

EMED Mining



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Date:	04.02.09
Share price p	4.50
12 month Hi/Lo	30.5p / 4.125p
Ord 25p (m) issued	240.1
Market cap £m	10.8

Down but not out

When we last published on EMED the price of copper was \$2.7/lb. Since then the price has collapsed in spectacular fashion, reaching a closing low of \$1.255/lb on 24th December 2008 before beginning to stabilise. The current price is about \$1.4/lb.

The EMED share price has reflected this fall, down from 17.25p to the present 4.5p. Clearly, the market is signalling doubts about the activation of the Rio Tinto copper project ('Rio Tinto'). Previous fair value calculations published by us¹ appear to be of academic interest at the moment.

However, the 2008 Q4 report just released by the company serves to counter the generally prevailing mood of pessimism. In an exercise of battenning down the hatches, EMED has cut outgoings by more than 50%, renegotiated the terms for the acquisition of the Rio Tinto mine², and has outlined plans for a further capital injection³. Staffing has been cut by more than 60%, and senior management personnel have embraced substantial salary cuts.

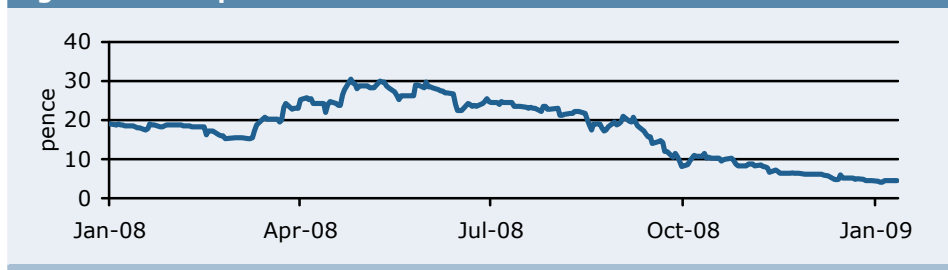
A copper price play

EMED is now a penny stock capitalised at about £11m yet, ignoring assets in Slovakia and elsewhere, it represents a resource base of 940,000 tonnes of copper. Even at the current depressed copper price of \$1.4/lb this is worth about \$3bn in the ground.

The point is, of course, that the metal is still in the ground and needs to be extracted for value to be crystallised – at a cost. The cost of doing so is currently slightly higher than the price which can be realised.

Operational gearing is dramatic, with the result that **the share price of EMED represents option money against the price of copper**. Cheap option money at that: a 36% rise in the copper price would result in an NPV for the Rio Tinto project of £90m, eight times the present market capitalisation of the company – ignoring other assets such as the 1.2m/oz gold resource at Biely Vrch in Slovakia – and the price of gold has held up well.

Figure 1: Price performance



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¹ Last was 65p per share on 6 October 2008 at a Cu price of \$2.7/lb, with a fallback to 42p at \$2.2/lb

² Terms renegotiated in principle with MRI Group to defer certain payments over a period of years which would otherwise have become payable on restart of the Rio Tinto mine, in return for a kicker on the future price of copper

³ Negotiations for a £5-6m convertible debenture are at an advanced stage with major shareholders and YA Global

EMED is quoted on AIM and investors should be aware that shares traded on AIM are subject to lighter due diligence than shares quoted on the main market and are therefore more likely to carry a higher degree of risk than main market companies.

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What needs to happen

Rio Tinto would be at long term breakeven at a Cu price of just over \$1.4/lb. **At \$2/lb, IRR would be 39% with an NPV of £90m - equal to 23.4p per share on fully diluted capital** (assuming further dilution from convertibles and options). This does not take into account the company's other assets, to which we have previously attributed a value of £44m (9.4p per share).

At \$2.50/lb this rises to £223m or 52p per share.

Measured against older high grade copper mines, Rio Tinto C1 LOM cash costs at \$1.35/lb will look relatively high, but compare favourably with newer lower grade mining projects. In addition because so little needs to be done to re-start the Rio Tinto mine and processing facilities, C2 costs are only marginally higher than C1 at \$1.42/lb, compared with new projects at \$1.80/lb.

So Rio Tinto should in reason come some way down the list of projects to be abandoned in response to the extreme conditions we have seen recently in metals markets. Closures/abandonment of less economic mining projects should put pressure on the balance of supply and demand, with implications for the longer term price of copper.

The following chart shows the price action in copper over the past four years:

Figure 2: Copper price



Such a precipitate fall is not easily reversed, and there must be a risk that it will decline further before prices stabilise properly. Recovery could take some time, but it is not unreasonable to look at a base case range of \$1.5-2.5/lb over the next year or so.

Given the picture presented by the above chart, EMED would need to sell forward a substantial proportion of its copper production in order to secure cash flows in the early years of the mine and enable its re-start. This sober requirement reduces operational gearing against the copper price: it also implies some recovery of the price from its present level.

27 month copper futures are currently at a small premium to the spot price (6.4%). EMED will, however, have to look longer than this. Over five to eight

years the LME forward curve suggests a discount. Realistically, the spot price needs to move into the \$1.80/lb region before good conditions would exist for re-start.

This means there is still a price barrier to be overcome before the company (and project finance providers) can be confident enough to start production. It cannot be immediate.

It can't be immediate anyway, for practical reasons to do with putting into place the re-start requirements clearly laid out by the company. Attainment of these requirements has been a slow and tortuous process and, although largely completed, there are still one or two hoops through which EMED has to jump.

The company states: *'The primary focus of the permitting process is no longer the legal documentation required for the transmission of the mineral rights. The process has now moved onto the Company's demonstration of its technical and financial competencies and the resolution of any remaining landholder compensation issues.'* It is financial rather than technical competence which now really counts – and this is part and parcel with the price of copper.

There are ongoing negotiations with the major holder of lands directly adjacent to the mine. The tailings dams are located on this land, and the issue is obviously of crucial importance. The question of compensation may go via the regulators, which could add delay.

If these matters can be resolved in H1 of the current year (2009), EMED expects triggering of the re-start in H2 2009, with production and first revenues in H1 2010.

Realistically, we would expect this process to be delayed for six months.

In a sense, EMED has been fortunate that the collapse in the copper price occurred before it was fully committed to the re-start programme. It has effectively acquired an option period of six months or more on whether or not it will press the button.

To summarise, due to the global financial crisis, EMED has become much more speculative than we had imagined just a few months ago but, at the present price, it has taken the bull by the horns and represents one of the more interesting stock market candidates for really superior returns.

I certify that this report represents my own opinions

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