

3 November 2010

Baobab Resources

Year End	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
06/08	0.0	(2.2)	(3.8)	0.0	N/A	N/A
06/09	0.3	(1.6)	(1.9)	0.0	N/A	N/A
06/10e	0.0	(1.6)	(1.2)	0.0	N/A	N/A
06/11e	0.0	(2.2)	(1.3)	0.0	N/A	N/A

Note: *PBT and EPS are normalised, excluding intangible amortisation and exceptional items.

Investment summary: Exploration update

Baobab has released the results of three scout diamond drill holes at Chimbala, three scout diamond drill holes at South Zone and three step-out, reverse circulation (RC) drill holes also at South Zone. As a result of these drilling results, we have been able to refine our own estimate of global resources at Baobab's Massamba Group trend to 339.7Mt at 27.1% Fe. Owing to an expansion of its drilling programme, Baobab intends to release an updated resource statement in January 2011 to JORC standards. This will incorporate a resource statement for South Zone, although probably not yet for Chimbala, which will require additional drilling in 2011.

Security of tenure

At the same time as it announced its drill results, Baobab also informed the market that all of its exploration licences are "currently in good standing" and that those licences due for renewal have been granted extensions of two to five years.

Equity financing

Baobab has also announced the successful negotiation of a £5m equity facility with Dutchess Opportunity Cayman Fund Ltd. The facility will enable Baobab to obtain funding at any time during the next three years by way of subscriptions for new shares in the company, priced at a 6% discount to the market price at timings, intervals and in sizes determined by the company.

Valuation

Baobab's shares are currently trading at a level that gives the company an enterprise value equivalent to US\$2.00 per JORC-compliant resource tonne of iron based solely on its current resource of 47.7Mt at 25.3% (cf an industry average of US\$3.53/t – ie a 43% discount). Simply being rated at the industry average valuation would imply a 66% increase in Baobab's share price to 18.24p. This increases further, to 72.54p, in the event that the company increases its resources to 339.7Mt at 27.1% Fe at a valuation of US\$2.00/t Fe, and to 127.79p in the event that it re-rates to an industry average valuation. Even taking into account likely dilution as a result of future equity issues (above), this reduces to no less than 55.62p per share at current prices.

Price 11.00p
Market Cap £17m

Share price graph



Share details

Code BAO
Listing AIM
Sector Mining
Shares in issue 158.9m

Price

52 week High 12.5p Low 4.4p

Balance Sheet as at 31 December 2009

Debt/Equity (%) N/A
NAV per share (p) 1.8
Net cash (£m) 2.8

Business

Baobab Resources is focused on developing its Tete iron-vanadium-titanium open-pit project in central-western Mozambique. A pre-feasibility study is expected in mid 2011.

Valuation

	2009	2010e	2011e
P/E relative	N/A	N/A	N/A
P/CF	N/A	N/A	N/A
EV/Sales	N/A	N/A	N/A
ROE	N/A	N/A	N/A

Geography based on revenues

	UK	Europe	US	Other
0%	0%	0%	0%	100%

Analysts

Charles Gibson 020 3077 5724
Michael Starke 020 3077 5727
mining@edisoninvestmentresearch.co.uk

South Zone drilling update

In recent days, Baobab has released the results of three scout diamond drill holes at Chimbala, three scout diamond drill holes at South Zone and three step-out, reverse circulation (RC) drill holes also at South Zone.

A summary of the results is as follows:

Exhibit 1: Summary and analysis of Baobab exploration drill holes

Note: * Weighted with respect to width; RC = reverse circulation.

Drill programme	Area	Hole	Type	Total width (metres)	Average grade * (Fe %)
Scout	Chimbala	TDH0037	Diamond	13.0	28.6
Scout	Chimbala	TDH0043	Diamond	49.5	26.1
Scout	Chimbala	TDH0044	Diamond	29.5	28.0
Scout	South Zone	TDH0046	Diamond	22.5	27.2
Scout	South Zone	TDH0048	Diamond	118.5	26.8
Scout	South Zone	TDH0049	Diamond	30.5	22.1
Step-out	South Zone	TRC0001	RC	74.0	37.0
Step-out	South Zone	TRC0002	RC	37.0	26.0
Step-out	South Zone	TRC0003	RC	68.0	26.8

Source: Baobab Resources

The scout drilling campaign, comprising c 7,500m of diamond drilling in total, has now been completed. Of the total, 5,378m (or 72% of the aggregate metres drilled) were drilled in the Chimbala prospect in 25 holes (215.1m per hole on average).

