

Central Asia Metals

Profits soar as costs slashed

Despite a weak market for copper, Central Asia Metals (CAML) turned in an impressive first half 2016 performance by increasing profits and raising its half-yearly dividend. H1 2016 earnings per share was up 95% year-on-year, to US9.5c, and the company has increased its interim dividend by 22%, to 5.5p per share.

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 H1, the company produced a record 6,908t of copper (up 27%). Its already low unit costs fell by a phenomenal 40%, on higher production and exchange rate movements, firmly establishing its position as one of the lowest cost, if not *the* lowest, copper producer in the world.

CAML says it is on schedule to increase copper production to 13,000-14,000t in 2016, from 12,100t in 2015. Access to resources in the Western dumps will allow operations to continue through to 2034. The expansion is under budget and scheduled for completion in Q4 2016.

The company had cash of US\$30 million, and no debt, at the end of June 2016.

Year	Cu prod (kt)	C1 costs (US\$/lb)	Gross Rev. (US\$m)	EBITDA (US\$m)	EBITDA margin (%)	EPS (USc)
2015	12.1	0.60	67.3	34.9	52	20.1
2016f	14.1	0.45	70.3	41.7	62	22.2
2017f	14.2	0.53	77.9	40.6	58	20.5

Source: Marten & Co

Valuation summary

As a result of lower operating and capital costs this year, the sum of the parts estimate of CAML's net asset value has increased from 197.5p per share as at 21 April 2016 to 235.5p. CAML shares are currently trading at 171.3p. The model suggests CAML could pay a total dividend of 13.5p per share, equivalent to a yield of 7.8%.

Listed	LSE
Ticker	CAML LN
Base currency	GBP
Price	171.3p
Daily volume (1-yr. avg.)	83k shares
1-year high	185.0p
1-year low	124.0p
1-month performance	3.6%
3-month performance	14.4%
1-year performance	6.6%
Calendar YTD performance	14.7%
2016 yield (forecast)	7.8%

Perf. vs AIM Basic Res. rebased

Time period: 01/09/13 to 12/09/16



Source: Bloomberg, Marten & Co

Net cash (US\$m)	30.2
NAV ^{8%} per share	235.5p
Price/NAV	73%
Market cap (£m)	192.7
Shares outstanding (m)	111.6

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This note should be read in conjunction with the initiation report of 24 February 2016

Key points

- H1 2016 earnings per share (EPS) up 95% (see page 2)
- Net profit increased substantially from US\$6.0m in H1 2015 to US\$10.6m
- Earnings before interest, tax, depreciation and amortisation (EBITDA) was US\$17.4m representing a margin of 56%
- Interim dividend increased by 22% to 5.5p (see page 5)
- Record copper production of 6,908t in H1 2016 (see page 3)
- Copper sales up 27% year-on-year to 6,355t.
- Substantial reduction in C1 unit costs (a standard definition of costs – see the glossary on the QuotedData website for a more comprehensive definition) to US40c/lb (H1 2015: US67c/lb) (see pages 2 and 3)
- The Kounrad operation is on target to expand production to 14,000t in 2016 (see page 5)
- Internally-funded Western dumps expansion project on track and under budget (see page 6)
- Copper Bay definitive feasibility study (DFS) expected to be completed in Q4 2016 (see page 6)
- The model suggests there has been a significant uplift in CAML's net asset value (calculated with an 8% discount rate on future cashflows – abbreviated to NAV^{8%}) to 235.5p per share as a result of reduced costs due principally to the devaluation of Kazakhstan's currency, the tenge. Significant additional uplift due to weaker GB pound against the US dollar (see page 6)
- Shares currently trading at 26% discount to NAV^{8%}
- Year to date stock market performance – 15% rise
- Company has cash of US\$30.2m and no debt (30 June 2016)

H1 2016 results

CAML posted an impressive set of results for the first half of 2016, despite receiving a copper price 17% lower than the same period a year ago.

