Baker Steel Resources Trust

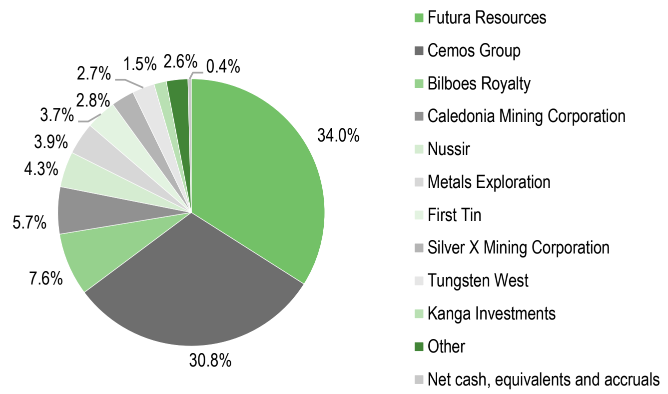
Key takeaways from the Cemos site visit

Investment trusts
Metals and mining

30 October 2024

We recently visited the Tarfaya cement grinding line of Cemos Group, one of the two largest holdings of Baker Steel Resources Trust (BSRT), which made up 30.8% of the trust's NAV as of end-September 2024. The facility's location in Southern Morocco allows it to benefit from the extensive public infrastructure investments in the region. Cemos's two major investment projects (a compact calcination unit (CCU) and second grinding line) offer the prospect of a significant increase in earnings from 2025. The business is considering, on successful completion of these investments, an IPO on the Casablanca Stock Exchange, where we believe it could command an attractive valuation.

Cemos Group was BSRT's second-largest holding at end-September 2024



Source: Baker Steel Resources Trust

Strategic focus on producing 'green' cement

Cemos's management believes that the CCU will significantly reduce the company's production costs from 2025 onwards and facilitate its growth strategy, focused on the development and marketing of low CO_2 'green cement' products. The carbon footprint reduction will be achieved by lowering the clinker content in the cement product to as low as 45%, compared to the current 70%, through the use of alternative binders supplied by the CCU. Cemos's strategic focus on low-carbon cement is aligned with the national agenda of addressing the carbon footprint of the local cement industry.

High income potential from BSRT's two key assets

Cemos Group is one of BSRT's more mature assets, with an expected EBITDA of the Tarfaya grinding line of c €8m in 2024, according to BSRT. On completion of its two major investment projects, Cemos Group plans to adopt a progressive dividend policy, and BSRT's management earlier estimated the annual dividend potential at €3–5m. Together with the c A$14–21m royalty and dividend income of Futura Resources (the owner of two coking coal mines in Australia) expected by BSRT's management, this represents an annual income potential for BSRT of c 20–30% of the trust's current market capitalisation (on full production ramp-up of both projects).

Price	**47.00p**
Market cap	**£50.0m**
NAV	**£84.7m**
NAV*	79.6p

*At end September 2024.

Discount to NAV	41.0%
Yield	0.0%
Shares in issue*	107.2m

*Including 700k treasury shares.

Code/ISIN		BSRT/GG00B6686L20
Primary exchange		LSE
AIC sector		Commodities & Natural Resources
52-week high/low	56.0p	34.0p
NAV high/low	81.0p	65.9p

Gearing

Net cash and accruals at 30 Sep 2024	0.4%

Fund objective

Baker Steel Resources Trust is a closed-end 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 10–20 investments. Its 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.
- Maturing portfolio, with several projects approaching mine construction or production, offering the potential to generate income or exit proceeds.
- Some 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.

Bear points

- The tough funding environment may delay project progress and/or result in fund-raising at depressed valuations.
- Risk of cost overruns due to the inflationary environment.
- High portfolio concentration makes BSRT's performance dependent on a narrow set of assets.

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Edison profile page

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

High infrastructure spending and housing aid ahead

After peaking in 2011 at 16.1m tonnes, cement consumption in Morocco has been gradually declining and in 2022–23 stabilised at around 12.5m tonnes per year. With total production capacity of the members of the Moroccan Cement Association of over 24m tonnes per year, the Moroccan cement market is therefore characterised by significant excess capacity and some cement plants of Cemos's competitors are operating at a moderate utilisation level.

