

28 July 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)	(1.4)	0.0	N/A	N/A

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

### Investment summary: Resources to quintuple?

Baobab has released potentially significant updates with respect to the drilling programme at its Tete project and also a capital injection from a third party into its Changara deposit. While the company made no estimate of resources based on the drill holes, we calculate that they are indicative of a resource of approximately 198.5Mt at 26.1% iron (Fe) – ie four times larger than the company's current declared JORC-compliant resource of 47.7Mt at 25.3%. In total therefore, we estimate that these holes could increase Baobab's resource base to c 246.2Mt at 25.9%. As such, they go a long way to confirming the plausibility of the company's 300-700Mt exploration target.

### Changara agreement

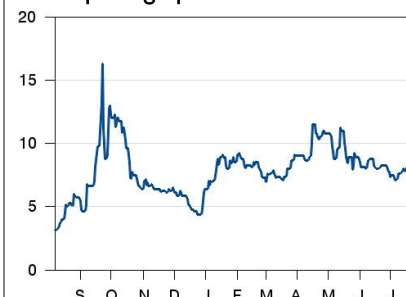
In addition to its drilling results, Baobab has also announced the signing of a joint venture heads of agreement with Southern Iron Ltd with respect to its Changara base metal and manganese project. Under the terms of the agreement, Southern Iron will have the option to earn in to up to 80% in the Changara project in a four stage process culminating in the production of a definitive feasibility study (DFS). We calculate that the minimum value uplift to Baobab's shares under the terms of the agreement is 0.19 US cents per share, with a likely uplift of 0.47 US cents (0.31p) per share – or 4.3% of Baobab's current share price.

### Valuation: Pro-rata 53p per share

Baobab's shares, having fallen back to 7.2p from c 11p in May, are now trading at a level that equates to an EV of US\$1.06/t per resource tonne of iron compared to an industry average of US\$3.53/t – ie a discount of 70% – based solely on the current resource of 47.7Mt at 25.3%. In the event that it defines a resource of 300Mt at a constant 25.3% (as implied by its latest drilling result), then Baobab's EV will drop to US\$0.17/t and the discount expand to 95%. Alternatively, applying the US\$3.53/t average industry-wide valuation to a 300Mt resource base at 25.3% Fe suggests an enterprise value of US\$267.9m, a market cap of US\$272.1m and a share price of US\$1.71 (£1.14). At its current US\$1.06/t it implies a share price of 53p.

Price 7.2p  
Market Cap £12m

#### Share price graph



#### Share details

Code BAO  
Listing AIM  
Sector Mining  
Shares in issue 158.9m

#### Price

52 week High 18.000p Low 1.875p

#### 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%	100%	

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## Significant drilling updates plus corporate initiatives

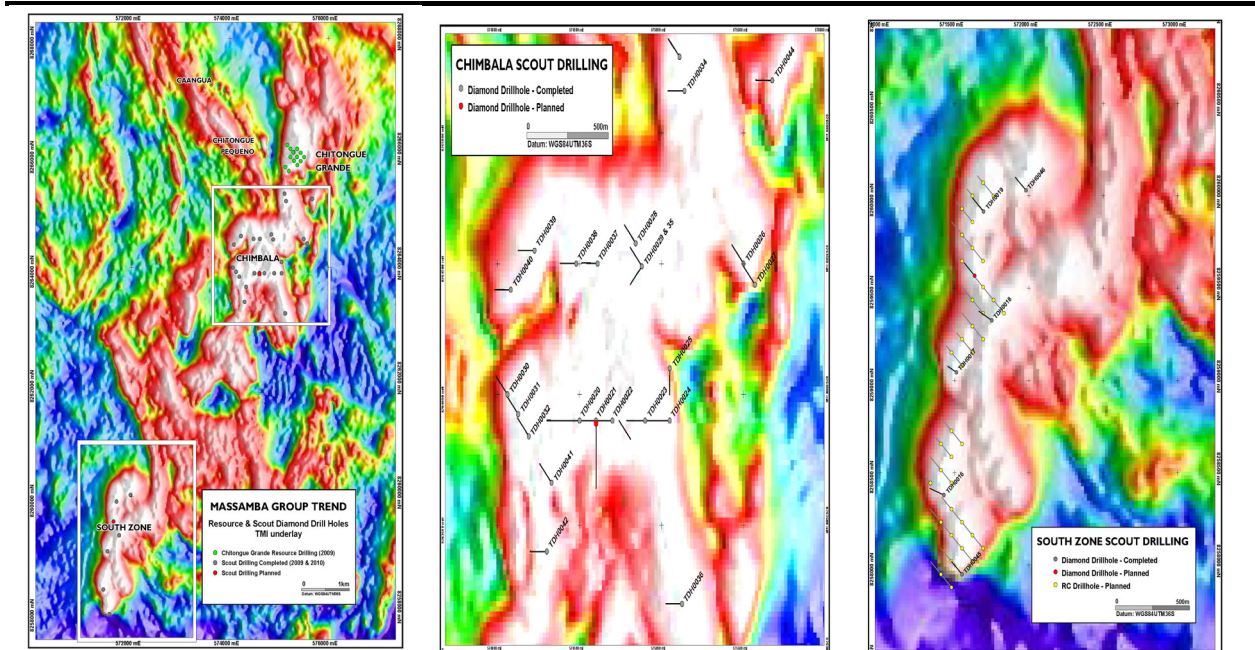
Baobab has released potentially significant updates with respect to the drilling programme at its Tete project and also an injection of capital from a third party into its Changara deposit.