H1 2016 EPS up 95% to US9.5c

In H1 2016, CAML reported a profit of US\$10.6m, an 80% increase from 2015 despite a fall in the average price of copper sold from US\$5,936/t to US\$4,903/t. EPS was US9.5c, a 95% improvement on H1 2015.

EBITDA for the six-month period was US\$17.4m (H1 2015: US\$16.0m), representing an EBITDA margin of 56%.

CAML maintained revenue levels despite a 17% fall in the copper price as sales volumes increased by 27%

Gross revenue of US\$30.9m was in line with the corresponding period of the previous year despite the fall in copper prices as the amount of copper sold rose 27% to 6,355t.

The dramatic improvement in profitability resulted from a significant reduction in unit operating costs, in part because of a higher production base, but primarily as a result of a massive depreciation of 86% in the Kazakh tenge, which meant that costs incurred in the local currency translated to much lower values when reported in US dollars in the

A currency depreciation and a reduction in depreciation costs lowered total costs and unit costs also benefited from increased sales volume

Record copper production in H1

CAML can make money even with low prices as it is probably the world's lowest cost copper producer

Most operating costs are in tenge, which has depreciated some 86% against the US dollar

financial statements. The importance of low unit operating costs is explained in more detail in the next section.

The cost of sales in the income statement fell from US\$13.4m to US\$8.3m with costs further benefitting from a reduction in depreciation charges of U\$3.9m for H1 2016 compared to H1 2015. The company has been able to change its accounting approach and is now depreciating and amortising certain assets over a longer productive life since the approval for development of the Western dumps at the end of 2015, which will extend production through to 2034.

The Kounrad operation produced a record 6,908t of copper in H1 as a result of an increase in solution flow rates through the plant while maintaining a grade consistent with 2015. Plant utilisation was 98% again and the cathodes produced were of high quality, indicating that the expanded plant is working very efficiently.

In H1, the company sold the majority of its output as normal through its offtake agreement with international commercial services group, Traxys (see pages 13 and 22 of the February 2016 initiation note).

After capital spending of US\$10.4m in H1 and dividend payments of US\$12.5m, the company had cash of US\$30.2m and no debt as at 30 June 2016.

CAML's cost advantage explained

In running a resource business, management must focus on controlling costs to grow its bottom line as the price of its product is a variable usually outside of its control.

CAML is a low cost copper producer; one of the lowest, if not the lowest, in the industry. This gives it a significant advantage over other copper producers, especially in the low-price environment that the industry is having to contend with. It can make money when others may be struggling.

CAML's competitive advantage derives principally from the nature of its business model. Its copper extraction business is low cost because the operation simply involves processing pre-mined material. This means that mining costs, which are usually the largest component of total operating costs for a traditional copper mining company, are zero.

And in H1 2016, the company strengthened its competitive position further by reducing its already low unit operating (C1) costs by 40%, by virtue of increased production, exchange rate movements that worked in its favour, and lower depreciation and amortisation charges, for some of assets, now that development of the western dumps has been approved thereby extending production through to 2034.

