

KENMARE RESOURCES PLC

(KMR : LN : £0.13.5 : ISSUED 262.2M)

BUY

12-MONTH TARGET PRICE: £0.35↑

Mike Jones (44) 20 7518 7365

mike_jones@canaccordeurope.com

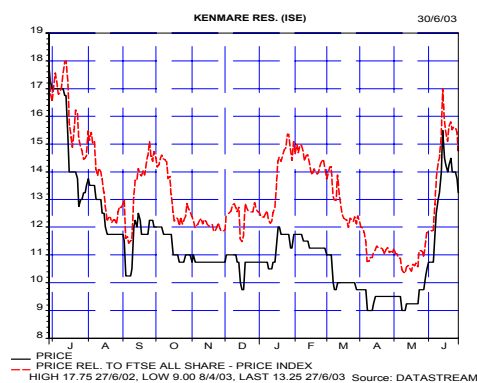
Company Statistics:

Listings:		LSE
Symbol:		KMR
Share price:		£0.135
52-week high:		£0.178
52-week low:		£0.09
Shares O/S:	basic	262.2M
	fd	290.0M
Weekly trading volume:		1.6M
Market capitalisation:		£35.4M
Net current assets:		£3.0M est
Long term debt:		£0.9M
Enterprise Value		£33.3M

Earnings Summary:

FYE Dec 31	2005E	2006E	2007E
Tonnes Mined, Mt	11.22	22.51	22.28
Heavy Minerals Sold, 000t	341	686	687
Turnover, US\$M	38.1	77.8	78.2
Operating costs, US\$M	20.3	21.5	20.4

Share Price Performance:



HIGHLIGHTS

- On June 6, the company announced that the zircon production from its 100% owned Moma heavy minerals project in Mozambique would be more than double that which was originally estimated. We have now modelled that increase in production and estimate that this, plus a slight reduction in forecast operating costs, would add between US\$8-10 million per annum to the company's EBITDA, significantly enhancing project value.
- Zircon production will rise from the previously assumed 24,000tpa to 49,000tpa, and customers have already indicated strong interest in increasing their offtake from the committed level of 24,000tpa.
- Today, the company announced another offtake agreement for ilmenite and all of the rutile. We estimate that around 60% of the forecast revenue is now committed under long-term contracts. Details of the individual contracts are confidential.
- These important developments follow on previous announcements of firm offtake contracts, the issuance of all environmental and other development permits for the mine, and the approval at board level of debt finance terms from the first two of the group of five counterparty banks.
- We are now awaiting only the final engineered cost proposal for a turnkey construction contract to be supplied by Fluor, due shortly, after a three-month delay. We understand the total capital cost is likely to come in close to the previous estimates.
- Future equity requirement will depend to some extent on the final capital cost, but at present we are estimating a need for around US\$40 million of equity to construct the project. Our improved NPV assessment (following the zircon upgrade) is over US\$200 million or 46p per share (13% discount rate), without considering any expansion cases.
- We continue to recommend Kenmare as a BUY, and have raised our interim target price from 30p to 35p.

Comment

Kenmare is still continuing to clear its last few remaining hurdles towards project implementation. It already has full permitting from the Mozambique government, and all the required offtake contracts for the products (ilmenite, zircon and rutile) in place. Although the terms of those contracts are confidential, we believe that they cover all of the rutile production (around US\$6 million pa), what was previously considered to be all of the zircon production (24,000tpa, or over US\$8 million pa) and around 55% of the various ilmenite products (estimated at around US\$28 million pa). We estimate that this represents around 60% of revenue prior to the zircon upgrade. Banking terms require that sufficient offtakes are in place to cumulatively cover the operating costs, debt servicing costs and sufficient margin for the first five years of production. The hurdle is not necessarily a “percentage of revenue” hurdle, but we understand that this offtake comfortably exceeds that required by the banking syndicate.

The improvement of the zircon production estimates comes about as a result of optimisation tests on the zircon circuit. Recovery has been boosted significantly after the testing carried out by Roche Mining (MT), more than doubling the output. Zircon production will be 34,000t of standard grade zircon (up from 24,000t) and an additional 15,000tpa of Special Grade zircon. Zircon contracts are typically US\$350/t for standard grade, and this improvement represents in the region of an additional US\$8-9 million per annum in revenue. The project enjoys tax-free status.

The first two financial institutions providing debt for the project (African Development Bank and the European Investment Bank), formally announced board level approvals for the loans on May 22, and the three remaining institutions in the syndicate (plus political insurance agencies) are advancing the loan applications through the various internal processes. All are expected to be approved in the next few weeks.

Fluor suffered a three-month delay in its EPC estimate from its original deadline date of the end of March. However, it is working towards supplying a proposal for a fixed cost turnkey contract price for the construction of the project, still likely to be around the early US\$200 millions, and is expected within the next week or so.

Project start date is now firmly expected to be towards the end of Q3, for an early 2005 start-up following a 20-24 month construction period. Once in production, the mine will generate around US\$80 million pa in revenues at a 75% operating margin (previous estimates were US\$70 million pa at a 70% margin).

The zircon upgrade adds more than US\$80 million to our 13% NPV over the first 20 years of the project, taking it to US\$206 million, an addition in itself of more than 18p per share. This upgrade represents more value in the improvement alone than the current share price.

We understand that the formal capital cost proposal, and subsequent acceptance should it be reasonable, will trigger the formal approval from the three

remaining banks and the political risk agencies, and at that point there will be a need for a further equity funding.

We believe that that requirement will be in the order of US\$40 million, plus whatever contingencies may be stipulated by the banks.

The last remaining issues (fixed capital cost proposal, completion of banking approvals) should be cleared up in the next few weeks, and we continue to recommend Kenmare as a BUY, now with a raised interim target price of 35p per share.