### Tete drilling updates

The first round of a scout diamond drilling campaign at Tete is now nearing completion, with 24 holes drilled over an aggregate length of 4,950m (206.25m per hole, on average). The scout campaign forms part of a wider 12,000m combined diamond and reverse circulation (RC) drilling campaign designed to assess the Chimbala and South zone prospects of the Massamba group trend. The purpose of the campaign is to both improve confidence in Baobab’s 400-700Mt exploration target and also to clarify geological domains for continued metallurgical testwork.

The Chimbala prospect comprises the central portion of the Massamba group trend and is underlain by a 3km long zone of strong aeromagnetic response. Without exception, the drilling has intersected stacked packages of both cumulate and intrusive style magnetite-ilmenite mineralisation. The locations of the drill holes are shown in the maps below.

Exhibit 1: Drill holes



Source: Baobab Resources

Since our Outlook note, Baobab has released the analytical results relating to eight holes drilled in the Chimbala prospect of the Massamba group trend of its Tete project. A summary of the analytical results derived from these holes (plus four earlier ones) is given below.

**Exhibit 2: Summary of analysis of Baobab scout drilling campaign holes**

Hole	Cumulative width (metres)	Weighted average grade (Fe %)
TDH0020	56.0	22.4
TDH0021	64.0	25.1
TDH0022	30.0	28.1
TDH0023	48.5	24.8
TDH0024	24.0	23.8
TDH0026	26.5	28.4
TDH0027	61.0	25.3
TDH0028	20.5	27.9
TDH0029	45.5	25.6
TDH0030	8.0	28.7
TDH0031	30.5	26.3
TDH0032	34.0	22.9