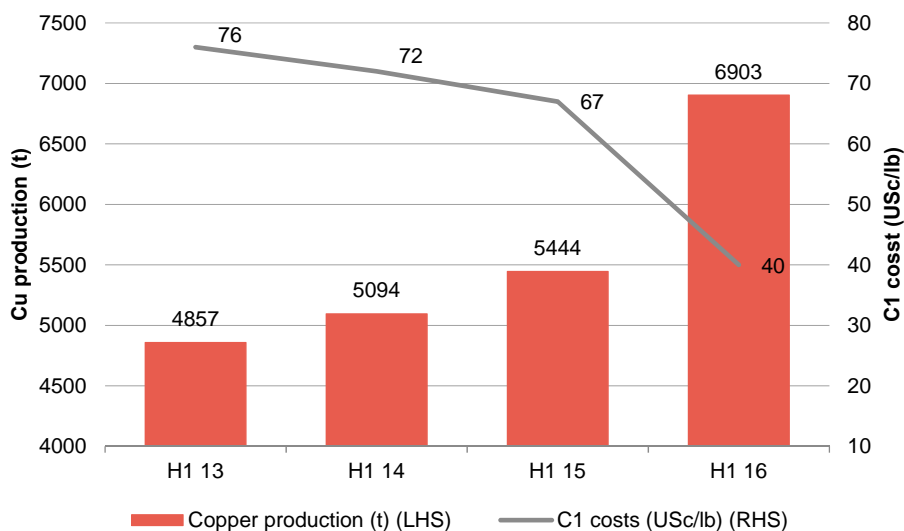
Increasing production tends to lead to a reduction in unit operating costs. Although there are certain variable costs that will increase as the treatment rate increases, for instance the costs of chemical reagents, a large proportion of costs, such as overheads, are fixed. Increased copper production means that fixed costs are spread over a wider volume resulting in a lower cost figure per pound of copper sales.

Furthermore, most of CAML's operating costs (70% of C1 costs) are in the local currency whereas the company reports its results in US dollars. With a massive depreciation of the tenge over the past year or so, the company is fortunate to report US dollar-denominated costs that have automatically declined.

Of course, any reversal of the depreciating trend of the tenge against the US dollar, will impact negatively on costs and lead to a rise in those costs.

Figure 1 compares the half-yearly copper production and C1 costs at Kounrad since 2013, clearly demonstrating the increasing production trend and the improvement in costs.

Figure 1: H1 copper production and costs 2013-2016



Source: Central Asia Metals C1 costs as reported by the company. Note that 2013 and 2014 figures are reported using a prior convention, which leads to slightly inflated costs

The following table shows all elements of CAML's operating cost structure and identifies the variances between H1 2016 and H1 2015

Figure 2: Comparison of half-yearly operating costs

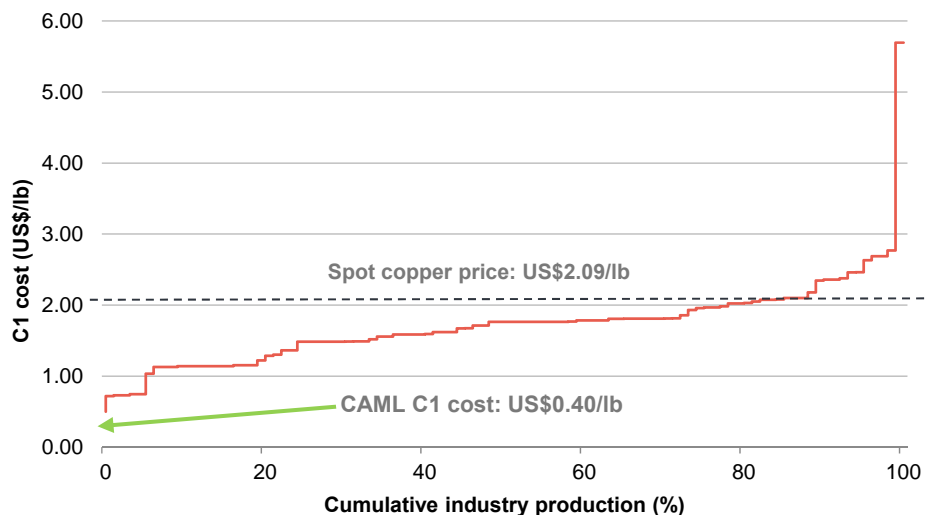
Costs (USc/lb)	H1 16	H1 15	Variance
Labour	0.08	0.15	-47%
Reagents	0.05	0.10	-50%
Power	0.05	0.11	-55%
Materials	0.05	0.05	0%
Other	0.03	0.04	-25%
Cost of production	26.0	45.0	-45%
Selling	0.10	0.13	-23%
Local G&A	0.04	0.09	-56%
C1 costs	0.40	0.67	-40%
MET & local taxes	0.14	0.20	-30%
Depreciation	0.15	0.54	-72%
Inventory impairment	0.00	0.06	-100%
Corporate G&A	0.28	0.40	-30%
Full inclusive cost	0.97	1.87	-48%

