

KEFI Minerals

Convertible loan note restructuring

Refinanced and updated valuation

Metals & mining

21 August 2019

Price **1p**

Market cap **£7m**

US\$1.2112/£

Net debt (£m) at 31 December 2018 0.5

Shares in issue 706.8m

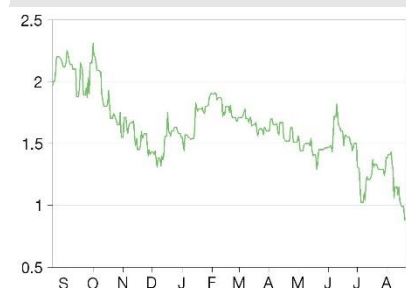
Free float 94.8%

Code KEFI

Primary exchange AIM

Secondary exchange N/A

Share price performance



% 1m 3m 12m

Abs (32.5) (30.1) (54.4)

Rel (local) (29.1) (28.3) (51.3)

52-week high/low 2.31p 0.88p

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

Community resettlement Mid-2019

Engineering & procurement Mid-2019

Construction start End-FY19

Closing of project infrastructure bond January 2020

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On 5 August, KEFI announced the restructuring of its £4m working capital convertible loan facility (of which £3.1m remained undrawn) into a new £1.5m facility, with £1.6m of the original convertible facility still remaining available to it. Importantly, neither the original loan facility nor the new loan facility will henceforward have any security attached to them, which will allow KEFI maximum flexibility in structuring the remaining portion of Tulu Kapi's funding, which could now potentially 'include a larger initial Project equity investment by Ethiopian private sector investor, ANS Mining Share Company'.

Year end	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
12/17	0.0	(3.6)	(1.2)	0.0	N/A	N/A
12/18	0.0	(4.6)	(1.0)	0.0	N/A	N/A
12/19e	0.0	(3.6)	(0.3)	0.0	N/A	N/A
12/20e	0.0	(9.0)	(0.5)	0.0	N/A	N/A

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

Assumptions and valuation updated

Apart from the terms of the new (unsecured) convertible loan facility (for which, see page 2), in updating our valuation, we have made three material changes to our erstwhile assumptions: 1) we have adjusted our gold price assumptions to those set out in our recent report [Portents of economic weakness: Gold – doves in the ascendant](#), published on 14 August 2019, 2) we have adjusted the forex rate downwards from US\$1.2706/£ to US\$1.2112/£ and 3) we have adjusted KEFI's share price – which affects the price at which conversion of the new loan facility is presumed to occur – from 1.53p to 0.90p.

Valuation: Share price offering up to 85.5% IRR

Assuming the full drawn down and conversion of KEFI's new £1.5m convertible loan facility (as well as the successful financing and execution of the project), we calculate that Tulu Kapi is capable of generating free cash flow of c £53.9m a year for seven years, from 2021 to 2027 inclusive (cf £48.0m pa previously). This, in turn, drives average (maximum potential) dividends of 1.11p/share for the nine years from 2021 to 2029 (cf 0.95p/share previously), which values KEFI at 5.50p/share (cf 4.70p/share previously) when discounted back to FY19 at a 10% discount rate. This implies a value for KEFI of £48m, or US\$58m, based on the dividend potential of Tulu Kapi alone. However, this ignores the exploration and development of the pipeline of targets in the KEFI portfolio. In the event that KEFI is ultimately successful in leveraging its cash flow from the mine into its other assets in the region, our valuation increases to 10.03p/share (cf 8.53p/share previously). Stated alternatively, we estimate an investment in KEFI shares currently at a price of 0.90p could generate an internal rate of return to investors equivalent to 85.5% per annum over 11 years to 2029 in sterling terms (cf 36.8% previously). In the meantime, investors can purchase shares in KEFI at a price that equates to just US\$7.65 per resource ounce (even after its minority partners' investment into the asset at project level).

