

# KEFI Minerals

Convertible issue

## Honing in on production

On 6 December, KEFI announced that it had arranged for project equity funding of the Tulu Kapi gold mine project in Ethiopia for both Q119 and Q219, and that activities are progressing to this end, including government indications that the handful of outstanding permits are still expected to be granted in December to allow for community resettlement and development. The announcement also reports completion of the project due diligence for the US\$160m bond/lease proposal (see previous notes) and follows KEFI's announcement, on 28 Nov, that it had entered into an up to £4.0m secured convertible loan facility to underpin parent company working capital as it triggers the development of the project in Q119.

Year end	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
12/16	0.0	(2.5)	(1.6)	0.0	N/A	N/A
12/17	0.0	(3.6)	(1.2)	0.0	N/A	N/A
12/18e	0.0	(3.8)	(0.9)	0.0	N/A	N/A
12/19e	0.0	(11.6)	(0.9)	0.0	N/A	N/A

Note: \*PBT and EPS are normalised, excluding amortisation of acquired intangibles, exceptional items and share-based payments.

## Overall funding plan

While KEFI continues to assemble the majority of funding for development of Tulu Kapi at the project level, it has steadied the parent company's working capital capacity ahead of the project launch. It has also further augmented its working capital flexibility by arranging to pay some service providers in equity at 2p/share.

## Valuation: 7.21p, or 5.27p with full facility conversion

Before the announcement of its convertible facility, we calculated that Tulu Kapi was capable of generating free cash flow of c £41.7m a year for seven years from FY21–27, and paying average (maximum potential) dividends of 2.15p/share for the six years from FY23–28. We valued this stream of dividends at 7.21p/share (at a 10% discount rate) as at 1 January 2019, rising to 10.56p/share in FY23, when we estimated the first potential dividend could be paid. This remains ostensibly unchanged if the facility is considered as conventional debt. However, it reduces to 5.27p/share with 794.2m shares in issue assuming the drawdown and conversion of the full facility (albeit with a maximum net debt requirement reduced by almost £4.0m, from £69.4m to £65.7m, when all components of the financing are considered, whether on- or off-balance sheet). Note that this valuation rises to 9.68p if KEFI is successfully able to leverage its cash flow from the mine into its other assets in the region (vs 13.30p previously). Stated alternatively, assuming full drawdown, we estimate an investment in KEFI shares on 1 January 2019 at a price of 1.43p could generate an internal rate of return to investors of 36.7% over the 11 years to 2029 in sterling terms. A median scenario would be to assume drawdown of £3m and the conversion of half of that amount into shares, in which case our valuation reduces to 6.11p/sh with an assumed 666.7m shares in issue. Combined with the convertible facility, the planned imminent transfer of development funding obligations from KEFI down to project level is intended to provide flexibility to KEFI so that it may minimise risk as well as minimising share dilution.

## Metals & mining

6 December 2018

**Price** **1.4p**
**Market cap** **£8m**

US\$1.2761/£

Net cash (£m) at 30 June 2018 0.5

Shares in issue 552.7m

Free float 94.8%

Code KEFI

Primary exchange AIM

Secondary exchange N/A

## Share price performance



%	1m	3m	12m
Abs	(8.7)	(23.2)	(61.6)
Rel (local)	(8.8)	(16.1)	(58.9)

52-week high/low 10.9p 4.1p

## Business description

KEFI Minerals is an exploration and development company focused on gold and copper deposits in the highly prospective Arabian-Nubian Shield – principally the Tulu Kapi project in Ethiopia and, to a lesser extent, the Jibal Qutman project in Saudi Arabia.

## Next events

Closing of project equity investment	December 2018
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General meeting	17 December 2018
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Community resettlement	Q119
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Engineering and procurement	Q119
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Construction start	H119
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## Analyst

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## Project update

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On 6 December, KEFI announced that it has arranged for project equity funding of the Tulu Kapi gold mine project in Ethiopia for both Q119 and Q219, and that activities are currently progressing apace, including government indications that the handful of outstanding permits are still expected to be granted in December in order to allow community resettlement and development activities to commence. The announcement also reported completion of the project due diligence for the non-equity project finance of the US\$160m bond/lease proposal.

## Overall funding plan

While KEFI continues to assemble the majority of funding for the development of Tulu Kapi at the project level, it has also steadied the parent company's working capital capacity as it prepares to launch the project (see £4m secured convertible loan facility, below). New project equity of US\$50–58m has been committed by Ethiopian partners, the government and ANS Mining. Non-equity funding has been conditionally arranged with a bond arranger for US\$160m and Ausdrill for in excess of US\$50m of mining equipment. KEFI itself has also arranged some additional working capital flexibility by arranging to pay some service providers with shares at 2p/share as well as by arranging the secured convertible loan facility.

