Update | Resource companies

21 April 2016

Central Asia Metals

Defending the dividend

Central Asia Metals (CAML) annual results release confirm that the company recorded another profitable year in 2015 and has maintained its dividend for the year at 12.5p. With a dividend yield of 7.1% at the current share price, we view CAML as an attractive investment for yield investors.

It is a measure of the robustness of the company's business that it has remained profitable ever since commencing operations, despite a downward trend in the copper price, which led to six-year lows in 2015.

CAML's main asset is its Kounrad copper dump treatment operation, in Kazakhstan, which produces copper through an SX-EW plant without the need for expensive mining.

In 2015, Kounrad increased production by over 8%, to 12,071 t and reduced its already low unit costs by 3%, firmly establishing its position as one of the lowest cost copper producers in the world. The company earned US20c per share against comparable earnings of US25c per share in 2014.

After completing an expansion of its plant in 2015, CAML expects to increase copper production to 13,000-14,000 t in 2016. Work to access resources in the Western dumps, which will allow operations to continue through to 2034, has commenced.

The company had cash of US$42 million and no debt at the end of 2015.

Year	Cu prod (kt)	Cash costs (US$/lb)	Rev. (US$M)	EBITDA (US$M)	EBITDA margin (%)	EPS (USc)
2015	12.1	0.60	67.3	34.9	52	20.1
2016f	13.4	0.60	67.3	35.3	52	14.6
2017f	14.2	0.65	77.9	31.6	47	13.3

Source: Marten & Co

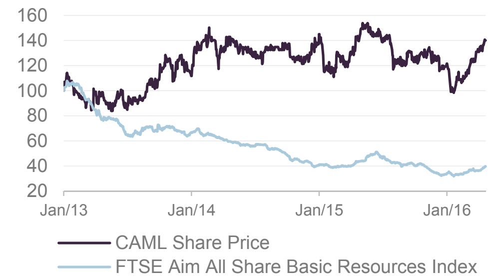
Valuation summary

CAML shares are currently trading at 176.62p, with significant upside potential compared with our net asset valuation of 197.5p per share.

Listed	LSE
Ticker	CAML LN
Base currency	GBP
Price	176.62
Daily volume (1-year avg)	127k shares
1-year high	194.0
1-year low	124.0
1-month performance (%)	11.8
3-month performance (%)	41.3
1-year performance (%)	(2.4)
Calendar YTD performance (%)	15.2
Current yield (%)	7.1

Perf. vs Aim Basic Res. rebased

Time period: January 2013 to April 2016



Source: Bloomberg

Net cash (US$ million)	42.0
NAV$^{8\%}$ per share	197.5p
Price/NAV	89%
Market cap (£ million)	198.0
Shares outstanding (million)	112.1

Click here for our initiation note

2015 results

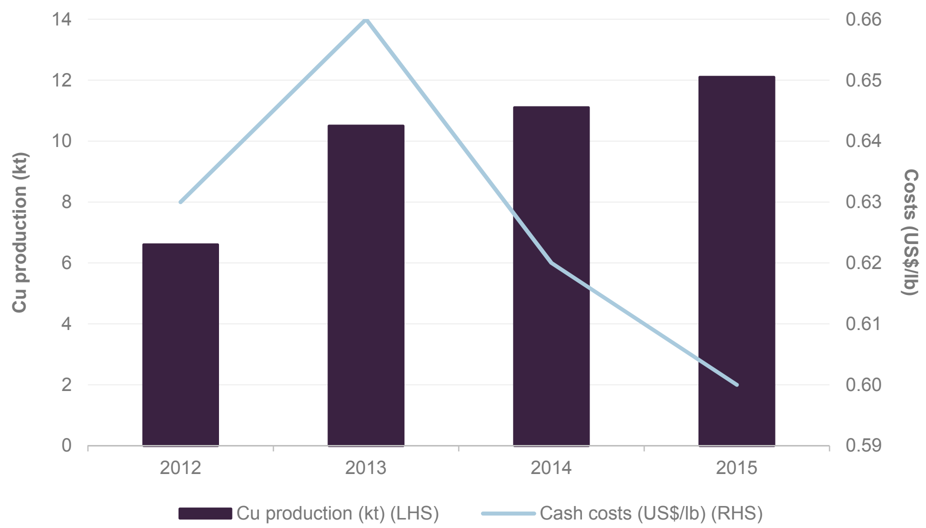
CAML released its 2015 annual results on 11 April 2016.