Working capital convertible loan facility restructuring

On 5 August, KEFI announced the refinancing of its £4m working capital convertible loan facility (see our note, KEFI Minerals: [Honing in on production](#), published on 6 December 2018), the salient features of which are as follows:

- £0.9m of the original £4m convertible loan facility has been drawn down, of which £0.45m has been repaid, leaving £3.1m available under the terms of the original agreement. This remaining £3.1m has now been replaced in part by a new £1.5m facility (leaving up to £1.6m of the original convertible facility available – see below).
- The new loan facility may be drawn at KEFI's discretion at a rate of £0.5m per month in £0.25m tranches and, if drawn, is repayable in cash within two years in an amount of 105% of the principal amount plus a fee of 10% of the principal amount being repaid. There is no coupon attached to the new loan facility. In the meantime, it is convertible into new KEFI shares at the election of the provider at the lower of 90% of the lowest volume-weighted average share price of KEFI shares over the preceding three days or 2p.
- Once any amount drawn under the new loan facility has been repaid, the company will be able to draw from the remaining £1.6m of the original convertible loan facility, if required.

In consideration of the changes made to the working capital convertible loan facility, neither the original loan facility nor the new loan facility will henceforward have any security attached to them and both are therefore now provided on an unsecured basis, as a result of which KEFI has been released from all of its security encumbrances (other than minor cash security deposits), allowing it maximum flexibility for structuring the remaining financing of the Tulu Kapi gold project, which 'potentially could include a larger initial Project equity investment by Ethiopian private sector investor, ANS Mining Share Company'.

Cost

The direct cost of the changes in security and related arrangements to KEFI amount to £207,500 to be paid by the issuance of 8.5m new KEFI shares at 2p per share, together with a cash consideration of £37,500.

Aside from the direct cost, the most obvious indirect cost is that the new £1.5m facility is now convertible into equity at the lower of 90% of the lowest volume-weighted average share price of KEFI shares over the preceding three days or 2p, whereas under the original loan facility it would have only been convertible at 2p – thereby the new facility potentially entails additional dilution to existing shareholders, depending on the share price prevailing at the time of conversion.

In addition, the provider of the new facility is being issued with warrants to subscribe for 13m new ordinary KEFI shares at an exercise price of 2.5p per share for a period of three years, until August 2022. Note that, applying the Black-Scholes option pricing model to these warrants and assuming annual KEFI share price volatility of 75.8% and a continuously compounded annual risk-free interest rate of 0.51%, we value these warrants at 0.22p apiece currently.

Benefit

The benefit of the restructured facility is threefold:

- As stated previously, neither the original loan facility nor the new loan facility will henceforward have any security attached to them and both are therefore now provided on an unsecured basis, as a result of which KEFI has been released from all of its security encumbrances (other

than minor cash security deposits), allowing it maximum flexibility for structuring the remaining financing of the Tulu Kapi gold project.

- The maturity of the new facility has been extended to two years from early August 2019 (ie to August 2021), rather than the original facility, which had a maturity of 12–18 months from November 2018 (ie to May 2020).
- Inasmuch as the original facility is not drawn down to its maximum extent, there will be a saving to KEFI potentially up to £0.35m in fees payable in shares at a conversion price of 2p per share.

Interim developments

Since our last note ([Final government approvals granted](#), published on 7 June 2019), KEFI has issued 37.2m new shares at a price of 2p per share, 22.5m of which were issued in relation to the conversion of £0.45m drawn under the original convertible loan facility and 14.7m of which were issued to settle £0.294m in amounts owing to third-party service providers.

Subsequent to the restructuring of the new working capital loan facility, on 14 August, KEFI announced that it had received notice from one of the providers that it wished to convert £168,000 of the loan note issued on 5 August 2019 into new KEFI ordinary shares at a price of 0.96 pence per share, entailing the issue of an additional 17,510,944 shares.