Source: Central Asia Metals

Comparing CAML's C1 costs of US40c/lb with the 2015 industry C1 cost data from GFMS Thomson Reuters would suggest that CAML is probably now the lowest cost producer in the world.

The chart in Figure 3 shows the industry cost curve with CAML's position at the low end of the curve marked. To give an idea of cash margins, the current spot copper price has been included.

Figure 3: Copper mining industry cost curve 2015 (C1, US\$/lb)



Source: Thomson Reuters GFMS/Marten & Co

Moreover, CAML's total production costs (as shown by the data in Figure 2) are less than US\$1/lb. This compares favourably against their notional cathode selling price of US\$2.09/lb.

Dividend increased by 22%

Interim dividend increased by 22%

The company has a policy of paying an annual dividend of a minimum of 20% of the revenue from Kounrad (subject to the company's cash reserves providing a dividend cover of three times or greater). Maintaining the dividend policy is a key pillar of the company's strategic planning and the executive chairman has said that CAML will not consider any financing plans for Copper Bay that would jeopardise its own dividend policy.

In 2015, the company maintained its total annual dividend from the previous year at 12.5p despite a lower copper price and increased capital spending on the expansion project.

CAML company has declared an interim dividend for 2016 of 5.5p, equivalent to 26% of gross revenue, and a 22% increase on the interim of 4.5p declared a year ago.

2016 production target maintained

The company is on track to achieve guidance copper output for 2016

2015 copper production was 12,100t and following the completion in an expansion of plant capacity in mid-2015, the company has given production guidance of between 13,000t and 14,000t of copper for 2016.

With H1 copper production of 6,903t the company is on track to achieve its 2016 target.

Expansion to the Western dumps on schedule and under budget

Kounrad expansion under budget

CAML expanded the capacity of the SX-EW plant at Kounrad by 50% in 2015. The second stage of the expansion plan is now under development to allow exploitation of the Western dumps, with completion expected in Q4 this year and the first copper production targeted for Q2 2017.

The original budget for this Phase 2 expansion project was US\$19.5m, but the company reports that, in large part due to the devaluation of tenge, the cost is now estimated to be 25% under budget.

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

Copper Bay DFS expected Q4

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.

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 Q4 2016.

Please see pages 15 to 21 of the February 2016 initiation note for more detail on Copper Bay.

The model suggests CAML's NAV^{8%} is 235.5p per share

Valuation increased

A valuation model has been used to estimate a sum-of-the-parts net asset value for CAML using a discounted cash flow analysis, taking into account the after-tax net present value of the Kounrad operation, using a discount rate of 8%. The model treats CAML's 75% interest in Copper Bay as an investment and values it at CAML's cost of acquisition (which was US\$6.2 million).

Using this approach, the model suggests a NAV^{8%} of 235.5p per share, suggesting that CAML is trading in London at a 27% discount of to that NAV.

Figure 4 summarises this.

Figure 4: Valuation model for CAML

	US\$M	£M**	Pence per share
Kounrad NAV ^{8%*}	311	235	210.8
Investments (Copper Bay)	6	5	4.2
Cash	30	23	20.5
NAV ^{8%}	347	263	235.5

Source: Marten & Co * NAV discounted at 8%

** at US\$1.32/£

The NAV valuation suggested by the model has increased from 197.5p per share to 235.5p per share since 21 April (when the last update note was published) because of:

- A reduction in operating costs,
- Higher expected copper production in 2016,
- A 25% reduction in capital costs in 2016 for completion of the Western dumps infrastructure, and