As a result of the significant widths of mineralisation, as well as its interpreted lateral continuity, the South Zone prospect was subsequently prioritised for step-out RC drilling in a programme designed to assess a sequence of seven mineralised zones over a strike length of c 2km, drilling on traverses 100m apart. A total of 50 RC holes have been planned encompassing 7,000m of drilling (140m per hole, on average). To date, 23 holes (46% of the total) have been completed over 3,000m (43% of the total).

The company is currently trying to secure a second RC drill rig to accelerate its drilling campaign. It is its intention to combine the results of the scout diamond drilling and RC programmes to estimate a formal global resource for the South Zone prospect in January 2011.

Updated resource estimate

In our note of 9 September we made the following order-of-magnitude estimate of Baobab's resources, based on the results of the drill programme up to that date.

Exhibit 2: Edison estimate of Baobab potential resources (9 September 2010)

Note: * See Edison note dated 17 August 2010.

Resource	Tonnage (Mt)	Grade (Fe %)
Maiden resource	47.7	25.3
Subsequent Chimbala drilling*	225.7	26.8
Sub-total	273.4	26.5
South Zone upper limit	155.5	30.3
South Zone mid-estimate	116.6	30.3
South Zone lower-limit	77.8	30.3
Grand total estimate (upper limit)	428.9	27.9
Grand total estimate (mid-estimate)	390.0	27.6
Grand total estimate (lower limit)	351.1	27.3

Source: Baobab Resources

Given the wide drill spacing at the time of writing, our confidence in the South Zone estimate was $\pm 33\%$ (ie 77.8Mt < resource < 155.5Mt). In the light of the company's recent results, we have now updated our resource estimates as follows:

Exhibit 3: Updated Edison estimate of Baobab resources (November 2010)

Note: * See Edison note dated 17 August 2010.

Resource	Previous estimate		Updated estimate	
	Tonnage (Mt)	Grade (Fe %)	Tonnage (Mt)	Grade (Fe %)
Maiden resource	47.7	25.3	47.7	25.3
Subsequent Chimbala drilling*	225.7	26.8	213.7	27.1
Sub-total	273.4	26.5	261.4	26.7
South Zone upper limit	155.5	30.3	N/A	N/A
South Zone mid-estimate	116.6	30.3	78.3	28.5
South Zone lower-limit	77.8	30.3	N/A	N/A
Grand total (mid-) estimate	390.0	27.6	339.7	27.1

Source: Baobab Resources

Although our 'mid-estimate' of the resource tonnes contained at South Zone has declined, it remains within the range originally indicated. Of more significance, our confidence in our estimate has increased such that the upper and lower limits are now effectively redundant.

Note the current RC drilling campaign will define JORC resources at the South Zone (anticipated to be formally announced in January 2011); the Chimbala resource by contrast will require further systematic drilling to elevate it to a JORC classification and will therefore not form part of the South Zone resource announcement, but will be the subject of a later announcement.

Valuation

Baobab's shares are currently trading at a level that gives the company an enterprise value equivalent to US\$2.00 per tonne of JORC-compliant resource iron (cf an industry average of US\$3.53/t). Exhibit 4 demonstrates the value that Baobab potentially offers investors in the event that the company successfully increases its resource to 339.7Mt at 27.1% Fe at both its current EV per tonne Fe valuation and the industry average valuation.

Exhibit 4: Tete project valuation summary at Baobab's current valuation and the industry average

Note: * Before dilution; ** Including FY10 cash estimate.

Resource	47.7Mt @ 25.3% Fe	47.7Mt @ 25.3% Fe	339.7Mt @ 27.1% Fe	339.7Mt @ 27.1% Fe
EV/t Fe valuation (US\$/t)	2.00	3.53	2.00	3.53
Valuation (US\$m)	**24.18	**42.60	184.46	324.97
Per share (US cents)*	17.60	29.19	116.06	204.47
Per share (pence)*	11.00	18.24	72.54	127.79
Share price (pence)	11.00	11.00	11.00	11.00
Share price discount (%)	0.0	-39.7	-84.8	-91.4

Source: Edison Investment Research, Thomson Reuters

Security of tenure

At the same time as it announced its drill results, Baobab also informed the market that all of its exploration licences are “currently in good standing” and that those licences due for renewal have been granted extensions of between two and five years (four years in the case of all Tete project licences).

Equity facility

Via its £5m equity facility (announced on 25 October) with Dutchess Opportunity Cayman Fund Ltd, Baobab has secured its financial future until the end of FY13. The facility will enable Baobab to obtain funding at any time during the next three years by way of subscriptions for new shares in the company, priced at a 6% discount to the market price at timings, intervals and in sizes determined by the company. In consideration for the facility, Baobab has agreed to pay its arrangers, First Columbus LLP, a commitment fee of 666,667 shares. It has also issued Dutchess and First Columbus 444,444 warrants in aggregate, exercisable at 16.88p.