That said, this still allowed the large players to generate a solid return on equity, which for LaFargeHolcim Maroc and Ciments Du Maroc stood at 13.6% and 28.8% in 2023, respectively (with EBIT margins of over 30%). Interestingly, rather than shutting down some of the plants, major Moroccan cement companies are looking to expand capacity in certain regions. We believe that the local players currently favour a less volatile price environment (characterised by gradual cement price increases over the long run) over aggressive buying of market share through price reductions.

Prospective demand for cement in Morocco should be driven by solid economic growth of c 3%+ in the coming years (according to the latest forecasts of the International Monetary Fund), supported by the recent onset of monetary easing by the local central bank. We also note the extensive infrastructure investments in the country. For instance, Morocco will host two important sports events in the coming years: the Africa Cup of Nations in 2025 and the World Cup in 2030 (together with Spain and Portugal). The estimated cost of co-hosting the World Cup is US$5bn and is mostly attributable to the construction and renovation of stadiums, training centres, as well as transport and infrastructure, according to a recent study by Sogécapital Gestion. We also note the latest edition of the direct housing aid (Daam Sakane) programme launched by the Moroccan government in January 2024 (covering the period 2024–28) to drive property ownership, especially for low-income and middle-class citizens (it aims to benefit 114,000 citizens per year).

Cemos Group's Tarfaya plant is benefiting from its location in Southern Morocco

The local cement market in Morocco is dominated by five major players. These include two listed companies that are part of international groups (LaFargeHolcim Maroc and Heidelberg-owned Ciments Du Maroc) and two local companies: CIMAT and Novacim. Cemos is a relatively small player in the sector, as its Tarfaya cement grinding line has a capacity of 280k tonnes per year (ie c 1.5% of total installed capacity across the Moroccan cement market) but with an ambitious growth objective.

We note that due to high transportation costs, the cement market is segmented into distinct regional markets. Cemos's Tarfaya operations (see Exhibit 1) benefit from being situated in the southern part of Morocco, given the government's emphasis on significant public infrastructure investments in Western Sahara in this large and underdeveloped region. This includes especially investments in and around Laayoune (the region's main city) and along the coast down south, where Morocco is building the Dakhla Atlantic Port, a US$1.2bn megaproject scheduled for completion in 2028. There is also a high development potential for wind farm projects across Western Sahara, which may drive demand for concrete as a material for wind tower foundations, but also a potential alternative to steel for the construction of wind towers. Finally, OCP Group (Morocco's state-owned phosphate and fertiliser company) is developing a large power-to-X green ammonia project in Tarfaya, featuring hydrogen and ammonia plants, a 2.8GW wind farm, a 1GW solar power plant and 2.7GWh of battery storage. All the above bode well for the demand for cement in the region in the coming years. At the budgeted sales volume for 2024 of around 200k tonnes, Cemos estimates its share in the Southern Moroccan/Western Saharan market at 25%, second to Ciments Du Maroc (63%), which has 1m tonnes of annual production capacity in the region, but ahead of LaFargeHolcim Maroc (12%), which has only 200kt of local production capacity.

Exhibit 1: Cemos's Tarfaya operations

Source: Edison Investment Research

Vertical integration and capacity expansion

Compact calcination unit due to come on stream in 2025

An important project for Cemos at present is the construction of a compact calcination unit (CCU) next to the Tarfaya grinding line (scheduled for completion by end-2024 or early 2025), which will enable the company to produce its own low-CO_2 and other hydraulic binders (which represent up to 70% of production costs), as well as supplementary cementitious materials that can be used in concrete as low-CO_2 binders. This will significantly reduce Cemos's production costs from 2025 and facilitate its growth strategy focused on the development and marketing of low CO_2 'green cement' products. The carbon footprint reduction will be achieved by lowering the clinker content in the cement product to as low as 45% compared to the current 70% through the use of alternative binders supplied by the CCU such as calcinated clay, oil shale ash and pozzolans. Cemos also sees potential to reduce the carbon footprint of the calcination process via the use of oil shale; oil shale deposits are located next to the Tarfaya site (Cemos was originally meant to be an oil shale project). Finally, we note that the electricity supplied to the site is mostly based on renewable energy, wind and solar in particular. Cemos is also preparing various quarry and mining permits for the materials used by the CCU.