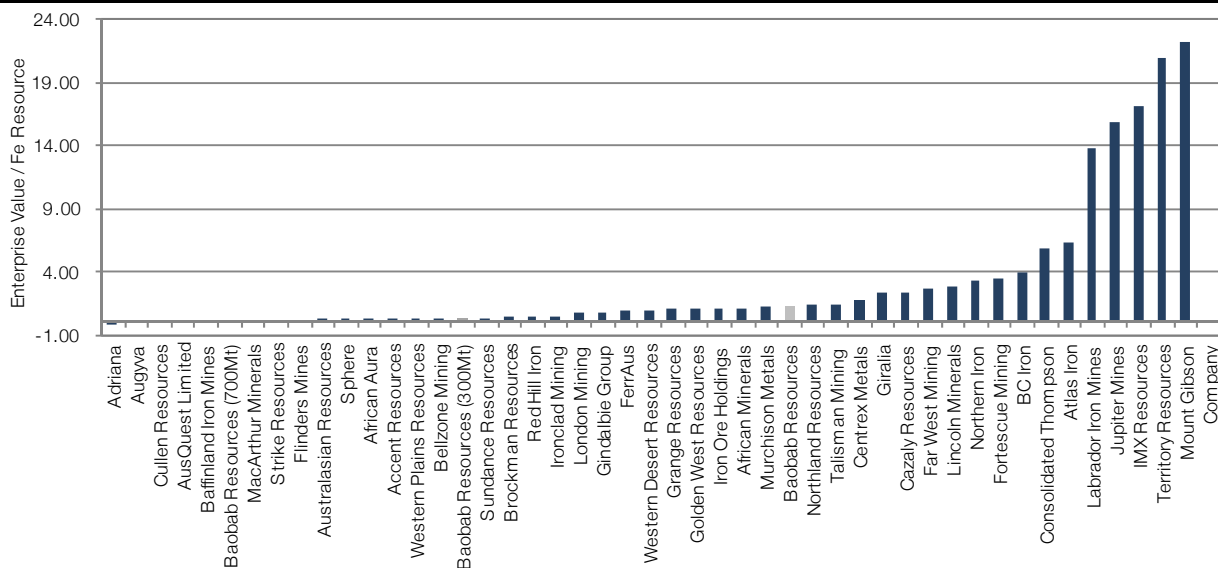
Source: Baobab Resources

Extrapolating from individual drill results to a potential resource estimation is a notoriously hazardous process. Nevertheless, it is notable from the maps of the drill holes that the area covered by the drill holes of the scout campaign is significantly larger than that of the Chitongue Grande prospect, from which Baobab's current JORC-compliant inferred resource of 47.7Mt grading 25.3% Fe is derived.

Nevertheless, making an estimate about the area encompassed by the holes, the average width and grade of the mineralisation and an estimate of the density of the rock ( $2.7\text{t/m}^3$ ), we calculate an order-of-magnitude estimate of the resource bounded by the drill holes is 198.5Mt at 26.1% Fe (plus  $\text{V}_2\text{O}_5$  etc).

At the same time, it should be noted that, while the drill spacing is as little as 100m in an east-west direction, it is as much as 600m (or more) in a north-south direction and it is possible that this is beyond the limits required to be immediately admissible as a JORC-compliant resource in the absence of some additional infill drilling.

In the meantime however, our estimate of the potential resource bounded by the 12 drill holes for which results have been released should provide tangible evidence of the fact that Baobab's exploration target of 400-700Mt is achievable. The exhibit below demonstrates the value that Baobab offers investors should it successfully increase its resource to either 300Mt or 700Mt. Compared with an industry average value of US\$3.53, at 300Mt, Baobab's enterprise value (EV) per tonne of iron resource would be US\$0.17/t and, at 700Mt, would be US\$0.07/t (assuming a constant Fe grade of 25.3%).

**Exhibit 3: Ore exploration and mining peer group EV per contained Fe resource**

Source: Edison Investment Research, Thomson Reuters

Alternatively, Exhibit 4 gives Baobab's potential valuation within the context of the 300Mt and 700Mt resource targets at the average industry valuation.

#### **Exhibit 4: Baobab Resource's Tete project valuation summary with respect to resources**

Note: \* Before dilution.

Resource	47.7Mt @ 25.3% Fe	300.0Mt @ 25.3% Fe	700.0Mt @ 25.3% Fe
Investment required (US\$m)	Nil	4	6
EV/t Fe valuation (US\$/t)	3.53	3.53	3.53
Valuation (US\$m)	43	268	625
Per share (US\$)*	0.27	1.69	3.93
Per share (£)*	0.18	1.11	2.58
Share price (£)	0.07125	0.07125	0.07125
Discount (%)*	60.4	93.6	97.2

Source: Edison Investment Research, Thomson Reuters

Samples from the next batch of holes are currently at the laboratory in Australia, with analytical results expected to be available in early August. In the meantime, scout drilling has recommenced at the South Zone (see Exhibit 1), at which three of four planned diamond holes are reported to have intersected 'substantial widths of mineralisation of between 20 and 100m (true width).' RC drilling is planned to commence at the South Zone in the very near future.

## **Changara Heads of Agreement**

In addition to its drilling results, Baobab has announced the signing of a joint venture heads of agreement with Southern Iron Ltd with respect to its Changara base metal and manganese project. An extensive soil survey conducted over 70% of Baobab's Changara licence area demonstrated robust geochemical anomalies and suggested Broken Hill-type polymetallic mineralisation. Southern Iron will now have an option to earn in to up to 80% in the Changara project in a four stage process culminating in the production of a definitive feasibility study (DFS). The minimum value uplift to Baobab's shares under the terms of the agreement is 0.19 US cents per share, with a likely uplift of 0.47 US cents (0.31p) per share – or c 4% of Baobab's current share price.