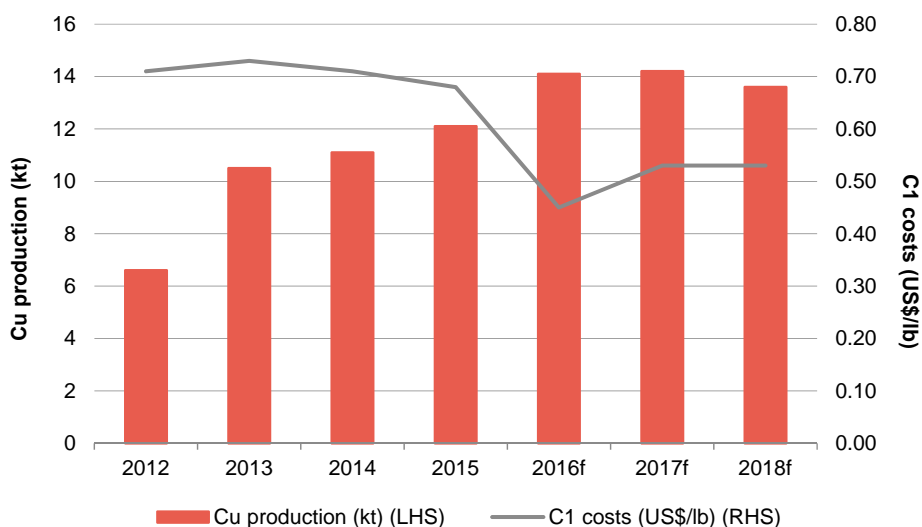
- The use of a lower exchange rate of £1.32/US\$ (against £1.45/US\$) when calculating the NAV to reflect the weakness of the pound following the Brexit vote.

Some assumptions have changed within the model since 21 April.

- Cost estimates for 2016 are lower given the dramatic reduction CAML has achieved in the first six months of 2016. although a slight increase in unit costs in late 2016 and 2017 has been factored in as the company is expecting some inflation to creep in, plus the tenge may strengthen and the company will start to process the Western dumps, which are further away from the SX-EW plant and thus require more power.
- The company produced 6,908t of copper in H1. Assuming higher flow rates through the warmer summer period, following the usual pattern of production, and a grade maintained at 2.3g/l copper, the model assumes the company will slightly exceed the upper level of its guidance of 13,000-14,000t for the year.
- Meanwhile, for Kounrad, the model 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.
- In addition, the model assumes that the company will complete its major capital expenditure programme for the Western dumps in 2016, and thereafter with only sustaining capital of US\$2-3m/y, cashflow should increase.

Figure 5 shows the historic annual production and cost profile since start up and the figures suggested by the model through to 2018.

Figure 5: Annual copper production and costs – actual and forecast



Source: Central Asia Metals and Marten & Co

Note that 2012-2105 figures are reported using a prior convention, which leads to slightly inflated costs

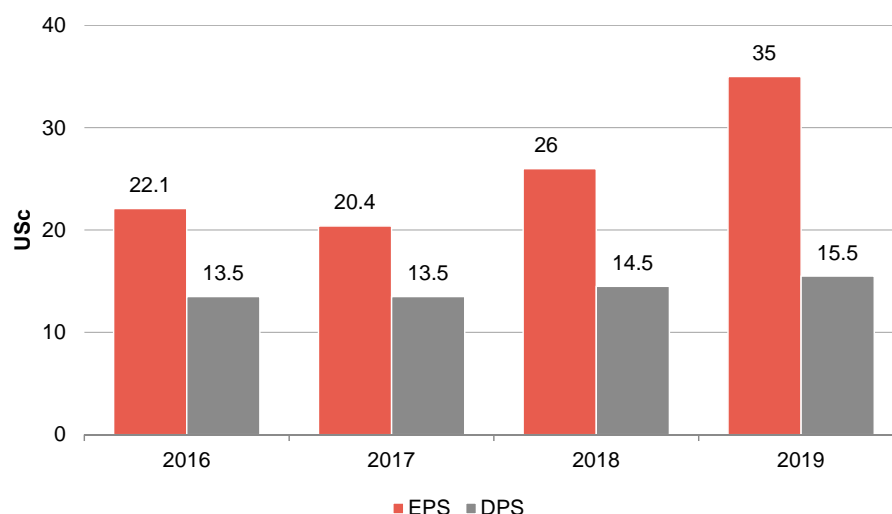
Given the fact that the company has raised its interim dividend to 5.5p per share, the model suggests that CAML could declare a final dividend of 8.0p per share (as per 2015). The capital for completion of the second stage of the expansion programme is much lower than budget.

