

mining

Buy

Share price	3.7p
Target price	10.0p

shares (m)	1861
market value £m	68.4
net debt \$m (est)	40.0
copper mining in Kazakhstan ...	

**Analyst****Tim Freeborn**

+44 (0)20 216 2626

tim.freeborn@xcapgroup.com

Sam Brindle

+44 (0)20 216 2625

sam.brindle@xcapgroup.com

Corporate broking

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XCAP Securities UK Equity Research

Frontier Mining

Great time to buy

Events are gathering pace at Frontier as it gears up for production at its Benkala copper mine in Kazakhstan. The completion of the purchase of the nearby south Benkala project gives Frontier the capacity to produce 30,000 tonnes per year for seven years or 20,000 tonnes for 11 years. Funding is complete and the lenders who have sold collateral shares face a squeeze.

Buy before production

One of the best times to buy a mining share is usually in the run-up to production. In Frontier's case this was complicated by the decision to defer start-up from last autumn until March 2012. Now there is a clear schedule and the shares look well placed for a re-rating. Planned capacity this year is 7,000 tonnes of cathode grade copper, rising rapidly towards its full capacity. South Benkala gives Frontier the flexibility to run hard if spot copper is strong, or pace itself if the markets are cooler. Energy costs will also be a factor, as they represent around a third of the expected \$2,300 per tonne cash cost of production. But energy and copper prices are highly correlated, so it is more realistic to project a copper-minus-energy margin per tonne when considering scenarios. At current prices, we estimate this is about \$7500, with non-energy cash costs of \$1500, which is clearly very attractive.

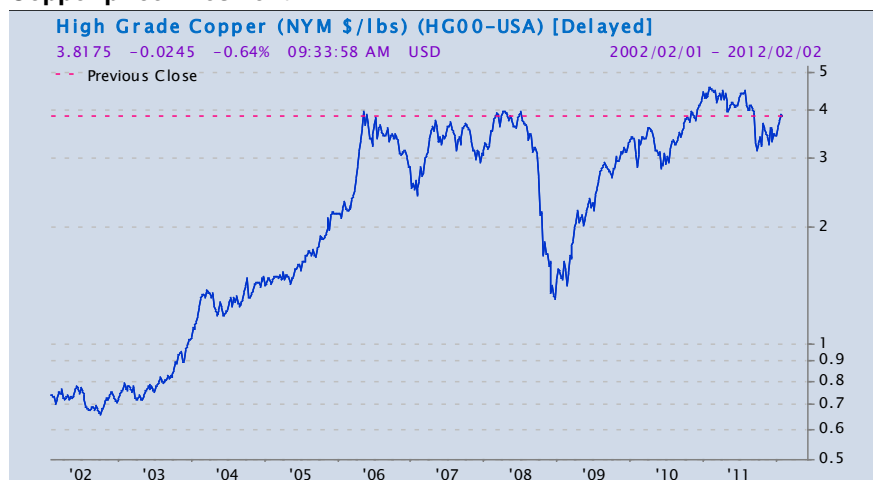
Sellers are finished

One factor which has clearly held back the price from its normal run-up has been selling by lenders to two large holders. BMF International and Teratorn had pledged their combined 9.4% stakes, 175m shares, to their lenders. Frontier estimates that over 160m of these shares have been sold. The lenders are obliged to deliver the shares back to the holders when the 3-year loans are repaid. The first loan was taken out in April 2011. This means that not only is the source of selling largely exhausted but there is also the prospect of a serious squeeze.

Funding enhanced - and local

Uncertainty over the funding of capex for Benkala has also overhung the shares. The \$37m sale of the Maminskoye gold project largely closed the gap but some investors still feared a share issue would be needed. We believe this issue was banished with last month's facility signed with Sberbank Kazakhstan. This consisted of \$20m at 9% for four years plus a \$9m three year facility at 7-5-9.5%. The loan replaced (and repaid) an \$8m loan from HSBC, whose further lending was restricted by a limit to its regional exposure. It is encouraging to see Frontier win powerful East European backing.

Copper price – resilient



Source: Factset

The copper price has been remarkably resilient, helped by falling grades in the major producers and, of course, surging demand from Asia. A collapse in demand is always possible, but we believe the Chinese authorities stand ready to ease credit if a housing crash threatens.

Surface oxides are just the curtain raiser

The surface oxide mining at Benkala is literally only scratching the surface. The sulphide ore directly below contains about seven times as much copper. Capex estimates for this mining this ore, which will require flotation sifting and then smelting, range from \$250m to \$400m.

Using the current copper price, we would expect Frontier to be able to fund this fully by around 2017 just using the oxide cashflow, In practice we think it will want to move more quickly. We will publish a full note later this year when we have a full picture on the ramp-up. In the meantime we are happy to restate our 10p price target. This would value Frontier at £186m, versus a projected ebitda at 20,000 tonnes per year of around \$120m (£76m) and net debt in early 2014 of \$20m. Net debt is currently \$40m.

DEFINITIONS**Buy**

Expected to outperform the FTSE All Share by 15% or more over the next 12 months.

Outperform

Expected to outperform the FTSE All Share by 5/15% over the next 12 months.

Market Perform

Expected to perform in line with the FTSE All Share over the next 12 months.

Underperform

Expected to underperform the FTSE All Share by 5/15% or more over the next 12 months.

Sell

Expected to underperform the FTSE All Share by 15% or more over the next 12 months

Speculative Buy

The stock has considerable level of upside but there is a higher than average degree of risk.

The research analyst attests that the views expressed in this research report accurately reflect his personal views about the subject security and issuer. Furthermore, no part of his compensation was, related to the specific recommendation or views expressed in this research report.

xcap research recommendations

H2 2011	House	Non-house
BUY	24	12
SPECULATIVE BUY	5	
OUTPERFORM	2	1
MARKET PERFORM		4
UNDERPERFORM		
SELL		
CORPORATE	2	

xcap broking team

Jon Belliss 0203 216 2630

jon.belliss@xcapgroup.com

John Grant 0203 216 2660

john.grant@xcapgroup.com

Karen Kelly 0203 216 2661

karen.kelly@xcapgroup.com

Halimah Hussain 0203. 216 6416

halimah.hussain@xcapgroup.com

David Lawman 0203 216 2664

david.lawman@xcapgroup.com

Disclaimer

Broker	yes
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Factual changes	yes

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