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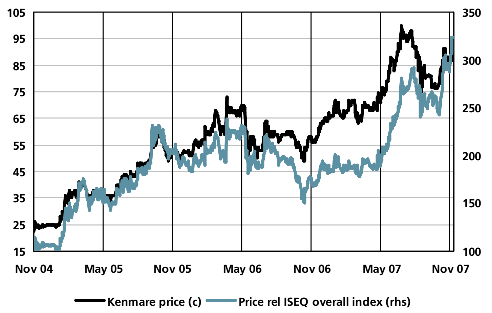
Share Price Performance



Recent research and research resources

Recent research and financial data on Kenmare

Sector research and data on Resource

Davy Research

February 18, 2008

Equity Report: Forecast changes

Kenmare

Price: **44p**	Target **59p**	Issued **18/02/08**	*Previous 62p*	*Issued 27/04/07*

Fundamentals intact; new price target of 59p per share

Kenmare has underperformed the market

- Kenmare is down 18% year-to-date versus a flat FTSE E300 Mining Index.
- The market is clearly disappointed by a slower-than-expected ramp-up to full production at Kenmare's Moma titanium minerals mine in Mozambique.
- Investors now appear to believe that the development risk in the Moma project is greater than previously anticipated and/or that future cashflows are not as strong as expected.

Market is overestimating the development risk

- Our recent site visit reassured us that operational issues affecting Moma are not fundamental in nature.
- Commercial shipments demonstrate that the process works well. Furthermore, the resource base continues to expand.
- Management has identified a clear path to full production in 2008.

Healthy demand for product suite; market and resources represent excellent growth profile

- While future cashflows have been delayed and debt has increased, product prices are growing or remain robust.
- Our year-end price target for Kenmare is 59p per share based on a conservative 20-year mine life.
- One possible way of valuing the strategic (large-scale, low-cost and long-life) nature of Moma suggests a total valuation of 71p per share.

Production and sales continue, but ramp-up is slower than expected

During 2007, Kenmare began to take control of the Moma titanium minerals' mine from the contractor. When operating at initial design capacity, the Moma project on the northern coast of Mozambique will produce:

- 800,000 tonnes of ilmenite per annum (p.a.);
- 21,000 tonnes of rutile p.a.;
- 56,000 tonnes of zircon p.a.

Most of Moma's plant is now operating under Kenmare's management, and the mine is currently producing and shipping product. However, problems with faulty equipment and power dips have delayed the onset of full production. Our recent site visit reassured us that operational issues affecting the ramp-up to full production at Moma are non-core.

- **Customers have confirmed that received product is in line or exceeds specification**

Firstly, commercial shipments demonstrate that the process works well. To date, the company has achieved the following:

- 4.5m tonnes or 1% of commercial reserves have been mined. Those reserves lost to production have since been replaced with an upward revision to reserve estimates.
- 67,000 tonnes of concentrate await processing (separation) into final product.
- 57,000 tonnes of ilmenite are stockpiled and ready for shipping.
- Two shipments have already left Moma, with customers confirming that the shipped product was delivered according to or exceeding specifications.

- **The next shipment alone will generate $3m in revenues**

While we were on-site, a third shipment of c.12,000 tonnes of ilmenite was being loaded. A fourth shipment, which is expected to depart in February, will alone generate some $3m in revenues for the group.

- **Upward revisions to reserve estimates mean Kenmare has replaced reserves lost to production**

Secondly, the geology at Moma continues to improve. Kenmare is currently mining the Namalope deposit. Recent technical work carried out at the deposit concludes the following:

- a 2% increase in the quantity of ore and a 2% improvement in the grade of ore at Namalope;
- a 15% decrease in slimes to 6.4%. (Slime content can affect mineral recovery as well as impair dredge performance. In general, the lower the slime content of the orebody, the better.)

Since ramping-up, Kenmare has encountered problems with equipment not working to specification. Much of the faulty equipment was delivered under the fixed-price contract agreed with Multiplex and Bateman, the joint-venture contractors. Second-hand plant comprising the Wet Concentrator Plant (WCP) and Minerals Separation Plant (MSP) bought from BHP Billiton in 2000 has performed in line with expectations.

- **Faulty equipment is under warranty and will therefore be replaced at the cost to the contractor**

Most of the faulty equipment will be replaced in March at the cost to the contractor. Consequently, ilmenite production will move from some 28,000 tonnes in February to 50,000 tonnes in May. Later in 2008, Kenmare intends to produce 65,000 tonnes of ilmenite per month through improvements to the process design. Ultimately, Kenmare believes that Moma will produce some 600,000 tonnes of ilmenite in 2008. Rutile and zircon are also currently produced.

- **Moma is supplied by low-cost, hydroelectric power from the Cahora Bassa dam in Mozambique**
- **The base price is circa USc2.5/kWh, less than half the cost of industrial power in developed economies**

Moma has experienced some power dips and outages. Moma is energised by low-cost, hydroelectric power generated from the Cahora Bassa dam in Western Mozambique. Management is currently installing standard technology in the form of UPSs that will provide redundancy in the event of power dips.

Market remains healthy

While on-site at Moma, management gave a presentation on the market for titanium minerals and zircon. Key points from the presentation include:

- The titanium minerals market was in deficit in 2007.
- There is strong price growth (>10%) for certain grades of ilmenite and good demand for other titanium products.
- Industry consultants IBMA are forecasting 3.2% CAGR in the main market for titanium minerals.
- Current supply-demand balance in the zircon market is uncertain due to new artisanal supply from Indonesia.
- In the longer-term, zircon demand is expected to average 4.3% CAGR to 2015.
- There is 'strong support' for Moma expansion – a number of customers for titanium minerals have been identified for first production expansion at Moma.

