Davy
STOCKBROKERS

Kenmare
Very industrious

Ticker
KMR

Sector
Resources

Current Price
Stg15.75p

12 month High/Low
Stg22.5p/Stg13,5p

No. of Shares
191m

Market Cap
Stg£30m

EV
Stg£30m

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Rapid progress has been and continues to be made. Kenmare is rapidly approaching a point in time when it can begin to crystallise the value of its 100% equity holding in the Moma Titanium Mineral Project in Mozambique, East Africa.

Significant recent developments. In recent months Kenmare has made very good progress in negotiating offtake sales arrangements for the product range that will be produced at Moma. Offtake agreements are vital for the successful financing and ultimate development of a project. Negotiations with a number of consumers are at an advanced stage. It is expected that offtake sales agreements will be completed in tandem with project financing.

Financing terms should be agreed by the end of the third quarter. This should set the stage for the start up of the Moma development later this year. Construction and commissioning is scheduled to take 23 months.

The new mine will come on stream in 2004. Market studies suggest there is an opportunity to enter the market in 2004 when supply dips relative to demand. The Moma mine will add circa 7% to the existing market. Whether Kenmare develops the entire project on its own is debatable, and ultimately Kenmare may well end up with a joint venture partner. Alternatively, a larger player anxious to maintain the status quo in the titanium dioxide feedstock industry or grow its own share of that business could acquire Kenmare.

We suspect that neither the equity market nor the industry believes that Kenmare can or will deliver Moma. This creates the investment opportunity. We believe that the successful conclusion of offtake agreements, a financing agreement and construction start-up will change this perception. Based on the value generated by the definitive feasibility study, the Moma project is worth around Stg75p per share on an NPV basis. Although Kenmare will have to fund the equity portion of the development plan, as the start-up of development draws closer the risk discount will wither. **The stock is a buy at current levels.**

Project Update

Latest developments

Kenmare has been involved with the project since the late 1980s and in 1993 concluded a joint venture deal with BHP whereby BHP earned an interest in return for investment in the licence. This deal resulted in several years of heavy expenditures on the project as BHP began to earn an interest of up to a maximum of 75%. However, in 1999 BHP decided at senior board level to withdraw from the titanium dioxide industry completely. As a result the licence and all the work which had taken place up to that point reverted to Kenmare.

Since then, there has been a major acceleration towards the ultimate development of the project. A definitive feasibility study was completed by GRD Minproc in early 2001 which confirmed the financial viability of the project as well as the operating and capital cost parameters.

During the following summer N.M. Rothschilds & Sons Ltd was appointed to help arrange the necessary financing for Moma. Kenmare is also in the process of negotiating offtake agreements for the heavy minerals that will be produced at the mine. Recently it concluded a number of agreements with the Mozambican government, namely a modified mineral licencing agreement with better provisions for lenders and an implementation agreement covering the industrial free zone status accorded to the project.

Table 1 : Moma project

Mine life	20 years
Mine start up	2004
Mining method	Dredge
Annual ore mined	21m tonnes
Grade mined	4.4%
Average annual ilmenite production	612k
Average annual zircon production	23k tonnes
Average annual rutile production	12.5k tonnes
Ilmenite production (life of mine)	14m tonnes
Total ilmenite available	63m tonnes

Table 1 outlines the basic parameters of the project.

Capital and operating costs

The Moma project is on a virgin site with no existing infrastructure of any kind. Construction of a mine requires infrastructure, most notably power, accommodation and an export jetty. Total capital costs are now expected to be in the region of US$175m with a further working capital requirement of about US$10m. This now includes power straight to site, which involves some extra up-front capital costs, although very favourable power tariffs have been agreed.

Moma will produce a product suite consisting of three different kinds of ilmenite ore - depending on the contained grade of titanium dioxide, rutile and zircon.

The closing down of BHP's Beenup plant in Western Australia presented Kenmare with an opportunity to acquire two pieces of plant that are suitable for the Moma project. The concentrator and separator plants, which were acquired for a combined cost of AUS$10.5m (US$6m), have been independently valued on a depreciated replacement cost basis at US$40m, and would have cost considerably more if built from scratch. The purchase of this plant was important for two reasons. It not only represented a major saving on costs, but it sent a crucial message of intent to the industry and market.

Historic exploration and other costs have been valued at some US$25m. Altogether the project has a total cost base of US$250m.

Operating costs are estimated at around US$1.25 per tonne of ore mined. The Mozambican government has approved a full environmental impact assessment report, conforming to World Bank guidelines and the environmental law of Mozambique.

FINANCING MOMA

The Moma project will be financed through a mixture of debt and equity. One of the requirements of a lender will be evidence that offtake agreements have been put in place. We believe that negotiations with a number of consumers are at an advanced stage and therefore meaningful discussion regarding loan structures and term sheets can get underway.

We expect that the financing will be completed by the end of Q3 and that construction at Moma will start in Q4. The total borrowing base is likely to be in the region of US$250m. A 70% debt/ 30% equity ratio is the most likely outcome of any bank financing, so the total equity required is US$75m. However, Kenmare has already booked US$65 which implies a future equity requirement of some US$10m.

