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FAR EAST CAPITAL
The Mining Investment Experts

Weekly Commentary

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Kalina Power - addressing data centre electricity needs

It is almost getting monotonous; repeated record gold prices. As I write there is only $20 to go before it hits US$5,000. I don't think anyone expected it to get to this level so quickly - even the serious gold bulls.

The rise has been so strong in such a short space of time that the market is struggling to translate the rise into the effect on the large range of gold companies, particularly the non-producers. This is certain to result in some stocks with merit being overlooked, while others with superior promotional capability will be all about aspirations rather than delivery. Interestingly, there is sufficient scepticism in the share market that trading has not yet hit the frenzy stage. There is more caution than what might have been anticipated, perhaps because it is uncertainty that is actually driving the gold price - geopolitical uncertainty - and there is diminished trust in where we are all going.

There was a timely piece in the newspaper today, quoting Black Rock's Larry Fink. He said in a speech at Davos that data centres cannot rely on clean energy to supply uninterrupted high-capacity electricity, constantly. Data centres need perfect reliability and wind and solar sources cannot guarantee this. While The Australian mentioned this to show the flaw in Labor's conflicting policies of nominating Australia as a future source of digital infrastructure in the AI boom, while also excessively promoting renewables, it has relevance to Kalina Power, the feature stock this week.

Kalina is an early mover on electricity supply for data centres with a series of projects in the much cooler Alberta climate, in Canada. It is doing it, whereas Jim Chalmers is just fantasising about it in Australia. This week we update you on Kalina's progress and add some economics to the narrative.

Caution: The market is very hot right now. Look at the Sentiment Oscillator on page three. There will be a market correction soon.

Kalina Power and Data Centre Electricity

We first covered Kalina Power (KPO) in September 2024, at a time when the business model had changed to a focus on electricity generation from gas in Alberta, including carbon sequestration. At the time it was an early mover on the concept of power for data centres. Since then the datacenter and AI thematic has become more widespread. Fifteen months ago while the Kalina vision was there, the bells and whistles were not all in place. There was excitement but there was not a direct line of sight to earnings. We are seeing better visibility now.

Current status of the Company

Kalina's 100%-owned subsidiary, KDP, is an Alberta-based power developer with real estate for up to 1.7 GW of power generating facilities. So far, permit applications for 1 GW are in the queue now.

Modular, individual production units will have capacity of < 200 MW. There may be multiple units on each location. This size conveniently fits beneath the threshold limit before the Federal authorities get involved in the permitting process. It also facilitates a more simple manufacturing process off-site, for subsequent transport to location.

Alberta has been selected as the optimum province in which to operate because;

i) it is one of the world largest, lowest cost natural gas producing regions,

ii) there is a serious electricity supply gap, and

iii) it has the cool climate needed.

One of the issues that the Company has had to deal with relate to carbon capture and sequestration to keep regulators happy on the environmental front. However, the strict requirements have recently been relaxed on this front to allow companies to pay a carbon tax instead. Suppliers will not be forced to capture their emissions. There has been ongoing debate as to whether the correct tax levy is C$95 pt, as it is in Alberta, or the $180 pt, as set by the Feds. It looks like it will settle at C$130 pt, but we won't go into a discussion on this tax because it is a matter for the end user rather than for Kalina, as a supplier of projects.

Up front capital costs - $600m x 5

In trying to get an idea of the economics, we can estimate a $600m capex for each 200MW unit of a combined cycle plant (meaning ~ 70% of the electricity comes from gas turbines and the waste heat generated will also provide 30% from steam turbines). Apparently there is no technology risk with the well-understood and commonly used methodology. As a rough guide to capex, 25-30% of the $600m will be attributable to equipment and the balance to construction and installation costs.

Where will the capex come from?

The stock market is not the usual source of funding for infrastructure style developments. Given their long life and contractual reliability of future revenue streams, and take or pay contracts, specialist capital providers will be employed. An example of such a firm is New York investment bank, PEI Global Partners who are leading the financing of KDP's portfolio capital needs. Accordingly, Kalina's shareholders should not be intimidated by big capex numbers.

A debt to equity ratio might reasonably be 70:30. It remains to be seen what the level of dilution Kalina is able to secure, in its subsidiary, as a way of making equity available to incoming parties.

Effectively the plants will "toll treat" the gas to power

The corporate customers e.g. data centre companies, will be paying for electricity from facilities that effectively toll treat gas. Kalina is targeting an annual rate of return on these facilities of 17% on a levered basis, but customer companies may need to agree to the facilities generating

this sort of rate of return as a precondition for Kalina being able to secure finance.