In 2015, CAML produced a record 12,071 t (12.1 kt) of copper from its Kounrad operation, an improvement of 8% on 2014.

On a unit of production basis, C1 cash costs were US$0.60/lb in 2015, a reduction of 3% from 2014, owing to a decrease in the fixed buyer's fee on copper cathode sales and a devaluation in the Kazakh currency.

Copper production and cash costs since start-up of operations at Kounrad are shown in Figure 1.

Figure 1: Annual copper production and costs



Source: Central Asia Metals

The company has adopted an industry standard for defining its C1 cash costs and now reports them inclusive of local administration expenses and before Kazakhstan mineral extraction tax.

The company sold a total of 12,040 t of copper in 2015 (up 8% on 2014), the majority in terms of its offtake agreement with international commercial services group, Traxys, at an average price of US$5,336/t, 21% lower than in 2014. Consequently, gross revenue decreased by 12% to US$67.3 million.

EBITDA for the year was US$34.9 million, down from US$47.3 million.

With its final dividend, CAML will have distributed US$74 million to shareholders, significantly in excess of the US$60 million raised at its 2010 initial public offering (IPO).

CAML earned US$22.2 million in 2015 against a figure of US$59.5 million in 2014, when the results benefited from a one-off non-cash gain of US$33.0 million, arising from the revaluation of CAML's initial 60% stake in Kounrad when it consolidated ownership to 100%. The 2015 figure includes a foreign exchange rate gain of US$9.0 million. Earnings per share were US20.2c (2014:US24.9c excluding the one-off gain).

The company intends to pay a final dividend of 8.0p, taking the total dividend for the year to 12.5p, identical to 2014, and equivalent to 30% of gross revenue.

Owing to an 85% devaluation of the tenge over the course of 2015, the company has recorded significant foreign exchange losses within fixed assets on its balance sheet, leading to a fall in total assets from US$216.3 million to US$133.1 million. As a further result of the tenge devaluation, the company has recognised a non-cash loss of US$77.4 million in shareholder equity.

As at 31 December 2015, the company had cash of US$42.0 million and no debt.

2016 forecast production

In Q1 2016, Kounrad achieved copper production of 3,207 t, which is 36.5% higher than the corresponding period of 2015. The increase reflects the completion of the expansion of the SX-EW plant in Q2 2015 as well as milder winter conditions.

Copper production is expected to rise to between 13,000 t and 14,000 t in 2016.

The company is on track to achieve its 2016 production guidance of between 13,000 t and 14,000 t of copper.

Update on Kounrad expansion

CAML expanded the SX-EW plant by 50% in 2015 and it is now fully operational. In March 2016, the company commenced groundworks on the US$19.5 million second stage of the expansion programme, which will enable it to leach copper from the larger resource within the Western dumps. The 12 km, 10 kilovolts (kv) overhead power line and substation are complete, and a significant portion of process equipment and pipes has been delivered to site.

Stage 2 expansion is on track and being funded from cash flow.

The company expects to produce the first copper from the Western dumps in H1 2017.

CAML is also looking at ways to extract some of the residual copper in the Eastern dumps, once primary operations move to the west, through an intermediate leaching system.

Copper Bay progress

CAML has a 75% interest in private company, Copper Bay Limited (Copper Bay), which is evaluating the potential to process beach-deposited copper tailings at Chañaral, in northern Chile.

A definitive feasibility study on Copper Bay is expected by end-2016.

In 2015, CAML injected US$3 million into the company to enable it to undertake a definitive feasibility study, which is on schedule for completion in late 2016.

The study will focus on reducing the initial capital investment (estimated at US$88 million in the 2015 pre-feasibility study (PFS)) and lowering life-of-mine operating costs, which were estimated at US$1.34/lb in the PFS.

Board changes

Nigel Hurst-Brown is stepping down as chairman and current chief executive officer, Nick Clarke, will assume the role of executive chairman. Mr Hurst-Brown will remain on the board as a non-executive director in the role of deputy chairman.

In addition, technical director, Howard Nicholson, will be stepping down from the board. Importantly though, Mr Nicholson will remain with the company as an employee and will continue to oversee delivery of the Western expansion programme at Kounrad.

Meanwhile, Gavin Ferrar, business development director, will be appointed to the board.