Assumptions

In updating our valuation, we have made the following four changes to our assumptions:

- We have assumed that the new £1.5m loan facility will be fully drawn down, but that the remaining £1.6m of the original convertible facility will now be left undrawn (note that, for the purposes of comparison, this assumption roughly equates to our erstwhile scenario in which only £3m of the original £4m loan facility was to be drawn down and only half of that was then to be converted into equity – see Exhibit 2, below).
- We have adjusted our gold price assumptions to those set out in our recent report, *Portents of economic weakness: Gold – doves in the ascendant*, published on 14 August 2019. The principal near-term changes to our forecasts are provided in the Exhibit below:

Exhibit 1: Updated Edison gold price forecasts*

US\$/oz	2020	2021	2022	2023
Updated real gold price forecast (US\$/oz)	1,572	1,395	1,387	1,350
Previous real gold price forecast (US\$/oz)	1,482	1,437	1,304	1,303

Source: Edison Investment Research. *See *Portents of economic weakness: Gold – doves in the ascendant*, published on 14 August 2019

- We have adjusted the forex rate from US\$1.2706/£ (the rate prevailing at the time of our last note) to US\$1.2112/£, being the rate currently prevailing.
- We have adjusted KEFI's share price – which affects the price at which conversion of the new loan facility is initially presumed to occur – from 1.53p (being the price prevailing at the time of our last note) to 0.90p, being the current price.

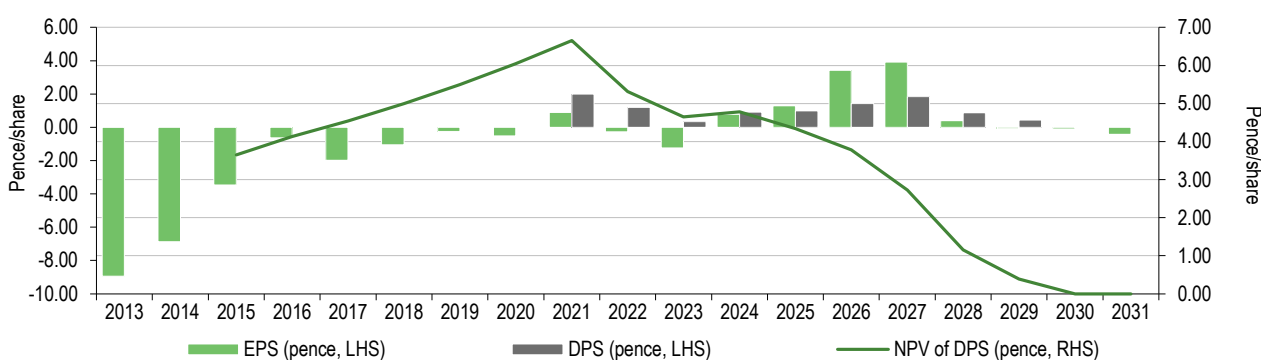
Updated valuation

In our last note, we valued KEFI at 4.70p/share (discounted back to FY19 at a rate of 10% per year), assuming the full draw down and conversion (at 2p/share) of the original £4m loan facility.

However, this rose to 5.35p/share in the event that only £3m of the original loan facility was drawn down and only half subsequently converted into shares.

On the basis of the above assumptions and assuming the full drawn down and conversion of KEFI's new £1.5m (now unsecured) convertible loan facility, we calculate that Tulu Kapi is capable of generating free cash flow of c £53.9m per annum (cf £48.0m previously) for seven years, from 2021 to 2027 (inclusive) – NB with £3.3m (56%) of the increase being attributable to our altered gold price assumptions and £2.6m (44%) being attributable to the change in the cable rate. With average (maximum potential) dividends of 1.11p/share (cf 0.95p/share previously) for the nine years from 2021 to 2029 inclusive (after deduction of a 55% 'minority' interest), this implies a valuation for KEFI of 5.50p/share (cf 4.70p/share previously) when discounted back to FY19 at a rate of 10% per year. This valuation then rises to 6.65p/share in FY21 (cf 5.69p/share previously), when we estimate that the first potential dividend could be paid to shareholders (given that the majority of the proposed debt financing is in the form of a bond).

Exhibit 2: Edison estimate of life of mine KEFI EPS and maximum potential DPS (pence/share), FY13–31e



Source: Edison Investment Research

An analysis of the evolution of the valuation relative to the altered assumptions highlighted above is as follows:

Exhibit 3: Edison valuation of KEFI relative to potential convertible loan facility scenarios (pence/share)

Treatment of original £4m secured convertible loan facility	Previous (pence/share)	June equity issue	Forex	Treatment of new £1.5m and original convertible loan facility	New £1.5m facility, updated share price & Aug conversion	Updated gold prices
Repaid in cash (ie considered as conventional debt)	5.85	5.59	5.89			
Drawdown of £3m and conversion of half into shares	5.35	5.18	5.46	Drawdown and conversion of £1.5m new facility only	4.96	5.50
All £4m converted into equity	4.70	4.64	4.88	Drawdown & conversion of new facility plus residual £1.6m of original facility	4.49	4.97

Source: Edison Investment Research. Note: Current KEFI share price 0.9p (vs 1.53p previously).