The model suggests a dividend of 13.5p per share in 2016, rising to 15.5p per share by 2019

Thereafter, the model suggests annual dividends could increase from 13.5p to 15.5p per share by 2019.

Figure 6 overleaf shows the earnings and dividends projections derived from the model.

Figure 6: Earnings (EPS) and dividends (DPS) projections (USc/share)



Source: Marten & Co

Sensitivity analysis

Figure 7 uses numbers derived from the model to show the sensitivity of the NAV estimate for CAML to changes in the key variables: the copper price and discount rate.

With its low cost of production, the company could continue to generate free cash flow, even if copper prices were to fall 30% below the long-term, base case price of US\$6,600/t used in the model, assuming all other factors remain unchanged.

Figure 7: NAV sensitivity analysis (GBP per share)

Discount rate	Copper price (US\$/lb)						
	-30%	-20%	-10%	Base	+10%	+20%	+30%
5%	161	201	242	282	322	362	403
8%	135	168	201	234	267	300	334
10%	122	151	180	210	239	268	297
12%	110	137	163	189	215	241	267

Source: Marten & Co Assumptions: US\$1.32/£; shares outstanding 112.1 million

The model suggests that the company's NAV is relatively insensitive to downside risk in copper prices

Copper prices

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 traded in the US\$4,409/t-US\$5,071/t range and the spot price is currently around US\$4,608/t (US\$2.09/lb).

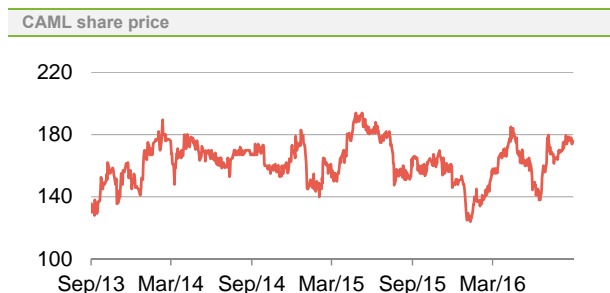
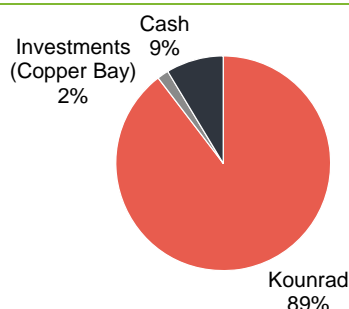
The company has the ability to hedge up to 30% of production on a short-term (rolling 12 months' future production) basis.

2016 copper prices have been kept at US\$5,000/t in the model and it has been assumed that prices to remain soft until 2018.

