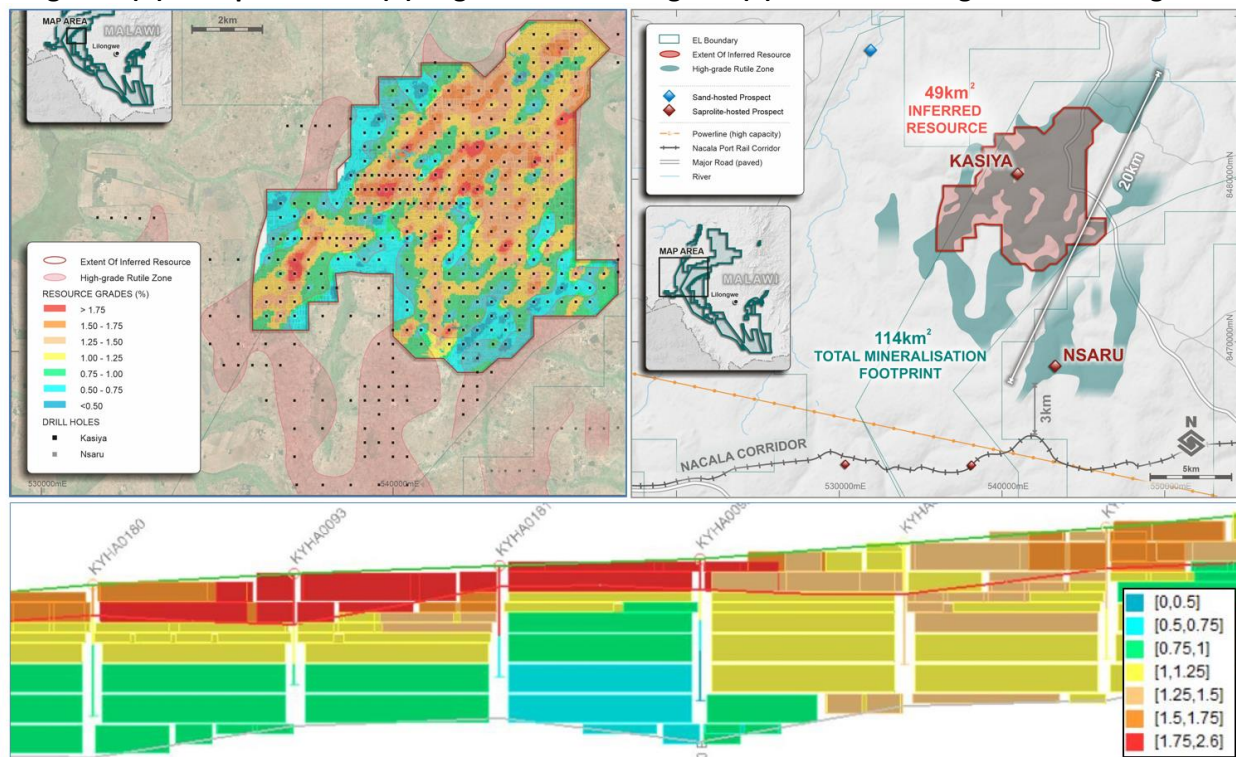
SCPe drilled inventory	SCP	MRE	Δ (%)
Tonnes (Mt)	275	644	134%
Grade (% rutile)	0.96	1.01	5%
SCPe drilled + undrilled potential (Mt)	935	1498*	60%
Kasiya in-situ value @ 644Mt (US\$bn)	8.0	Basic shares on issue (m)	414
Kasia @ 5% insitu value (US\$m)	401	Dilutive options and RSUs (m)	54.1
Kasiya asset valuation (A\$m)	521	Average strike (A\$/sh)	0.24
Plus cash on hand (A\$m)	8.9	Fully diluted shares (m)	468
Nominal graphite valuation (A\$m)	10.0	SCP NAV/sh (A\$/sh)	1.18
Plus cash from dilutive options (A\$m)	12.8	Recommendation	BUY
Sovereign group NAV (A\$m)	553	Price target (A\$/sh):	1.20

Source: Sovereign, SCP estimate

Maiden MRE more than double SCP estimate with >1Bt, incl. 644Mt @ 1.0% or 137Mt @ 1.4% rutile

Resource: The maiden rutile resource for Kasiya, in Malawi, of 644Mt @ 1.01% rutile at a 0.7% cut-off comes just 18M post-discovery. The at-surface resource drives a strip ratio near zero beyond ~30cm of topsoil, with the highest grades on surface. Based on a recovered grade, the resource is entirely inferred based on nominal 400m drill spacing of auger holes, with some diamond twin holes also. With no extreme grades, no top cut was applied, based on conventional dry-mining, although hydro-mining is to be investigated. **Grade tonnage:** The resource is highest-grade at surface, enabling selective mining of higher grade components; at a 1.4% cut-off, Kasiya still has 59Mt @ 1.57%, or 137Mt @ 1.41% at a 1.2% cut-off. At ~6.5Mt contained rutile, this is the second largest resource globally after the 7.5Mt Sierra Rutile, ~3.5x larger than Iluka's Balandal and ~9x larger than Base's Kwale. **Resource upside:** The MRE covers 49km², against the total 89km² of Kasiya, and pre-resource 25km² at Nsaru, i.e. representing only 43% of the drilled mineralisation footprint. Infill on 800x800m Kasiya drilling outside the new MRE is now underway with two rigs starting this week, while Nsaru will also be drilled, with an updated MRE targeted for year end while step-out drilling is continuing on new greenfield targets. **Next steps:** The company is targeting a PEA by year end, and to this end has appointed a lead Study Manager and experience African mineral sands Technical Manager. The team is currently working on mining methods and pit optimisations, tailings disposal, metallurgical variability, and ESG studies. In addition, the company is reviewing graphite by-product credits.

Figure 1 (A) MRE plan within (B) larger licence holding and (C) section with higher at-surface grade



Source: Sovereign Metals

Why we like Sovereign Metals

1. Pure rutile deposit increases margin, addresses downstream ESG requirements
2. Unique metallogenesis drives large grain size and premium low-deleterious product
3. On hydropower, hydro mineable, on modern rail to deep-water port with allocation
4. PFS-level Malingunde graphite project adds diversification and second pillar to value

5. Potential 'province scale' discovery with 4,000km² of unique geology largely undrilled

Catalysts

1. **2Q21:** Kasiya infill, Nsaru definition drilling
2. **1H21:** Maiden JORC compliant resource estimate for Kasiya
3. **2H21:** SCPe PEA

Research

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SELL:	0
UNDER REVIEW:	0
TENDER:	0
NOT RATED:	0
TOTAL	41

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