## £4m secured convertible loan facility

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KEFI's update follows its announcement, on 28 November, that it had entered into an up to £4.0m secured convertible loan facility with a longstanding institutional shareholder with c 1.11% of the company's equity. The loan facility will underpin KEFI by providing much needed flexibility in managing the working capital of the group, while triggering the development of the Tulu Kapi Gold Mine (TKGM) in Ethiopia at the start of FY19.

While community resettlement and initial development jobs are to be funded at the project level by KEFI subsidiary TKGM share issues to local Ethiopian investors, this proposed, parent company working capital arrangement provides capacity for the group. Among other things, it will provide KEFI with the hard currency funds to enable the parent company to fund the procedural and documentary closing of the US\$260m project financing package for TKGM. Any amounts drawn under the secured loan must be repaid upon drawdown of the TKGM project finance debt.

Otherwise, all that remains for the project to proceed is the conclusion of the remaining Ethiopian government processes and approvals during December, so that the project can commence, and formal documentation of the debt so that it can close – all of which KEFI reports to be “proceeding well”.

## Terms and conditions

KEFI is not obliged to draw down the facility. On account of the fees paid by KEFI in shares at 2p or higher, any amount drawn down is not subject to interest payments. Amounts drawn are repayable after one year or, by agreement with the lender, 18 months. KEFI has the right to repay the facility at any time in cash. By the same token, the lender has the right to convert any amounts outstanding into shares at a price of 2p and, if KEFI moves to repay the loan itself, the lender has the right to ask for 50% of the repayment to be in shares at 2p, rather than cash.

In the worst case scenario, we calculate this would involve the issue of an additional 241.5m shares (£4.0m outstanding all converted at an equity price of 2p plus £830,000 in fees, again all converted at 2p).

KEFI management has indicated that it is targeting drawdown of the full project financing in Q219 and it will therefore repay any loan outstanding at that point. This could result in the issue of up to 114m new shares (Edison calculation), based on KEFI's drawing £3m of the loan and repaying it at end-Q219, half in shares and half in cash plus £0.78 in fees paid in shares.

## **Valuation: 7.21p, or 5.27p with full facility conversion**

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Before the announcement of its convertible facility, we calculated that Tulu Kapi was capable of generating free cash flow of c £41.7m a year for seven years from FY21–27, and paying average (maximum potential) dividends of 2.15p/share for the six years from FY23–28. We valued this stream of dividends at 7.21p/share (at a 10% discount rate) as at 1 January 2019, rising to 10.56p/share in FY23, when we estimated the first potential dividend could be paid. This remains ostensibly unchanged (except for slight dilution by shares issued for fees) if the facility is not drawn down or if it is fully repaid in cash (ie it is considered as conventional debt).

The worst case scenario would be to assume the drawdown of all £4m and the conversion of the entire amount into shares, in which case our valuation reduces to 5.27p/share with an assumed 794.2m shares in issue (albeit with a maximum net debt requirement reduced by almost £4.0m, from £69.4m to £65.7m, when all components of the financing are considered, whether on- or off-balance sheet).

A median scenario would be to assume drawdown of £3m and the conversion of half of that amount into shares, in which case our valuation reduces to 6.11p/sh with an assumed 666.7m shares in issue.

Note that our worst case 5.27p/share valuation rises to 9.68p if KEFI is successfully able to leverage its cash flow from the mine into its other assets in the region (vs 13.30p previously). Stated alternatively, assuming full drawdown and conversion, we estimate an investment in KEFI shares on 1 January 2019 at a price of 1.43p could generate an internal rate of return to investors of 36.7% over the 11 years to 2029 in sterling terms.