Table 1 contains the latest pricing information to hand, with the data published in December 2007. The data confirm product price increases as reported by titanium mineral producers.

Table 1: Product prices ($ per tonne, FOB)

	Oct 07	*Sep 07*	*Aug 07*	*Jul 07*	*Jun 07*	*May 07*	*2007**	*2006*	*2005*
Bulk rutile from Australia	460-500	470-510	470-510	470-510	470-510	470-510	481	467	458
Bagged rutile from Australia	664	681	653	635	678	662	676	685	639
Sulphate ilmenite from Western Australia	85	99	87	82	85	85	85	79	79
Bulk zircon from Australia	783	781	782	774	787	812	789	744	643
Bagged zircon from Australia	927	923	869	919	886	882	897	807	768

*Year-to-date average for 2007
Source: TZMI

Although there is some uncertainty surrounding new supplies of zircon and rutile and the subsequent impact on prices, we believe ilmenite prices continue to track upwards. In particular, some producers are achieving $130-135 per tonne for sulphate ilmenite in China. Monto Minerals has also reported strong demand for its sulphate ilmenite in Europe as well as Asia.

We also note that Exxaro has called for substantial price increases for its titanium feedstocks. Exxaro currently has some 8-9% share of the global titanium feedstocks market.

Supply security as well as supply-side costs could also bolster product prices. Some 20% of global titanium feedstock supply emanates from three mining operations in South Africa. Eskom, the national utility, has recently reduced power supply to the South African mining industry and has stated that power supply could be unreliable until 2013.

- **Our product price assumptions are not aggressive**

In our updated model and forecasts, we have not made aggressive price assumptions (please refer to Table 2). We have imposed modest reductions to our original rutile and zircon price assumptions. For ilmenite, we assume a starting price of $104 per tonne and inflate this by a modest 2% for the next five years of production. Our ilmenite price assumption is a blended price, based on the various grades of ilmenite from Kenmare's Moma mine as well as on our perception of discounts delivered under pre-production contracts.

First expansion at Moma in design stage

Even when operating at an initial design capacity of 800,000 tonnes of ilmenite per annum, a substantial part of Moma's plant will be underutilised. By removing bottlenecks in the system (principally at the MSP stage), Kenmare believes that Moma could produce 1.2m tonnes of ilmenite per annum.

The proposed expansion to 1.2m tonnes per annum is at the design stage, and management is still targeting end-2009 for its full implementation. We believe this target date is challenging and regard a gradual ramp-up to 1.5x current capacity over the course of 2010 as more likely.

Until the design of the production expansion has been finalised, the associated cost remains uncertain. Management estimates capex to be some $50m, but the final cost could be higher if widespread cost inflation in the mining industry persists. In our updated forecasts, we have budgeted for a $50m expansion programme, up from $40m previously.

New price target of 59p per share

We are adjusting our valuation and forecasts to reflect:

- the slower ramp-up in production;
- new price forecasts;
- increased costs of expansion.

- **Our price target of 59p per share does not include a value for Moma's strategic qualities**
- **Moma could be worth at least 71p per share if we assume its substantial resources are mined beyond the initial 20-year period**

Our new price target of 59p per share is based on production out to 2026. However, Moma has enough resources to mine for more than 100 years at a rate of 1.2m tonnes of ilmenite per annum. A possible way of valuing the strategic (large-scale, low-cost and long-life) nature of Moma is to calculate a terminal value for production post-2026. For example, by assuming Moma is worth 6x forecast EBITDA in 2026 and discounting this back to today increases our valuation for Moma to 71p per share.

Another way that Kenmare can enhance value for shareholders is to implement a second stage of expansion in the next decade. Such a step is a natural progression for Moma and Kenmare. However, we believe management will need to achieve initial design capacity production levels before further expansion plans win investor confidence.

Table 2: Forecast changes – sales volumes and pricing

	2007F previous	*2007F new*	*Variance*	*2008F previous*	*2008F new*	*Variance*	*Yoy change*	*2009F previous*	*2009F new*
Sale volumes – tonnes									
Ilmenite	64,000	36,000	-44%	800,000	480,000	-40%	1233%	800,000	800,000
Zircon	4,480	0	-100%	56,000	33,600	-40%	N/A	56,000	56,000
Rutile	1,680	0	-100%	21,000	12,600	-40%	N/A	21,000	21,000
Price – $ per tonne									
Ilmenite	89	90	1%	95	104	9%	15%	97	106
Zircon	730	700	-4%	745	700	-6%	0%	759	700
Rutile	460	460	0%	469	460	-2%	0%	479	460

Source: Davy

Table 3: Forecasts – 2007 to 2009

	2007F	*2008F*	*Yoy change*	*2009F*	*Yoy change*
Revenues ($m)	0.0	79.0	N/A	133.4	69%
EBITDA ($m)	-9.7	42.4	N/A	88.9	110%
EBIT ($m)	-9.7	28.6	N/A	65.9	130%
PBT ($m)	-6.7	6.6	N/A	43.3	553%
EPS - Basic (USc)	-1.0	0.9	N/A	5.8	553%
EPS - FD (USc)	-0.8	0.8	N/A	5.3	553%
Capex ($m)	50.6	37.7	-26%	19.7	-48%
Net debt ($m)	263.2	302.9	15%	279.5	-8%

Notes to forecasts: We have assumed that net costs are capitalised in 2007. We have not capitalised any costs in 2008, although Kenmare may elect to do this. The loss forecast for FY2007 relates to foreign exchange losses on Euro-denominated debt.
Source: Davy

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