Allowing for contingencies and cost creep, we believe that it at some stage this year Kenmare may look to fund new equity of around US$20m. There are other options though, most notably a joint venture route, a strategy facilitated by the fact that Kenmare has full ownership of the project.

THE TITANIUM DIOXIDE MARKET

The feedstock market for titanium dioxide pigment, a white very opaque and non-toxic whitening agent is highly disciplined. There are three major producers of feedstock – Rio Tinto, Iluka Resources and Anglo American - which account for 55% of the market.

Demand for ilmenite (titanium dioxide ore) mirrors the demand for titanium pigment (92% of all titanium dioxide is used as pigment). Pigment use in turn mirrors global industrial production as it is used in a wide range of industrial processes.

Annual demand for ilmenite ore is around 8.0 million tonnes which is equivalent to a market of around 4-4.5 million tonnes of titanium dioxide per year. Growth has been at rates of around 2-3 % per annum on a long run basis. Pricing of ilmenite has been resilient as might be expected in an industry with such a tight supply base.

While pricing tends to follow the level of contained titanium dioxide, there is some differentiation in the market based on quality and lack of contaminants.

Figure 1 : Ilmenite feedstock price for chloride process - 60% TiO2 (US$ per tonne)

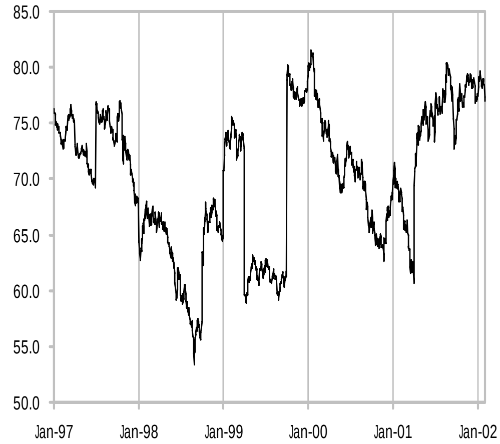
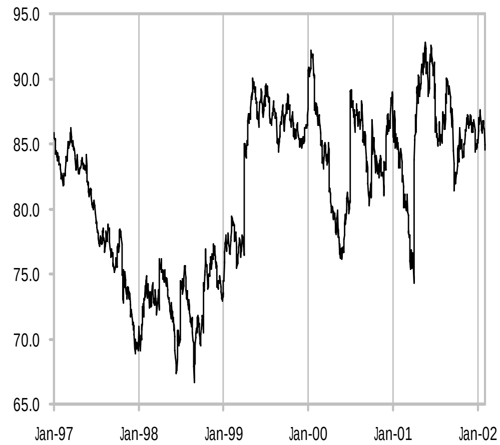


Figure 2 : Ilmenite feedstock price for sulphate process - 54% TiO2 (US$ per tonne)



There are two main processing routes to process ilmenite into titanium dioxide pigment, a chloride process and a sulphate process. Preliminary testwork suggests that Moma can supply both these markets. Moreover, Kenmare's product can also be used to produce a titanium slag - a process route that produces a high value TiO_2 feedstock and pig iron as a by-product.

Kenmare believes that it has identified a window of supply shortfall in 2004 that will allow it to enter the market in that year. Assuming an output of 0.6m tonnes of ilmenite per annum, Kenmare's Moma project will add an additional 7% to the market.

VALUATION

A definitive feasibility study was successfully completed by GRD Minproc on the Moma project in early 2001. This took into account full costing and cash flow analysis. A NPV (net present value) for the project was generated using the forecast capital costs, and assuming no gearing and a discount rate of 10%, the project had a NPV of US$205m.

Using the ilmenite product suite produced by Moma, the model produces an average revenue line of around US$80m per annum. Operating costs were assumed at US$22m per annum with cash margins of circa 70% over the life of the project.

Moma will be taxed according to one of two revenue streams produced. Mining activities will be subject to income tax of 17.5% in the initial 10 year period of production and 35% thereafter, together with a royalty of 3% based on minerals sold. Import and export taxes and VAT are exempted. Processing activities will be covered by an Industrial Free Zone scheme and will be exempted from import and export taxes, VAT and other corporate taxes. A turnover tax of 1% is charged after six years of operation.

The NPV produced is equivalent to a value per share of Stg75p. This compares with a current market value of Stg15.75p. The difference between the imputed price and the current market price has to be the risk factor that the market believes to be appropriate for this project.

We believe the difference in price is too much because:

- The reserves used in the definitive feasibility study are only about 20% of the overall resource.
- Those concerned with country risk should look at the success of the Mozal aluminum smelter investment by BHP Billiton in Maputo, the capital of Mozambique, where plans are underway for a significant expansion.

The 'small company big project ' factor is a fact of life and does contain inherent risks. However based on the difference between the value of the project - as implied by the NAV calculation, and the market price, there is a large risk factor already built in. As the project makes progress this risk factor should reduce materially.

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