**Exhibit 1: Financial summary**

£000s	2013	2014	2015	2016	2017	2018e	2019e	2020e
December	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
<b>PROFIT &amp; LOSS</b>								
Revenue	0	0	0	0	0	0	0	33,150
Cost of Sales	(927)	(2,071)	(1,634)	(2,260)	(3,522)	(3,204)	(3,365)	(25,994)
Gross Profit	(927)	(2,071)	(1,634)	(2,260)	(3,522)	(3,204)	(3,365)	7,157
EBITDA	(927)	(2,071)	(1,634)	(2,260)	(3,522)	(3,204)	(3,365)	7,157
Operating Profit (before amort. and except.)	(927)	(2,189)	(1,724)	(2,315)	(3,546)	(3,210)	(3,371)	7,150
Intangible Amortisation	0	0	0	0	0	0	0	0
Exceptionals	(442)	(379)	(428)	1,944	(2,359)	(91)	0	0
Other	0	0	0	0	0	0	0	0
Operating Profit	(1,369)	(2,568)	(2,152)	(371)	(5,905)	(3,301)	(3,371)	7,150
Net Interest	4	(413)	(319)	(136)	(75)	(589)	(8,200)	(10,626)
Profit Before Tax (norm)	(923)	(2,602)	(2,043)	(2,451)	(3,621)	(3,799)	(11,571)	(3,476)
Profit Before Tax (FRS 3)	(1,365)	(2,981)	(2,471)	(507)	(5,980)	(3,890)	(11,571)	(3,476)
Tax	0	0	0	0	0	0	0	0
Profit After Tax (norm)	(923)	(2,602)	(2,043)	(2,451)	(3,621)	(3,799)	(11,571)	(3,476)
Profit After Tax (FRS 3)	(1,365)	(2,981)	(2,471)	(507)	(5,980)	(3,890)	(11,571)	(3,476)
Average Number of Shares Outstanding (m)	29.0	56.0	92.8	194.9	315.3	442.7	673.5	794.2
EPS - normalised (p)	(7.4)	(6.2)	(3.0)	(1.6)	(1.2)	(0.9)	(0.9)	(0.2)
EPS - normalised and fully diluted (p)	(7.4)	(6.2)	(3.0)	(1.5)	(1.1)	(0.8)	(0.9)	(0.2)
EPS - (IFRS) (p)	(4.7)	(5.1)	(2.7)	(0.3)	(1.9)	(0.9)	(0.9)	(0.2)
Dividend per share (p)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Gross Margin (%)	-	-	-	-	-	-	-	-
EBITDA Margin (%)	-	-	-	-	-	-	-	-
Operating Margin (before GW and except.) (%)	-	-	-	-	-	-	-	-
<b>BALANCE SHEET</b>								
Fixed Assets	7,152	9,299	11,926	14,053	16,275	18,835	29,754	110,116
Intangible Assets	6,900	9,139	11,845	13,992	16,232	18,518	18,518	18,518
Tangible Assets	252	160	81	61	43	41	10,960	91,322
Investments	0	0	0	0	0	276	276	276
Current Assets	4,014	1,061	1,012	3,561	1,047	164,573	160,366	88,917
Stocks	0	0	0	0	0	0	0	1,381
Debtors	655	335	358	3,056	94	258	0	182
Cash	3,279	640	562	410	466	163,828	159,879	86,867
Other	80	86	92	95	487	487	487	487
Current Liabilities	(3,363)	(3,202)	(1,995)	(2,067)	(2,852)	(2,852)	0	(1,928)
Creditors	(3,363)	(3,202)	(1,995)	(2,067)	(2,852)	(2,852)	0	(1,928)
Short term borrowings	0	0	0	0	0	0	0	0
Long Term Liabilities	0	0	0	0	0	(125,392)	(142,074)	(152,534)
Long term borrowings	0	0	0	0	0	(125,392)	(136,039)	(147,603)
Other long term liabilities	0	0	0	0	0	0	(6,034)	(4,931)
Net Assets	7,803	7,158	10,943	15,547	14,470	55,164	48,046	44,570
<b>CASH FLOW</b>								
Operating Cash Flow	(1,424)	(2,006)	(2,729)	(2,211)	(51)	(3,380)	(5,959)	7,522
Net Interest	4	(413)	(319)	(136)	(75)	(589)	(8,200)	(10,626)
Tax	0	0	0	0	0	0	0	0
Capex	(877)	(3,133)	(3,507)	(3,014)	(2,625)	(2,776)	(10,925)	(80,369)
Acquisitions/disposals	(1,083)	(750)	0	16	0	0	0	0
Financing	4,735	3,663	6,480	5,192	2,807	44,715	4,444	0
Dividends	0	0	0	0	0	0	0	0
Net Cash Flow	1,355	(2,639)	(75)	(153)	56	37,970	(20,640)	(83,473)
Opening net debt/(cash)	(1,924)	(3,279)	(640)	(562)	(410)	(466)	(38,436)	(17,805)
HP finance leases initiated	0	0	0	0	0	0	0	0
Other	0	0	(3)	1	0	0	10	0
Closing net debt/(cash)	(3,279)	(640)	(562)	(410)	(466)	(38,436)	(17,805)	65,668

Source: KEFI Minerals, Edison Investment Research

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