**Exhibit 5: Financials**

	£'000s	2008 IFRS	2009 IFRS	2010e	2011e
Year end 30 June					
<b>PROFIT &amp; LOSS</b>					
<b>Revenue</b>		<b>1</b>	<b>276</b>	<b>43</b>	<b>0</b>
Cost of Sales		(2,204)	(1,792)	(1,561)	(2,191)
Gross Profit		(2,202)	(1,515)	(1,518)	(2,191)
<b>EBITDA</b>		<b>(2,202)</b>	<b>(1,515)</b>	<b>(1,518)</b>	<b>(2,191)</b>
<b>Operating Profit (before GW and except.)</b>		<b>(2,259)</b>	<b>(1,570)</b>	<b>(1,574)</b>	<b>(2,247)</b>
Intangible Amortisation		0	0	0	0
Exceptionals		0	0	0	0
Other		0	0	0	0
<b>Operating Profit</b>		<b>(2,259)</b>	<b>(1,570)</b>	<b>(1,574)</b>	<b>(2,247)</b>
Net Interest		68	19	11	41
<b>Profit Before Tax (norm)</b>		<b>(2,191)</b>	<b>(1,551)</b>	<b>(1,563)</b>	<b>(2,206)</b>
<b>Profit Before Tax (FRS 3)</b>		<b>(2,191)</b>	<b>(1,551)</b>	<b>(1,563)</b>	<b>(2,206)</b>
Tax		0	0	0	0
<b>Profit After Tax (norm)</b>		<b>(2,191)</b>	<b>(1,551)</b>	<b>(1,563)</b>	<b>(2,206)</b>
<b>Profit After Tax (FRS 3)</b>		<b>(2,191)</b>	<b>(1,551)</b>	<b>(1,563)</b>	<b>(2,206)</b>
Average Number of Shares Outstanding (m)		57.0	83.4	127.5	158.9
EPS - normalised (p)		(3.8)	(1.9)	(1.2)	(1.4)
EPS - FRS 3 (p)		(3.8)	(1.9)	(1.2)	(1.4)
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
<b>BALANCE SHEET</b>					
<b>Fixed Assets</b>		<b>114</b>	<b>58</b>	<b>16</b>	<b>(40)</b>
Intangible Assets		0	0	0	0
Tangible Assets		114	58	16	(40)
Investments		0	0	0	0
<b>Current Assets</b>		<b>937</b>	<b>530</b>	<b>2,067</b>	<b>64</b>
Stocks		0	0	0	0
Debtors		74	2	0	0
Cash		863	529	2,067	64
<b>Current Liabilities</b>		<b>(228)</b>	<b>(377)</b>	<b>0</b>	<b>0</b>
Creditors		(228)	(377)	0	0
Short term borrowings		0	0	0	0
<b>Long Term Liabilities</b>		<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>
Long term borrowings		0	0	0	0
Other long term liabilities		0	0	0	0
<b>Net Assets</b>		<b>823</b>	<b>211</b>	<b>2,083</b>	<b>24</b>
<b>CASH FLOW</b>					
<b>Operating Cash Flow</b>		<b>(630)</b>	<b>(539)</b>	<b>(1,106)</b>	<b>(1,045)</b>
Net Interest		68	19	11	41
Tax		0	0	0	0
Capex		(1,554)	(1,011)	(514)	(1,000)
Acquisitions/disposals		0	0	0	0
Financing		1,795	1,197	3,148	0
Dividends		0	0	0	0
Net Cash Flow		(321)	(334)	1,538	(2,003)
<b>Opening net debt/(cash)</b>		<b>(1,184)</b>	<b>(863)</b>	<b>(529)</b>	<b>(2,067)</b>
HP finance leases initiated		0	0	0	0
Other		0	(0)	0	0
<b>Closing net debt/(cash)</b>		<b>(863)</b>	<b>(529)</b>	<b>(2,067)</b>	<b>(64)</b>

Source: Edison Investment Research, company accounts

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