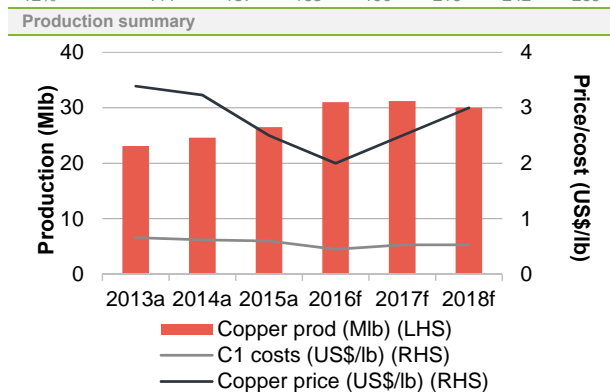
Figure 8: Central Asia Metals summary with extracts from the model

Sum-of-the-parts valuation – September 2016	US\$M	Pence per share
Kounrad NPV ^{8%}	311	211
Investments (Copper Bay)	6	4
Subtotal	317	215
Net cash/(debt)	30	21

NAV	347	236
Asset valuation summary		



NAV sensitivity analysis (pence per share)							
Disc. rate	-30%	-20%	-10%	Base	10%	20%	30%
5%	162	202	243	283	324	364	404
8%	136	169	202	235	269	302	335
10%	122	152	181	210	240	269	299
12%	111	137	163	190	216	242	269



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 (1,000/hr)	771	784	930	1,000	1,000
PLS grade (Cu g/l)	2.24	2.30	2.30	2.20	2.10
Recovery (%)	73.5	75.0	75.0	75.0	75.0
Copper production (kt)	11.1	12.1	14.1	14.2	13.6
C1 costs (US\$/lb)	0.62	0.60	0.45	0.53	0.53
Fully-absorbed costs (US\$/lb)	1.65	1.58	1.05	1.16	1.20
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	14.1	14.2	13.6
C1costs (US\$/lb)	0.62	0.60	0.45	0.53	0.53
Fully-absorbed costs (US\$/lb)	1.65	1.58	1.05	1.16	1.20

Profit & loss summary					
Gross revenue	76.6	67.3	70.3	77.9	89.7
Cost of production	(9.4)	(10.4)	(9.0)	(11.2)	(11.2)
Mineral extraction tax	(4.4)	(3.8)	(4.0)	(4.4)	(5.1)
Selling costs	(3.9)	(2.9)	(2.9)	(3.2)	(3.3)
G&A	(11.9)	(14.1)	(9.7)	(10.7)	(10.3)
EBITDA	47.1	34.9	41.7	40.6	48.0
Depreciation & amortisation	(11.3)	(10.3)	(6.0)	(6.0)	(6.0)
Interest	(0.3)	(0.3)	0.0	0.0	0.0
Taxation	(10.5)	(10.4)	(10.4)	(11.2)	(12.3)
Other	33.0	8.0	0.0	0.0	0.0
Net income	59.4	22.2	25.3	23.4	29.7
Average shares outstanding (million)	106.1	111.7	111.6	111.6	111.6
EPS (US\$)	0.56	0.20	0.22	0.20	0.26
Dividend (pence per share)	12.5	12.5	13.5	14.5	15.5

Abridged balance sheet Y/E					
Cash & equivalents	46.1	42.0	35.5	37.4	44.0
Fixed assets	162.7	85.3	91.0	88.6	88.6
Total assets	216.2	133.1	134.2	133.7	140.3
Current liabilities	4.7	6.3	4.7	4.7	4.7
Long-term debt	0.0	0.0	0.0	0.0	0.0
Other long-term liabilities	23.7	12.2	12.7	12.7	12.7
Total liabilities	28.4	18.8	17.4	17.4	17.4
Shareholders' equity	187.9	114.2	116.8	116.3	122.9

Cash flow summary					
Cash from operations	30.5	23.5	28.8	26.9	33.2
Cash from investing activities	(10.8)	(7.3)	(12.9)	(3.0)	(3.0)
Cash from financing activities	(15.7)	(20.6)	(21.9)	(21.9)	(23.6)

Cash at end					
	46.2	42.0	35.5	37.4	44.0

Profitability					
EBITDA margin (%)	61.5	52.0	61.9	57.8	61.6

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 the initiation note of February 2016. [Please click here](#). The contents are reproduced below.

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