Note, however, that this valuation is based on the projected dividend flow resulting from the execution of the Tulu Kapi project alone and ignores the exploration and development of the pipeline of targets in KEFI's portfolio. If KEFI is successfully able to leverage its cash flow from the mine into its other assets in the region, then our updated valuation of 5.50p/share rises to 10.03p (cf 8.53p previously).

Stated alternatively, we estimate that an investment in KEFI shares on 1 January 2019 at a price of 0.90p could generate an internal rate of return to investors of 85.5% (cf 36.8% previously) over the 11 years to 2029 in sterling terms.

Sensitivities

Two obvious sensitivities to our valuation of KEFI present themselves at the current time: one being the gold price and the other being the price at which the new loan note facility may be converted:

- In the former case, assuming the gold price remains at its current level of US\$1,500/oz in real terms over the life of Tulu Kapi's mining and processing operation, our valuation increases by 45.6% to 8.01p/share (in which case, the IRR of investing in the shares at the current share price of 0.9p/share increases to 105.9% in sterling terms over 11 years).
- In the latter case, assuming that KEFI's share price increases to 2p/share prior to conversion of the remainder of the new loan facility, our valuation rises by 10.9% to 6.10p/share.

Financials

KEFI had £0.5m in net debt on its balance sheet at 31 December 2018, after £6.9m in operating and investing cash outflows before working capital in FY18. This cash burn rate compares to an equivalent £5.6m in FY17 and £3.6m in H118.

KEFI plans to finance its US\$194.7m capex funding requirement (see our note, KEFI Minerals: [Final government approvals granted](#), published on 7 June 2019) principally via a TKGM bond (US\$160m) and project-level equity (US\$58m in addition to the US\$60m equity already invested) and an ore stockpile banking facility (US\$10–20m). In addition, we have assumed further mezzanine funding of US\$7.7m in the form of a streaming agreement to sell gold at US\$450/oz (escalating). While the principal financing is the off balance sheet infrastructure funding for TKGM, if all funding sources are considered, we forecast an almost unchanged maximum immediate aggregate net debt funding requirement overall in US dollar terms of US\$144.9m (cf US\$143.0m previously) in FY20, which (in our estimation) equates to an approximately 55:45 net debt:equity ratio at the project level. Note that our estimate of aggregate debt has deliberately incorporated all components at the project level, whether on or off balance sheet, and comprises cash, the TKGM bond (US\$160m), ore stockpile facility (US\$10–20m) and streaming contingent liability (US\$7.7m).

