

Good progress at ADAM's largest investment

20 January 2020

Re-enters production as planned, ramping up output and sales

ADAM holds an 85% controlling shareholding in Future Metal Holdings (FMH). FMH owns a large dolomite quarry in China and represents the largest single component of ADAM's asset base/NAV. Progress vs operational and strategic targets at the quarry is key to understanding FMH's potential and any assessment of ADAM's intrinsic value. That is particularly true short term, as ADAM continues to scale up its portfolio of income producing investments.

Dolomite quarrying operations restored, ramping up during H1

Over the last 12 months, ADAM has directed its investment in FMH to support plans to restart quarrying production and progressively, create a self-sustaining, profitable and saleable business. According to the latest update, the following initiatives are on target:

- **The quarry's processing line has been installed and commissioned.** It successfully completed an initial run that produced c 200 tonnes of product.
- **Production was stepped up in the second half of December** and is on track to achieve a daily production target of 800 to 1,000 tonnes in Q1 2020.
- **The first sales contract was secured on 30 Nov 2019.** A local construction company ordered 1,000 tonnes of wall rock at RMB48/tonne (US\$6.8/tonne). FMH reports enquiries from other potential buyers of products from the quarry.
- **Management expects daily production capacity to reach c 2,000 tonnes daily by midyear.** This reflects more efficient use of the current configuration of equipment onsite. Actual output will be configured to meet contracted sales.
- **Grant of Work Safety Permit and Discharge Permit.** This application is made after production has commenced and is expected to be completed during H1 2020.

Summary

Although still at a relatively early stage commercially, ADAM's strategy for FMH is rolling out broadly as anticipated. The next phases will be confirmation of (a) **production scalability** and (b) **firm, large volume orders** that provide revenue visibility at prices which underpin the financial model. Further updates should continue to narrow the disparity between ADAM's £36m market cap and our proforma NAV calculation of £76m.

As previously announced, independent estimates put FMH ore reserves at 113.4 Million Tonnes (Mt). The local management team has since configured processing plans to generate an initial total production capacity for dolomite of 300,000 Tonnes (300 Kt) pa, the current approved production level from the Linfen Ministry of Natural Resources.

Independently analysed production and sales estimates show potential for FMH to generate c US\$4.5m pa revenues and at c 50% gross/30% operating margins, post-tax annual earnings of c US\$1.0m. Delivering on these estimates would underpin a significant valuation for FMH and, in turn, ADAM.

Company Data

EPIC	ADAM
Price	35p
6 months Hi/Lo	40p / 18p
Market cap	£36m
ED Proforma NAV/share	74p

Share Price, p



Source: ADVFN

Description

Adamas Finance Asia (ADAM) is listed on AIM and intends to be the leading London-quoted investment vehicle focused on providing financing to a diversified portfolio of established and emerging SMEs across Asia. Its stated objective is to provide shareholders with attractive risk adjusted income with the potential for income and capital growth, from unique access to income generating assets with significant downside protection in growth sectors across Asia.

ADAM appointed a new Investment Manager, Harmony Capital Investors Limited, in May 2017. Harmony Capital has an established track record, with investment expertise and local networks in Asia with disciplined risk management processes and is based in London, Hong Kong and Singapore.

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Future Metal Holdings – investment update

This update sets out a broad overview of the progress reported by FMH vs its strategic targets. We have relied upon information contained in ADAM’s announcements, FMH’s website and discussions with ADAM’s investment manager Harmony Capital in London and Hong Kong, to provide a brief and hopefully accessible status update.

We have not accessed further detail on (a) the specific facility, (b) dolomite quarrying or (c) China’s domestic construction market, beyond that available from broad newsflow.

Dolomite Quarry, Shanxi Province, China

As at 30 September 2019, ADAM’s 85% stake represents 45.2% of its portfolio. **The business consists of the largest magnesium dolomite quarry in Linfen City, Shanxi Province, China** and ADAM believes that FMH is in a strong position to capture the growth of the substantial magnesium market in China.

