

Kenmare Resources

Rating
Neutral

Target Price
30p

Date: 5th February 2014

IRELAND

Basic Resources

Kenmare Resources – Forecast revisions following mine visit

We have revised our Kenmare FY14 forecasts following a mine visit. Power dips due to overloading on the Mozambican grid, developments in mineral sands markets and the company's ability to reschedule its debt coming due in FY15 are the most significant FY14 challenges. Management is likely to reach agreement with its lenders on debt rescheduling during Q114. However, power dip issues are likely to persist until at least Q115. We also believe mineral sands price weakness could take longer than expected. As a result, we have trimmed our FY14 production and pricing forecasts for KMR. In the short term, mineral sands pricing is likely to continue to weigh on the share price. Continued price weakness may also lead to balance sheet pressure. We do not rule out a further capital raise as a possibility. We retain our NEUTRAL recommendation and our DCF based TP of 30p per share.

Market Cap
£457.9m

Current Price
16.46p

YTD abs perf (%)	(21)
12 mth abs perf (%)	(55)
52 week high/low (p)	38/16.1

Operational improvements evident, power stability a challenge

Management has made progress in addressing operational issues that have affected production to date. These include changes to mine planning (to anticipate changes to the ore body) and a reduction in recovery time post power failure/dips. The installation of a dip doctor in FY 2013 has largely eliminated short duration dips. However, there has been an increase in the frequency of longer duration dips than the dip doctor is designed to address. Management believes that this is due to a higher than expected growth in demand leading to peak usage sometimes exceeding installed capacity. Kenmare is working with the state utility to address this. It does not expect a definitive solution until at least Q115. As a result, we have trimmed our FY14 ilmenite production forecast by 3% to 1.02mt and our zircon production forecast by 11% to 40kt.

Market weakness persists

The short term market outlook for mineral sands remains challenging. There has been an increase in sales volumes with Q413 and Q114 sales volumes significantly higher than Q313. Industry commentators expect some pricing recovery during H214. However, we see market headwinds as significant. The increase in sales volumes has yet to translate into improved pricing ahead of the spring decoration season. Economic data (e.g. Chinese PMI, US Housing) has been lacklustre. As a result, we see market weakness continuing for longer than industry commentators suggest, at least until Q414/Q115. As a result, we have reduced our FY14 average ilmenite price by 7% to \$195 per tonne. Our zircon pricing is unchanged at \$950 per tonne.

Balance sheet risk

Kenmare is negotiating with its lenders to restructure debt due in Q315 as it presents a short term cash flow risk. This may present temporary relief for Kenmare. However we believe a more permanent solution will be required if current market weakness continues. As such, due to the uncertain pricing environment, we do not rule out a capital raise as a possibility.

Year ended Dec	12	13f	14f
Revenue (US\$m)	235	168	251
EBITDA (US\$m)	102	23	78
EBITDA Margin	43%	14%	31%
Net profit (US\$m) (adj)	49.5	(41.0)	16.6
EPS (dil)(USc/sh adj)	2.00	(1.55)	0.58

Source: Company data, Merrion estimates

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Kenmare Resources – Financial forecasts

	2012	2013	2014	2015	2016
Income Statement					
Ilmenite prod (t)	567	720	1,010	1,190	1,200
Zircon prod (t)	44	31	40	65	65
Ilmenite price (\$/t)	290	225	195	250	250
Zircon price (\$/t)	2,400	1,000	1,400	1,450	1,451
Revenue	234,638	168,273	251,328	401,000	437,500
Cash operating costs	(132,575)	(145,007)	(173,135)	(178,329)	(183,679)
EBITDA	102,063	23,266	78,192	222,671	253,821
EBITDA Margin %	43%	14%	31%	56%	58%
Depreciation	(18,456)	(26,389)	(26,389)	(26,389)	(26,389)
Operating profit	83,607	(3,123)	51,803	196,282	227,432
Net Finance costs	(27,008)	(35,812)	(25,384)	(17,769)	(12,438)
Other	(3,812)	(381)	0	0	0
Profit before tax	52,787	(39,316)	26,420	178,513	214,994
Taxation/Royalties	(3,301)	(1,693)	(9,790)	(15,445)	(90,209)
Profit attributable to shareholders	49,486	(41,009)	16,630	163,068	124,785
Cashflow Statement					
Profit For the Year	52,787	(39,316)	26,420	178,513	214,994
Depreciation & Amortisation	18,456	26,389	26,389	26,389	26,389
Working capital changes	2,339	(23,928)	3,612	2,369	(1,163)
Other operating cash adjustments	28,787	31,544	15,594	2,324	(77,771)
Cashflow from operations	102,369	(5,311)	72,014	209,595	162,449
Net capital expenditure	(164,251)	(76,405)	(15,000)	(15,000)	(15,000)
Free cashflow	(61,882)	(81,716)	57,014	194,595	147,449
Cash flow from financing activities	53,156	83,114	(25,264)	(17,649)	(12,318)
Net change in net debt	(8,726)	1,398	31,751	176,946	135,131
Balance Sheet					
Fixed assets	889,689	964,707	952,765	941,376	929,987
Current assets	104,235	122,155	102,880	51,457	152,751
Total assets	993,924	1,086,862	1,055,645	992,833	1,082,738
Shareholder Equity	605,597	671,698	688,447	851,636	976,541
Debt	326,206	340,178	305,178	79,178	44,178
Provisions and other liabilities	9,326	23,116	23,116	23,116	23,116
Current liabilities	52,795	51,871	38,903	38,903	38,903
Equity and liabilities	993,924	1,086,862	1,055,645	992,833	1,082,738
Per share data					
Shares in issue (diluted)	2,473	2,650	2,846	2,846	2,846
EPS USc (diluted) (adj)	2.00	(1.55)	0.58	5.73	4.39
Valuation					
Net debt (US\$'000)	280,139	285,880	254,130	77,184	(57,948)
P/E (x)	19.0	(24.5)	65.0	6.6	8.7
P/Free cashflow	(13.9)	(10.5)	15.1	4.4	5.8
Accounting ratios					
ROIC	5.3%	-4.0%	1.6%	17.1%	12.0%
ROE	8.2%	-6.1%	2.4%	19.1%	12.8%

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