Exhibit 5 shows the effect of Baobab's issuing shares at a range of prices over the course of the next three years to raise £5m.

Exhibit 5: Effect of fund raisings on Baobab equity shares in issue at varying prices

Shares in issue (millions)	158.9	158.9	158.9	158.9	158.9	158.9	158.9
Funds to be raised (£m)	5.0	5.0	5.0	5.0	5.0	5.0	5.0
Market price at time of raising (pence)	11.00	15.00	20.00	30.00	50.00	72.54	127.79
Discounted price (pence)	10.34	14.10	18.80	28.20	47.00	68.19	120.12
New shares issued (millions)	48.4	35.5	26.6	17.7	10.6	7.3	4.2
Total shares in issue (millions)	207.3	194.4	185.5	176.7	169.6	166.3	163.1
Increase (%)	30.4	22.3	16.7	11.2	6.7	4.6	2.6

Source: Baobab Resources

Exhibit 6 shows the effect of such share issues on the valuations calculated in Exhibit 4:

Exhibit 6: Effect of fund raisings on Baobab valuation per share

Note: * See Exhibit 4.

Price at which funds raised (pence)	10.34	14.10	18.80	28.20	47.00	68.19	120.12
New total shares in issue (millions)	207.3	194.4	185.5	176.7	169.6	166.3	163.1
Valuation of US\$184.46m per share (US cents)*	88.99	94.89	99.42	104.41	108.78	110.94	113.10
Valuation of US\$324.97m per share (US cents)*	156.77	167.17	175.16	183.95	191.64	195.45	199.25
Valuation of US\$184.46m per share (pence)*	55.62	59.31	62.14	65.26	67.99	69.34	70.69
Valuation of US\$324.97m per share (pence)*	97.98	104.48	109.47	114.97	119.78	122.16	124.53

Source: Baobab Resources

Ongoing initiatives

In addition to its South Zone RC exploration programme, Baobab has commissioned well known consultants Coffey Mining to conduct a detailed metallurgical study in order to determine how the mineral processing requirements of the various domains of the Massamba group trend may best be optimised. Not only will these involve the construction of detailed mineral process flow-sheets, but they will also take into consideration the project's strategic access to infrastructure and complementary resources (eg Vale's and Tata-Riversdale's nearby coal deposits).

A pre-feasibility study is anticipated to be undertaken from early 2011 onwards.

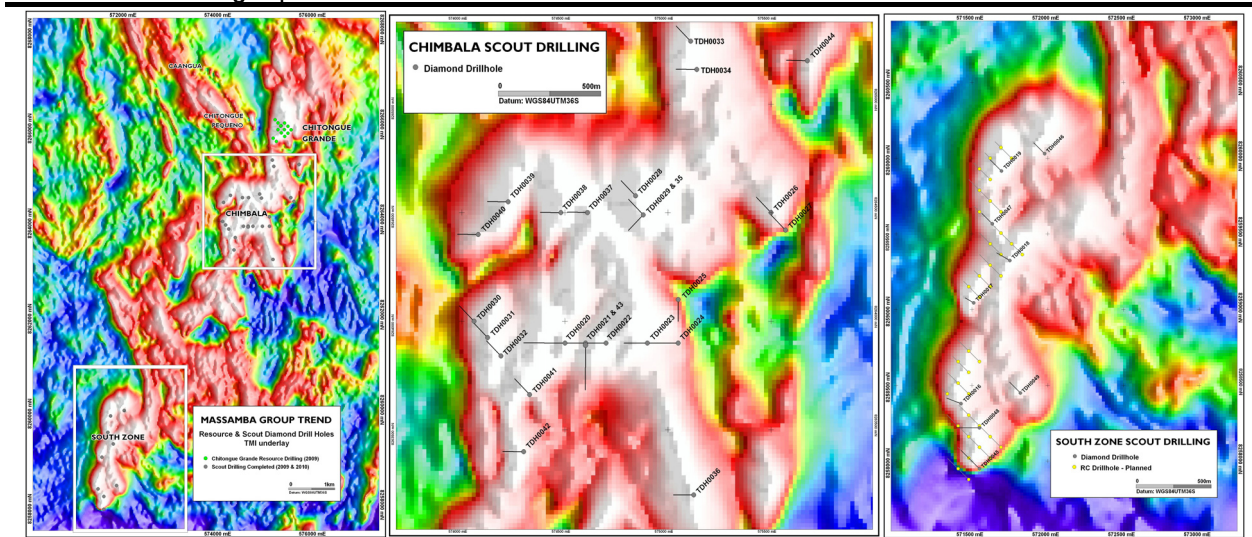
Background

Covering an area of 632km², the Tete Project is located immediately north of the provincial capital of Tete and shares licence boundaries with Vale and Riversdale's coal projects. The project contains two areas of magnetite-ilmenite mineralisation, namely:

- Singore (to the south), which is regarded as 'highly prospective', but remains largely untested
- The 8km long Massamba Group trend (to the north), which is composed of a series of five prospects (namely Chitongue, Pequeno, Caangua, Chimbala and South Zone) that have been the subject of little or no historical exploration

The South Zone prospect comprises the southernmost portion of the Massamba group trend. Like Chimbala, it is characterised by a strong aeromagnetic response. However, it is discrete and distinct from both Chimbala and Chitongue Grande, demonstrating, *inter alia*, a higher mass recovery.

Exhibit 7: Massamba group trend drill hole locations



Source: Baobab Resources

The primary iron, vanadium and titanium mineralisation at the South Zone occurs as cumulate sequences within the gabbro/anorthosite suite. A secondary phase of mineralisation, in the form of a vertical massive magnetite-ilmenite intrusive dyke, outcrops as a chain of small ridges along the western margin of the magnetic anomaly. The dyke has an apparent thickness in excess of 20m and appears to crosscut the primary mineralisation. Post-mineralisation tectonics has segregated the prospect into at least five discrete fault blocks.

The rail corridors from the ports of Beira and Nacala to Tete are in the process of being refurbished as are the ports themselves.

Exhibit 8: Financials

	£'000s	2008 IFRS	2009 IFRS	2010e	2011e
Year end 30 June					
PROFIT & LOSS					
Revenue		1	276	43	0
Cost of Sales		(2,204)	(1,792)	(1,561)	(2,191)
Gross Profit		(2,202)	(1,515)	(1,518)	(2,191)
EBITDA		(2,202)	(1,515)	(1,518)	(2,191)
Operating Profit (before GW and except.)		(2,259)	(1,570)	(1,574)	(2,208)
Intangible Amortisation		0	0	0	0
Exceptionals		0	0	0	0
Other		0	0	0	0
Operating Profit		(2,259)	(1,570)	(1,574)	(2,208)
Net Interest		68	19	11	47
Profit Before Tax (norm)		(2,191)	(1,551)	(1,563)	(2,160)
Profit Before Tax (FRS 3)		(2,191)	(1,551)	(1,563)	(2,160)
Tax		0	0	0	0
Profit After Tax (norm)		(2,191)	(1,551)	(1,563)	(2,160)
Profit After Tax (FRS 3)		(2,191)	(1,551)	(1,563)	(2,160)
Average Number of Shares Outstanding (m)		57.0	83.4	127.5	166.6
EPS - normalised (p)		(3.8)	(1.9)	(1.2)	(1.3)
EPS - FRS 3 (p)		(3.8)	(1.9)	(1.2)	(1.3)
Dividend per share (p)		0.0	0.0	0.0	0.0
Gross Margin (%)		N/A	N/A	N/A	N/A
EBITDA Margin (%)		N/A	N/A	N/A	N/A
Operating Margin (before GW and except.) (%)		N/A	N/A	N/A	N/A
BALANCE SHEET					
Fixed Assets		114	58	16	0
Intangible Assets		0	0	0	0
Tangible Assets		114	58	16	0
Investments		0	0	0	0
Current Assets		937	530	2,370	1,985
Stocks		0	0	0	0
Debtors		74	2	0	0
Cash		863	529	2,370	1,985
Current Liabilities		(228)	(377)	(302)	(300)
Creditors		(228)	(377)	(302)	(300)
Short term borrowings		0	0	0	0
Long Term Liabilities		0	0	0	0
Long term borrowings		0	0	0	0
Other long term liabilities		0	0	0	0
Net Assets		823	211	2,083	1,685
CASH FLOW					
Operating Cash Flow		(630)	(539)	(803)	(747)
Net Interest		68	19	11	47
Tax		0	0	0	0
Capex		(1,554)	(1,011)	(514)	(1,300)
Acquisitions/disposals		0	0	0	0
Financing		1,795	1,197	3,148	1,615
Dividends		0	0	0	0
Net Cash Flow		(321)	(334)	1,841	(385)
Opening net debt/(cash)		(1,184)	(863)	(529)	(2,370)
HP finance leases initiated		0	0	0	0
Other		0	(0)	0	0
Closing net debt/(cash)		(863)	(529)	(2,370)	(1,985)

Source: Edison Investment Research, company accounts

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Lincoln House, 296-302 High Holborn, London, WC1V 7JH ■ tel: +44 (0)20 3077 5700 ■ fax: +44 (0)20 3077 5750 ■ www.edisoninvestmentresearch.co.uk
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