



Summary

- Katanga Mining has many problems right now - their mine is closed, their debt is very high, and the copper and cobalt prices are still too low for them.
- Katanga has large copper and cobalt reserves, are significantly lowering their cost of production, and should be back in production in 2018.
- At current copper and cobalt prices valuation is fair, however a small increases in price makes a huge difference to Katanga's valuation, and vice versa.

Katanga Mining (TSXV:KAT) (OTCPK:KATFF) - Price = CAD 0.13, USD 0.09

Katanga Mining has many problems and has been on the decline for some years now; however rising copper and cobalt prices, and lowered costs of production promise to bring about a turnaround.

Katanga Mining is a Swiss mining company with large copper and cobalt reserves in the Katanga province of the Democratic Republic of Congo (DRC). Their KOV open pit and Kamoto underground mine stopped production in 2015 due to the low copper prices, and is undergoing a modernization of their processing plant to significantly lower their cost of production. Glencore (OTCPK:GLCNF) (LSX:GLEN) (HK:805) owns around 75% of Katanga Mining share float.

KAT 10 year stock price chart

You can see from the chart below that Katanga investors have had a wild ride, and a terrible period since mid 2007, when the stock peaked at CAD 26.20 in July 2007. In 2014 the last full year of mine operation the stock ranged from CAD 0.30 to 0.45.

[Source](#)

Copper and cobalt outlook

Put simply the outlook for both copper and cobalt is looking very good, hence the reason I have focused on these sectors.

You can read more on this topic with my three very recent articles here:

- [Top 5 Cobalt Miners To Consider.](#)
- [Top 5 Junior Or Mid-Tier Copper Miners To Consider.](#)
- [Which Of The Major Copper Miners Should I Buy.](#)

Katanga Mining history

The company began in 1996 as New Inca Gold Ltd, and changed names twice ending with the name Katanga Mining in 2005. In subsequent years their Kamoto mine in the DRC was established and various processing equipment installed and expanded. You can read the details [here](#). Apart from that there are some [stories](#) of corruption involved with other parties in the DRC.

The company [stated](#): "On September 11, 2015 the Company announced the decision to suspend the processing of copper and cobalt until approximately H1 2017. The Corporation will continue with the planned investment of \$880 million into ongoing processing plant upgrades and the waste stripping of the KOV Open Pit and Mashamba East Open Pit mines. These process upgrades include the commissioning of the new leach plant which will replace the existing oxide concentration process. This is expected to

significantly improve both copper recoveries and operating unit costs when processing resumes." The shutdown was later extended until early 2018.

Katanga Mining copper and cobalt project and resource details

Katanga resources table - 2012 technical report

Source

The table above shows Katanga has a very large resource, with 90.9Mt Proved and Probable reserves, with good average grades of 4.14% copper and 0.45% cobalt. The table also shows 207.3Mt Measured and Indicated resource at an estimated grade of 3.53% copper and 0.52% cobalt.

According to the company website, "Katanga Mining Limited operates a large-scale copper-cobalt project with substantial high-grade mineral reserves and integrated metallurgical operations in the DRC. Our single-site operation, which comprises brownfield assets and new facilities under construction, will have one of the lowest unit production costs in the world, net of by-product credits."

Global cobalt miners compared by resource size

Note in the table below that Katanga has an extremely low market cap/lbs resource ratio of 0.05 for its "cobalt" resource. It is the lowest in the table, and they have the largest resource.

Source: 24hGOLD

Production details

Katanga has a 75% interest in the Kamoto copper-cobalt mine. The other 25% is owned by Gecamines (state of DRC), although there has been some issues with the Gecamines share being corrupted (see linked story above).

100% of Katanga's offtake is sold to GIAG (Glencore). Cost of production is estimated to drop from US\$2.50 to US\$1.65 once the mine reopens due to the upgraded processing systems.

	C1 costs of production/lb	Average Copper Selling price	stock price range
2014	2.17	2.81	0.30-0.45
My 2018 forecast	1.65	3.00	1.03

The table above gives a comparison of 2014 (the last year of full production) to my forecasts once the mine restarts in 2018. My forecasts are higher, however this is due to the lowered cost of production boosting profits (see below), and the improved production as a result of the plant modernization, and importantly I have forecast copper at US\$3.00 and cobalt at US\$20 in 2018.

Valuation

Katanga's Price/Book multiple is 0.149. Debt to equity ratio is 2.6, with 2015 long term debt at CAD4.25b, with interest expense of CAD\$352m pa. The interest expense does not include CAD58m that was capitalized. No PE as earnings are currently negative due to the mine being closed. Market cap is CAD 248m (US\$186m).

Market cap comparison with similar large copper and/or cobalt miners

	Market cap (US\$), billions
Katanga Mining	0.186
China Molybdenum	8.1
Southern Copper	24.8

The table above shows that Katanga Mining has a market cap 43 times less than China Molybdenum, and 133 times less than Southern Copper. I realize that China Molybdenum also earns from molybdenum and tungsten, however it only owns 56% of the Tenke mine in the DRC. Also Southern Copper has

larger copper reserves. My point is not to say Katanga should be valued the same at this time, but merely to illustrate the enormous value difference which I believe is not entirely justified.

Comparison with 2014 net profit to my forecast

	Net profit (US\$, millions)	copper price (US\$/lb)
2014	135.8	2.80
My 2018 estimate	126	3.00

In 2014 (the last full year before the mine closed) Katanga made a net profit of US\$136m, or CAD183m. At that time copper was around US\$ 2.80/lb and cobalt was around US\$14/lb, so very similar to today with copper at US\$2.50/lb, and cobalt at US\$14.80/lb. The reason my profit estimate is lower (despite lower operating costs) is due to the higher interest expense.