All board changes will take place at the conclusion of the company's AGM on 8 June 2016.

Valuation

We value CAML on a sum-of-the-parts basis, taking into account the NPV of the Kounrad operation. We treat Copper Bay as an investment and value it on the basis of CAML's investment thus far of US$6.2 million.

CAML shares have significant upside potential from current levels compared with our net asset valuation of 197.5p per share.

Figure 2: Valuation model for CAML

	US$M	£M**	GBP/s
Kounrad NPV$^{8\%*}$	273	188	167.9
Investments (Copper Bay)	6	4	3.8
Cash	42	29	25.8
NAV	321	221	197.5

Source: Marten & Co * NPV discounted at 8% ** at US$1.45/£

Kounrad operations

After a temporary disruption to operations in the middle of 2015 - due to the failure of a piece of equipment in the plant – copper production improved in the second half of the year to reach a record in Q4, as a result of the higher capacity with the completion of the Stage 1 expansion and mild winter temperatures, which allowed higher pregnant leach solution (PLS) flow rates and grade.

After four years of operations, the company has collected data that indicates that leach times through the Eastern dumps are longer than originally projected (240 days against 180 days). Nevertheless, management is confident that with an increased area of dump being leached, it has enough flexibility within the process to achieve targeted production for the current year.

We have modelled copper production of 13.4 kt at a cash cost of US$0.60/lb for 2016.

Q1 is historically the lowest production quarter of the year, but Q1 2016 production was up over 36% from Q1 2015 to 3.2 kt, suggesting that the company's output target for the year of 13-14 kt is achievable. We have modelled output for 2016 at roughly the midpoint of the company's guidance.

Unit costs in 2015 averaged US$0.60/lb and after discussions with company, we feel that costs, given the increase in production, will be held at that level in 2016. We have reduced fully-absorbed unit costs in the future to reflect a lower depreciation charge after management extended the useful economic life of certain assets and the fair value uplift on the 2014 Kounrad transaction after receiving approval for the Stage 2 expansion. The company has extended the original useful life of 10 years through to 2034, which represents the end of the subsoil use licence.

Meanwhile, our NPV for Kounrad assumes that the company achieves first production from the Western dumps in 2017 and successfully brings them into full production in 2018 as activities at the Eastern dumps wind down.

We model copper production increasing in 2016, 2017 and 2018 before settling back to a steady rate of just under 13 kt/y until the licence expires in 2034.

Based on the market discussion below, we maintain our copper price forecasts from our initiation note of 24 February 2016, and use a price of US$5,000/t (US$2.27/lb) in 2016; US$5,500/t (US$2.50/lb) in 2017; and thereafter a long-term price of US$6,600/t (US$3.00/lb).

Copper Bay project

We value CAML's investment in Copper Bay at the cost of acquisition of its 75% interest, which is US$6.2 million. A definitive feasibility study is scheduled for the end of 2016 and its completion should provide much more certainty regarding the economics of the project. Assuming that CAML then makes the decision to develop Copper Bay, we will move our valuation methodology to a DCF based approach.

Based on the PFS, the project could commence operations in 2019, treating up to 5 Mt/y to produce 8.2 kt/y of copper for seven years for a capital cost of US$88 million.

Dividend

The company's decision to pay a final 2015 dividend of 8p per share (30% of Kounrad revenue), taking the total for the year to 12.5p (the same as 2014), is surprising given the high capital expenditure planned for the Western dumps, at Kounrad this year, and the uncertainty in the copper market. That said, we do not think it is imprudent and consider it is laudable in the current market.

Maintaining its dividend policy is of paramount importance to CAML and will dictate any future project developments.

According to chief executive Nick Clarke, maintaining the dividend policy is key to strategic planning, and he has confirmed that the company will not consider any financing plans (for Copper Bay) that jeopardise its dividend policy.

We believe that the company will have enough cash after the capital expenditure programme required to access the Western dumps at Kounrad in 2016 to maintain its dividend at 12.5p per share. In 2017 and 2018 we expect a dividend of between and 12p and 13p per share.

Sensitivity analysis

We have analysed the sensitivity of our NAV estimate for CAML to changes in the key variables: copper price and discount rate.

Because of its low cost of production, the company should continue to generate free cashflow, even at prices 30% below our base case price of US$6,600/t (long term) as shown in our sensitivity analysis in Figure 3.

The company's NAV is relatively insensitive to downside risk in copper prices.