Cemos's strategic focus on low-carbon cement is aligned with the national agenda of addressing the carbon footprint of the local cement industry (which contributes more than 20% of the greenhouse gas emissions in Morocco). The Moroccan standards agency is currently following the EU initiative to establish a low CO_2 cement category (expected to be approved in the coming months).

Second grinding line to become operational in 2026

Cemos plans to set up a second grinding line (which it had acquired in 2022) in the Atlas mountain region and city of Errachidia, with the plant installation to commence in 2025 and first production planned in early 2026. The company estimates the investment value for the new grinding unit with current cost at around €15m (Phase 1 Cemos Errachidia), which it can fund internally (it bought the main cement plant in 2022 for this purpose). As a result of this investment, Cemos aims to double current production capacity to 560k tonnes pa. Cemos pursues a nimble approach to capacity expansion, favouring compact facilities over large-scale cement plants, as the former are characterised by lower capital expenditure and shorter construction time (around one to two years, vs five to 10 years for the large-scale facilities), allowing it to quickly capture regional demand as it arises. Cemos is considering further capacity expansion in the future based on the compact cement plants concept, also outside Morocco.

Considerable valuation upside potential

The expected EBITDA for the Tarfaya grinding line in 2024 stands at c €8m, according to BSRT. The company sees potential to reduce clinker costs in the best case by €5–6m per grinding line by utilising its CCU for various hydraulic binders. This would bring the annual EBITDA run rate for the first grinding line to up to €15m (in the best case and subject to full capacity use of the plants in plan), with further growth potential from the second grinding line and a new cement plant in the Atlas region. On completion of the current investments, BSRT expects Cemos to adopt a progressive dividend policy, and BSRT's management earlier estimated the dividend potential at €3–5m per year on full ramp-up of the CCU and the second cement grinding line. This would imply a c 10–16% yield with reference to the end-June 2024 valuation of BSRT's investment in Cemos at £26.4m, which consists of straight equity (c 24.0m shares valued at £12.6m) and convertible loan units (£13.8m), translating into a 31.1% stake on a fully diluted basis.

We believe there is a significant potential for a valuation uplift on successful execution and ramp-up of Cemos's major investments over the next 12–18 months. One of the future development options the company is contemplating is an IPO in late 2026 or early 2027, which we believe would help further crystallise its value. The Moroccan equity market is characterised by a limited opportunity set (c 70–80 listed companies with an aggregate market cap of c £73bn). At the same time, there is a wide pool of local institutional capital (asset management, pension funds, insurance sector) with around US$100bn of assets under management, according to the Casablanca Stock Exchange citing the Supervisory Authority of Insurance and Social Welfare (ACAPS). Based on a discussion we had with a local broker, we understand that foreign investors play a limited role in the market with a c 15% share in trading volumes and 27% in total holdings. This translates into attractive valuations of listed businesses compared to foreign peers, as illustrated by LaFargeHolcim Maroc and Ciments du Maroc, which trade at multiples that are considerably higher than those of their parent businesses (see Exhibit 2). Based on a conversation we had with a local broker, we understand that any good quality deals of US$30–40m or more should attract local institutional capital. We believe that the value of shares offered in a potential IPO of Cemos Group could meet this threshold.

Exhibit 2: Valuations of listed Moroccan companies versus parent businesses

	P/E (x)			EV/EBITDA (x)		
	2024e	2025e	2026e	2024e	2025e	2026e
LaFargeHolcim Maroc	24.9	23.9	22.5	12.9	12.2	N/A
Ciments du Maroc	26.7	24.2	22.2	14.8	13.5	N/A
Holcim	14.8	13.5	12.4	9.1	8.7	8.2
Heidelberg Materials	9.1	8.3	7.7	6.0	5.7	5.5

Source: LSEG Data & Analytics as of 30 October 2024

The main risks to Cemos's investment case we identified include:

- The competitive response of major players to the company's capacity expansion and vertical integration,
- Potential technological challenges during the CCU ramp-up process, and
- Suboptimal capacity utilisation if major local demand drivers prove more limited than expected.

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