My earnings multiple valuation - with sensitivities

	2018 Copper	2018 Cobalt	2018 Katanga Price target
Cautious	2.50	15	0.14
Moderate	3.00	20	1.03

NB: Katanga's 2006 DFS production estimates were - copper 238.9m lbs pa, cobalt 12.5m lbs pa. By comparison 2014 copper production was 157,000 tonnes (345m lbs), and 2015 cobalt production was 2,901 tonnes (6.4m lbs). I used the later numbers as they are more recent and realistic. Target price based on a PE of 12. Cost of copper production assumed to be US\$1.65/lb.

The bottom line on Katanga's valuation in 2018 based on my model is this:

- At Copper US\$2.50, cobalt US\$15 - Katanga is valued at CAD 0.14 (similar to the current stock price).
- At Copper US\$3.00, cobalt US\$20 - Katanga is valued at CAD 1.03 (7.93 times higher than the current stock price).

Katanga Mining financials graph

Source: [4-traders](#)

Catalysts

- Announcement regarding the mine re-start (expected to start in early 2018), or a possible earlier (2017) re-start given the strong copper price recovery the past 2 months, and if cobalt prices surge.

Competitors

Southern Copper (NYSE:[SCCO](#)), Vale S.A. (NYSE:[VALE](#)), BHP (NYSE:[BHP](#)), Rio Tinto (NYSE:[RIO](#)), Freeport-McMoRan Inc. (NYSE:[FCX](#)), China Molybdenum (OTC:[CMCLF](#)) (HK:3993), Glencore, Tiger Resources (OTC:[TRSDF](#)), Antofagasta (LSE:[ANTO](#)) (OTC:[ANFGF](#)), Anglo American (LSE: [AAL](#)) (OTCPK:[NGLOY](#)), and China's Chinalco (OTC:[CNMLF](#)), and others.

Risks

- Sovereign risk - The DRC has been known for extreme corruption, mining licenses and contracts have been changed or cancelled, and royalties or taxes imposed unfairly. War, terrorism, electricity or water disruption, and poor infrastructure.
- The usual mining risks, except magnified being in the DRC.
- Liquidity risk, poor management, stock dilution, financing risks.
- Cobalt and copper price risks. If the copper price falls much below current level, Katanga may no longer be profitable. This was a problem in the past due to inefficient processing and high electricity costs.
- Best to buy on local exchanges (TSXV) to avoid liquidity issues.

The negatives of Katanga Mining

- A very poor stock price history since mid 2007 (however was perhaps too quick a rise prior to then). No earnings as the mine is closed.

- The DRC has plenty of bad stock history, and there is currently plenty of instability there with President Kabila refusing to call elections.
- A large debt, and interest expense that could cripple the company if commodity prices fall much lower.

Investors can view a company presentation [here](#).

Conclusion

Katanga Mining and many other DRC stocks (Anvil Mining comes to mind) have had a checkered history, and in the case of Katanga, have probably only survived thanks to Glencore's backing. Looking at the 10 year price history chart, I can assume sentiment towards the stock would understandably be very negative, as many investors would have lost money. Given this and the mine closure Katanga are trading on an extremely low market cap of just CAD 248m, relative to their large reserves, and established mining infrastructure.

My reasons for selecting Katanga Mining as a turnaround are as follows:

- I am positive on the outlook for copper and cobalt, based on strong future demand driven by electric vehicles, solar, and global construction to house the rising global middle class over the next 10-20 years.
- Katanga is reported to have by far the world's largest reserves of cobalt, and also have massive copper reserves. Cobalt is forecast to be in deficit in 2017, and hence the cobalt price should rise significantly.
- Katanga are significantly lowering their copper production costs from US\$2.50 to US\$1.65, making them globally competitive.
- The company [claims](#) to have the "potential of becoming Africa's largest copper producer and the world's largest cobalt producer." Production upside to my modeled numbers.
- Glencore are a significant backer, and the DRC Government would want the mine to start again so it can receive its 25% share via Gecamines, as well as the employees having their jobs back again.
- Katanga's valuation looks attractive if you are bullish on cobalt and copper. At copper US\$3.00 and cobalt US\$20 in 2018, then Katanga is valued at CAD 1.03 (7.93 times higher than the current stock price).
- The stock has dropped from around CAD 1.30 in 2011 to just 0.13 now (about a tenfold fall), as a severe victim of the commodities rout of 2011-2015. Copper and cobalt prices are now showing strong early signs of recovery.

The stock is not for cautious investors, as it is very high risk and high reward. I would suggest investing a sensible amount of money that you would not be too upset if the company went bankrupt, causing investors a 100% loss. Investing in DRC mining stocks requires some patience and understanding of the risks.

Katanga is basically a highly leveraged bet on copper and cobalt prices in 2018 and beyond. If copper and cobalt prices go up 20% from here Katanga stock can be a multi-bagger, and if they go down investors may lose the lot. I rate Katanga Mining as a very speculative buy, with huge upside if things go right, and huge downside if they go wrong. As I am very positive on cobalt in 2017 and beyond, and positive on copper, hence I think a small investment is worthwhile. If Katanga do escape their debt problem in the next few years and go on to be a huge producer, the current stock price will have been a steal.

As usual all comments are welcome.

Disclosure: I am/we are long KATANGA MINING (TSXV:KAT), TIGER RESOURCES (ASX:TGS), CHINA MOLYBDENUM CORP (HK:3993).

I wrote this article myself, and it expresses my own opinions. I am not receiving compensation for it (other than from Seeking Alpha). I have no business relationship with any company whose stock is mentioned in this article.

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