Future Metal Holdings																			
 <p>Energy and Resources</p> <p>Future Metal Holdings Limited Chinese Dolomite Mine</p> <p>2014 ADAM is the major shareholder in Future Metal Holdings Limited which owns a large open pit dolomite quarry in Linfen City, Shanxi Province, China</p>	<table border="1"> <tr> <td>Domicile:</td> <td>China</td> </tr> <tr> <td>Sector:</td> <td>Metals & Mining</td> </tr> <tr> <td>Carrying Value:</td> <td>US\$42.6m</td> </tr> <tr> <td>Governance:</td> <td>Quarterly and Annual Reporting</td> </tr> <tr> <td>Investment Type:</td> <td>Equity and Shareholder Loans</td> </tr> <tr> <td>Portfolio Attribution:</td> <td>44.1%</td> </tr> <tr> <td>Interest Rate:</td> <td>Not Publicly Disclosed</td> </tr> <tr> <td>Security:</td> <td>Not Publicly Disclosed</td> </tr> <tr> <td>Target Exit:</td> <td>IPO, Trade Sale etc.</td> </tr> </table>	Domicile:	China	Sector:	Metals & Mining	Carrying Value:	US\$42.6m	Governance:	Quarterly and Annual Reporting	Investment Type:	Equity and Shareholder Loans	Portfolio Attribution:	44.1%	Interest Rate:	Not Publicly Disclosed	Security:	Not Publicly Disclosed	Target Exit:	IPO, Trade Sale etc.
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Source: ADAM investor presentation November 2019

FMH is best described as a quarrying operation for now. It is an open pit quarry, whose products are extracted by drill and blasting, which then require simple crushing and sorting prior to sale.

ADAM has previously outlined operational targets and timeframes for FMH. These include:

- Recruitment and investment required to return the quarry to full production
- Receipt of all necessary licences and permits
- Renewed focus on sales and marketing to establish a new customer base.

The Mining Licence was successfully renewed in August 2018 and the Investment Manager appointed an onsite team, including a general manager to oversee operations at the site.

In addition to installing an expert onsite team, Harmony Capital appointed international accounting firm BDO Limited (**BDO**) to maintain the accounting records of the operating company in China.

BDO is also responsible for control of the operating company's local bank account, invoice processing, authorisation of payments and collection of sales receipts. Harmony Capital's analysts conduct monthly site visits in order to verify progress as reported by the local management team.

Progress to date

Restoration of quarrying operations is still at a relatively early stage, but we have attempted to understand the strategy and establish to what extent ADAM's plans for FMH are on track.

The quarry is now operational and has completed initial test runs.

Tracking progress vs operational and strategic targets is key to an assessment of ADAM's intrinsic value. According to the latest update:

- The quarry's processing line has been installed and commissioned and successfully completed an initial run which produced c 20,000 tonnes of products in total. Production was stepped up in the second half of December and it is on track to achieve a daily production target of 800 to 1,000 tonnes in Q1 2020.
- The operating company secured its first sales contract on 30 November 2019 from a local construction company that ordered 1,000 tonnes of wall rock at RMB48/tonne (US\$6.8/tonne). Although not a substantial sale vs a 60,000 Tonnes/month production target by mid-2020, it was a positive start. The price was lower than the typical RMB55-60/Tonne range, but that may be attributable to the timing of the sale just ahead of the Chinese New Year, as local construction works have slowed down during the holidays.
- The operating company is constructing a steel structure to enclose its stockpile site. It is installing dust removal equipment and commencing the land hardening process to comply with local environmental requirements. These are currently scheduled for delivery in the first half of 2020.
- Local management intends to obtain a Work Safety Permit and Discharge Permit. These can only be applied for after production has commenced and are expected to be completed in the first half of 2020. Concerted marketing efforts and promotion will commence after these permits are in place.
- The Investment Manager reports enquiries from other potential buyers and believes local demand could fully absorb quarry production. Marketing is at an early stage. The IM also provided some perspective on FMH's competitive positioning derived, in part, from an increasingly strict environmental policy.

It expects this to limit opportunities for competitors to obtain the necessary permits and licences (already granted to FMH or under application) to commence new quarrying operations.

- The projected c 2,000 tonnes daily production capacity reflects higher operational efficiency extracted from the current configuration of equipment onsite. Trial production is being run for five to six hours per day while the line is being tested. The projected output assumes formal production of ten hours/day across a full calendar month. Actual output will be configured to meet contracted sales.