Exhibit 4: Financial summary

	£000s	2013	2014	2015	2016	2017	2018	2019e	2020e
Year end 31 December		IFRS	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS									
Revenue		0	0	0	0	0	0	0	0
Cost of Sales		(927)	(2,071)	(1,634)	(2,260)	(3,522)	(4,145)	(3,573)	(1,000)
Gross Profit		(927)	(2,071)	(1,634)	(2,260)	(3,522)	(4,145)	(3,573)	(1,000)
EBITDA		(927)	(2,071)	(1,634)	(2,260)	(3,522)	(4,145)	(3,573)	(1,000)
Operating Profit (before amort. and except.)		(927)	(2,189)	(1,724)	(2,315)	(3,546)	(4,155)	(3,583)	(1,010)
Intangible Amortisation		0	0	0	0	0	0	0	0
Exceptionals		(442)	(379)	(428)	1,944	(2,359)	(180)	0	0
Other		0	0	0	0	0	0	0	0
Operating Profit		(1,369)	(2,568)	(2,152)	(371)	(5,905)	(4,335)	(3,583)	(1,010)
Net Interest		4	(413)	(319)	(136)	(75)	(459)	(58)	(7,982)
Profit Before Tax (norm)		(923)	(2,602)	(2,043)	(2,451)	(3,621)	(4,614)	(3,640)	(8,992)
Profit Before Tax (FRS 3)		(1,365)	(2,981)	(2,471)	(507)	(5,980)	(4,794)	(3,640)	(8,992)
Tax		0	0	0	0	0	0	0	0
Profit After Tax (norm)		(923)	(2,602)	(2,043)	(2,451)	(3,621)	(4,614)	(3,640)	(8,992)
Profit After Tax (FRS 3)		(1,365)	(2,981)	(2,471)	(507)	(5,980)	(4,794)	(3,640)	(8,992)
Minority interests		0	115	0	0	0	0	2,002	4,946
Net income (normalised)		(2,151)	(3,469)	(2,778)	(3,177)	(3,907)	(4,775)	(1,638)	(4,046)
Net income (FRS3)		(1,365)	(2,866)	(2,471)	(507)	(5,980)	(4,794)	(1,638)	(4,046)
Average Number of Shares Outstanding (m)		29.0	56.0	92.8	194.9	315.3	476.1	639.2	789.0
EPS - normalised (p)		(7.4)	(6.2)	(3.0)	(1.6)	(1.2)	(1.0)	(0.3)	(0.5)
EPS - normalised and fully diluted (p)		(7.4)	(6.2)	(3.0)	(1.5)	(1.1)	(0.9)	(0.2)	(0.5)
EPS - (IFRS) (p)		(4.7)	(5.1)	(2.7)	(0.3)	(1.9)	(1.0)	(0.3)	(0.5)
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.) (%)		-	-	-	-	-	-	-	-
BALANCE SHEET									
Fixed Assets		7,152	9,299	11,926	14,053	16,275	18,795	110,171	174,264
Intangible Assets		6,900	9,139	11,845	13,992	16,232	18,757	18,757	18,757
Tangible Assets		252	160	81	61	43	38	91,414	155,507
Investments		0	0	0	0	0	0	0	0
Current Assets		4,014	1,061	1,012	3,561	1,047	284	85,024	28,769
Stocks		0	0	0	0	0	0	0	0
Debtors		655	335	358	3,056	94	115	0	0
Cash		3,279	640	562	410	466	88	84,943	28,688
Other		80	86	92	95	487	81	81	81
Current Liabilities		(3,363)	(3,202)	(1,995)	(2,067)	(2,852)	(3,727)	(615)	(615)
Creditors		(3,363)	(3,202)	(1,995)	(2,067)	(2,852)	(3,112)	0	0
Short term borrowings		0	0	0	0	0	(615)	(615)	(615)
Long Term Liabilities		0	0	0	0	0	0	(132,100)	(147,705)
Long term borrowings		0	0	0	0	0	0	(132,100)	(141,347)
Other long term liabilities		0	0	0	0	0	0	0	(6,357)
Net Assets		7,803	7,158	10,943	15,547	14,470	15,352	62,481	54,714
CASH FLOW									
Operating Cash Flow		(1,424)	(2,006)	(2,729)	(2,211)	(51)	(3,291)	(6,570)	(1,000)
Net Interest		4	(413)	(319)	(136)	(75)	115	(58)	(7,982)
Tax		0	0	0	0	0	0	0	0
Capex		(877)	(3,133)	(3,507)	(3,014)	(2,625)	(2,835)	(91,386)	(64,103)
Acquisitions/disposals		(1,083)	(750)	0	16	0	0	0	0
Financing		4,735	3,663	6,480	5,192	2,807	5,128	50,769	1,225
Dividends		0	0	0	0	0	0	0	0
Net Cash Flow		1,355	(2,639)	(75)	(153)	56	(883)	(47,245)	(71,860)
Opening net debt/(cash)		(1,924)	(3,279)	(640)	(562)	(410)	(466)	527	47,772
HP finance leases initiated		0	0	0	0	0	0	0	0
Other		0	0	(3)	1	0	(110)	0	0
Closing net debt/(cash)		(3,279)	(640)	(562)	(410)	(466)	527	47,772	119,632

Source: Company sources, Edison Investment Research.

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