Figure 3: NAV sensitivity analysis (GBP per share)

	Copper price (US$/lb)						
Discount rate	**-30%**	**-20%**	**-10%**	**Base**	**+10%**	**+20%**	**+30%**
5%	127	164	200	237	273	310	346
8%	108	138	168	198	228	257	287
10%	98	124	151	177	204	230	257
12%	89	113	137	160	184	208	231

Source: Marten & Co Assumptions: US$1.45/£; shares outstanding 112.1 million

Update on the copper market

Copper prices collapsed last year and after averaging US$5,510/t for the year, fell to a near seven-year low of US$4,138/t in mid-January 2016.

Since that low, prices have recovered by approximately 17%, to around US$4,850/t.

According to the GFMS Copper Survey 2016, the copper market in 2015 reported a small surplus for the fourth year in a row. GFMS estimated refined production at 22.2 Mt against consumption of 21.9 Mt.

Despite a number of high-profile mine closures in 2015, copper supply continued to rise from 21.7 Mt in 2014 to 22.2 Mt in 2015. Primary mine production (excluding secondary copper from recycling) rose 3%, to 18.7 Mt in 2015.

Turning to refined consumption, continued growth in demand from China and to a lesser extent from the US, offset a marginal decline in European consumption, so that the market grew by just over 1%. Chinese demand accounted for 46% of global demand.

Looking forward, demand is expected to continue to rise, albeit at a slower pace than in recent years. Mine supply is expected to increase again in 2016 as expansion projects at existing mines come to fruition and mines that started in the last few years ramp up to full capacity.

Copper prices are expected to remain soft until 2018.

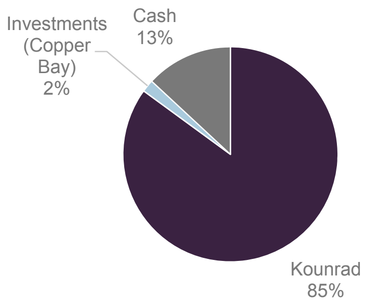
Within a couple of years, however, the situation is expected to change to a more positive environment for prices as mine grades continue to fall (reducing output) and prospective new, high-capital-intensity projects struggle to secure the necessary financing.

In summary, copper prices are expected to remain soft until 2018.

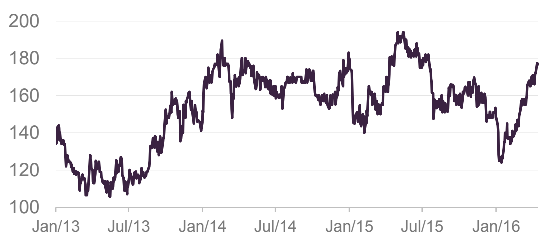
Figure 4: Central Asia Metals summary

Sum-of-the-parts valuation – April 2016	US$M	Pence per share
Kounrad NPV[8%]	292	180
Investments (Copper Bay)	6	4
Subtotal	279	172
Net cash/(debt)	42	26
NAV	321	198

Asset valuation summary



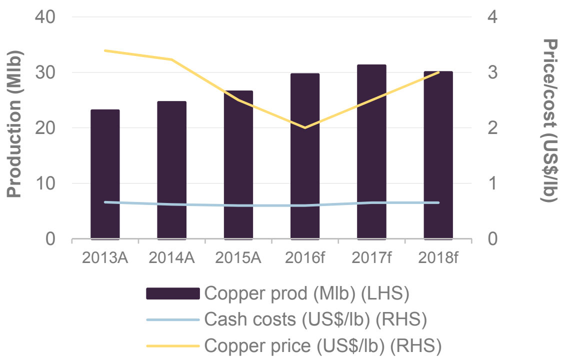
CAML share price



NAV sensitivity analysis (pence per share)

Disc. rate	-30%	-20%	-10%	Base	10%	20%	30%
5%	127	164	200	237	273	310	346
8%	108	138	168	198	228	257	287
10%	98	124	151	177	204	230	257
12%	89	113	137	160	184	208	231

Production summary



Copper resources (2013)	Mt	Cu %	kt
Kounrad			
Indicated	386.0	0.10	368.2
Inferred	261.1	0.09	246.0
Copper Bay			
Indicated	42.6	0.24	101.2
Inferred	5.4	0.23	18.8