Local market for dolomite in China

FMH's raw material is dolomite for magnesium smelting and wall rock for construction materials. Dolomite has a wide range of applications and demand has grown materially in recent years. In construction, it is used as a road base material, an aggregate in concrete and asphalt and in cement production. It is also an acid neutraliser used by the chemical industry, stream restoration and as a soil conditioner.

Our discussions with ADAM indicate that it anticipates demand will primarily be derived from the construction industry in regions adjacent to the quarry. There is a shortage of wall rock for construction in China as ongoing urbanisation and infrastructure improvements continue. In due course, the customer base may evolve to incorporate sale to smelters nearby.

The quarry asset is strategically located with convenient access points to maximise operational efficiency and can take advantage of convenient access and transport networks to surrounding cities. That leaves it well positioned to efficiently deliver its products to nearby markets and customers.

Additionally, some operators have lost their Mining Licences or been forced to reduce the size of their extraction areas due to changes in quarrying/extraction policy and government tightening of environmental policies.

Reserves & market conditions confirmed by independent studies

An indication of anticipated production levels, costs and product prices has been obtained from studies carried out by leading independent external consultants **China Market Research Centre (CMRC)** and **SRK Consulting**.

These have been substantiated by contracts with third party service providers or estimates from local management. The ranges given are indicative of annual production at current levels of capacity once the business has commenced and reached full production.

The report by SRK Consulting in March 2018 estimated that the quarrying operation contained **113.4 million tonnes** of ore reserve. Local management has since configured processing plans to generate an **initial total production capacity for dolomite of 300,000 tonnes pa**, the current approved level of dolomite production from the Linfen Ministry of Natural Resources.

The independent market study from CMRC gathered localised data from primary sources to build a picture of estimated market demand and dynamics and verify prevailing prices FMH's products. It concluded that there is a readily accessible market for FMH. Indeed prevailing market conditions include a shortage of supply, proximity to smelters and early mover advantage vis-à-vis compliance with strict environmental regulations.

These should provide challenging barriers to entry for some of FMH's existing competitors.

Longer term potential

Production/financial metrics

As at end September 2019 ADAM's 84.8% stake in the quarry was valued at US\$43.3m, equivalent to 45.2% of its total net assets. FMH is a legacy asset and, as ADAM's recent financial support brings operations towards full capacity, it should help reduce any uncertainty related to its value and potential exit strategy. **Currently, it is one component of what seems an unjustifiable c 50% discount of the shares to NAV.**

As FMH builds production and orders during H1 2020, we would expect to be able to produce a more meaningful assessment of the operation's financial potential and timeframe during which it could achieve steady state revenue and profitability. Contracted sales would build earnings visibility, and help to assess an NPV of future earnings as FMH accesses a 113 tonne ore reserves. We would then have a clearer sense of how production will scale.

ADAM's September 2019 RNS provided some details of the independent studies, including a range of estimates of potential production volumes, sales prices, quarrying and construction costs (set out below), which we have used as a guide to short term profitability. Other than execution risk, the variables are as in the table, plus USD/RMB. The operating metrics are based on 300,000 tonnes pa production capacity vs the estimated 113m tonnes ore reserve. That's equivalent to a mine life above 350 years at current capacity, which represents scope to expand capacity, increase and bring forward both the cashflow contribution and potential returns from a divestment by ADAM.

Mid-range sales estimates and sales in the proportions set out in the report would generate annual revenues of US\$4.5m, and c 50% gross and 30% operating margins. After deducting Chinese Corporate Tax at 25%, net earnings are c US\$1.0m.

Estimated Production, Sales Price and Costs

Expected Production Quantities (per annum at full production)

Total Rock Production	485-575 Kt
Wall Rock	300-350 Kt
Qualified Dolomite	150-180 Kt
Unqualified Dolomite	35-45 Kt

Estimated Sales Prices (per tonne), net of VAT

Qualified Dolomite	RMB 50-65 (USD 7.0-9.1)
Unqualified Dolomite	RMB 30-40 (USD 4.2-5.6)
Wall Rock	RMB 55-60 (USD 7.7-8.4)

Estimated Cost of Extraction (per tonne)

Contract Extraction Costs	RMB 21-28 (USD 2.9-3.9)
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Other Costs

Operating Expenses	RMB 4.0-5.7m (USD 0.6-0.8m)
Domestic Corporate Income Tax Rate	25%

Source: ADAM RNS (RMB/USD = 0.14)



Investor Access

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