How Kalina makes money - Development fee + NPI

Kalina will be a project development manager that can make money by bringing the project together, as well as from gaining a long term, free equity carried interest (if the customer wants to own the power 100%) Applying the traditional project development model (that predates the data centre boom), Kalina is targeting a one-time 5% development Establishment Fee (5% x $600m capex i.e. $30m) for each power plant as well as substantial recurring income from a 10% free carried interest in future profits. That would start at about $3.6m per plant, or $18m p.a. on all five of them. What the projects actually earn will be dependent on future energy prices, which keep going up. Actual earnings received by Kalina will be impacted by any equity dilution along the way, at the subsidiary level.

Working capital needed to get the ball rolling

Kalina will need to man-up with dedicated teams once the pre-development process gets a bit further down the line. At the moment it looks like Kalina's subsidiary will need working capital of $10m for the Pre-FEED work for the first five units. This will increase by another $50m once the FEED work commences.

Sequential construction and development

Once the ball gets rolling, Kalina will have assembled development crews that enable staggered development of each unit commencing at six monthly intervals. Currently it is expected that the first three plants may be completed by 2030. Each will take up to two years to construct and install.

Cash balance is strong

A cash balance of $458k was reported at the end of September. This received a significant boost in October with the receipt of $20m following settlement of a transfer agreement between Kalina's subsidiary KDP, Canadian JV Greenlight and its Hyperscaler customer. Kalina sold 180 MW of its 840 MW allocation which was effectively a licence granted by the Government to generate power. That sale does not compromise future activities but has been a good boost to cash levels.

The Bottom Line

The punchline slogan for Kalina is "*Addressing the Surge in Demand for power by AI Data Centres*". Additionally, it says that "*digital infrastructure and the need for power in one of the most exciting and critical investment themes in our time.*" Both statements are relevant and should command interest. However, it seems as if the market wants to see more detail than just quotes that may come from a mission statement.

We have made an effort to identify order of magnitude cost and to identify likely operating margins, and therefore potential earnings. They are preliminary but they are indicative, effectively coming from project management in the early stages and from net profit interests as time goes by. The sale of the MW allocation mentioned above provides tangible evidence that there is money to be made.

The highest risk phase of the project will be in getting the business plan completed and the arranging of finance, but these are very different to a mining project. This is all about infrastructure development and addressing the burgeoning demand for electricity. Speculation is not a word that is compatible with electricity and infrastructure, so that should mean Kalina is lower risk. It is all-about deliverability. The spice in the equation comes from expectations of what the future electricity prices will be.

West Wits Upscaled Placement - $33.75m

West Wits, and its shareholders, should be mightily pleased with the "bought deal" presented to it last week by Evolution Capital, raising $33.75m. For those of you who haven't heard of the term "bought deal", it is one with which the Canadians are more familiar. It means that rather than go through the time consuming process of negotiating and preparing for placement, which can take 1-3 weeks, the broker just gives a bid for stock and the company says yay or nay. It is very fast and efficient. From the point of view of the broker, it is "feeding the ducks while they are quacking".

In this event WWI was not considering a raising at all. It had not mandated a broker. The bid from Evolution came out of left field. Considering how much time was involved in preparing for previous raisings, this worked a treat for the West Wits.

Impressive Economics for Qala Shallows

You should be aware that WWI commenced mining in South Africa last October, and it is currently stockpiling ore ahead of first processing through a third party mill in March. Being an underground mine it requires a three year ramp up until it hits the 70,000 oz p.a. run rate. At that level, using AISC of around US$1,300/oz, and a gold price of US$4,700/oz, Qala Shallows could be earning A$376m p.a. (74% WWI, i.e. A$278m). The current market capitalisation after the placement last week is about A$344m, placing the shares on a prospective cash flow multiple of 1-2x. That leaves plenty of room for upside from here. The story gets better when you factor in the longer term plan to lift production to 200,000 oz p.a.

The Bottom Line

This is a good example of the high profitability levels being experienced by gold producers today. I still believe that there are many less well-known gold stocks that will be set for a re-rating when the penny drops.

Disclosure: Interests associated with the author own shares and options in West Wits and is a non-executive director.

Matsa - Another Example of an Underpriced Gold Stock

Matsa Resouces (MAT) is another example of a junior gold company that will profit big time from current gold prices. Last week it announced the commencement of the second campaign at the Devon Gold Mine in WA. Extrapolating the numbers in the October presentation, the Devon Pit is planned for gold sales of 42,476 oz over an 18 month time frame. Using A$7,000/oz for sales, and AISC of A$3,000/oz, there is potential to generate a pre-tax profit of A$170m.

Apart from that, AngloGold has an option to buy leases from Matsa, expiring in December 2026. The calculated exercise, which moves with the gold price, is currently around $115m.