Y/E 31 December, all figures in US$ million unless otherwise stated

Forecast assumptions	2014	2015	2016f	2017f	2018f
Copper price (US$/t)	7,114	5,510	5,000	5,500	6,600
Copper price (US$/lb)	3.23	2.50	2.27	2.50	3.00

Production summary	2014	2015	2016f	2017f	2018f
Kounrad					
Average flow rate (1,000l/hr)	771	784	930	1,000	1,000
PLS grade (Cu g/l)	2.24	2.30	2.20	2.20	2.10
Recovery (%)	73.5	75.0	75.0	75.0	75.0
Copper production (kt)	**11.1**	**12.1**	**13.4**	**14.2**	**13.6**
Cash costs (US$/lb)	0.62	0.60	0.60	0.65	0.65
Fully-absorbed costs (US$/lb)	1.65	1.58	1.38	1.43	1.47
Copper Bay					
Tonnes treated (kt)	-	-	-	-	-
Grade (Cu%)	-	-	-	-	-
Cathode production (kt)	-	-	-	-	-
Copper in concentrate production (kt)	-	-	-	-	-
C1 cash costs (US$/lb)	-	-	-	-	-
Fully-absorbed costs (US$/lb)	-	-	-	-	-
Company					
Total copper production (t)	**11.1**	**12.1**	**13.4**	**14.2**	**13.6**
Cash costs (US$/lb)	**0.62**	**0.60**	**0.60**	**0.65**	**0.65**
Fully-absorbed costs (US$/lb)	**1.65**	**1.58**	**1.38**	**1.43**	**1.47**

Profit & loss summary	2014	2015	2016f	2017f	2018f
Revenues	**76.6**	**67.3**	**67.3**	**67.2**	**77.9**
Cost of production	(9.4)	(10.4)	(11.9)	(14.1)	(14.1)
Mineral extraction tax	(4.4)	(3.8)	(3.8)	(4.4)	(5.1)
Selling costs	(3.9)	(2.9)	(2.9)	(3.1)	(3.3)
G&A	(11.9)	(14.1)	(13.4)	(14.0)	(13.5)
EBITDA	**47.1**	**34.9**	**35.3**	**31.6**	**42.0**
Depreciation & amortisation	(11.3)	(10.3)	(8.0)	(8.0)	(8.0)
Interest	(0.3)	(0.3)	0.0	0.0	0.0
Taxation	(10.5)	(10.4)	(10.4)	(8.2)	(10.1)
Other	33.0	8.0	0.0	0.0	0.0
Net income	**59.4**	**22.2**	**16.6**	**15.4**	**23.9**
Average shares outstanding (million)	106.1	111.7	112.1	112.1	112.1
EPS (US$)	**0.56**	**0.20**	**0.15**	**0.13**	**0.21**
Dividend (pence per share)	12.5	12.5	12.5	12.0	13.0

Abridged balance sheet Y/E	2014	2015	2016f	2017f	2018f
Cash & equivalents	46.1	42.0	29.5	24.9	30.1
Fixed assets	162.7	85.3	92.9	92.9	92.9
Total assets	216.2	133.1	126.9	125.3	130.5
Current liabilities	4.7	6.3	5.5	5.5	5.5
Long-term debt	0.0	0.0	0.0	0.0	0.0
Other long-term liabilities	23.7	12.2	12.0	12.0	12.0
Total liabilities	**28.4**	**18.8**	**17.5**	**17.5**	**17.8**
Shareholders' equity	187.9	114.2	109.4	107.8	113.0

Cash flow summary	2014	2015	2016f	2017f	2018f
Cash from operations	30.5	23.5	22.4	20.9	29.4
Cash from investing activities	(10.8)	(7.3)	(17.2)	(3.0)	(3.0)
Cash from financing activities	(15.7)	(20.6)	(20.3)	(19.5)	(21.1)
Net cash at end	46.2	42.0	26.5	24.9	30.1

Profitability	2014	2015	2016f	2017f	2018f
EBITDA margin (%)	61.5	52.0	52.4	47.0	53.9

Note that financial tables above are summaries and totals may not always agree

Source: Central Asia Metals & Marten & Co

Previous research publications

Further information is available at the company's website: www.centralasiametals.com

Readers interested in further information about CAML may wish to read our initiation note of February 2016. Please click here. The contents are reproduced below.

Dividend-paying, low cost copper producer – 24 February 2015

Dividend-paying, low cost copper producer - continued

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