



52-wk Range: £0.12-0.57 Market Cap (M): £80.6
 12 month target £0.90 EV (M): £69.9

Mining

After a company presentation

Summary

Australia headquartered Discovery Metals is focusing on developing its core asset, the Boseto copper project in Botswana, which it aims to take through BFS in the next 3 months



Event

Fox-Davies attended a company presentation by Discovery Metals, updating analysts on the latest developments at its Boseto Copper project.

Comment

Fox-Davies has made a number of changes to the model, the main ones being an increase in the strip ratio, and some changes to recoveries. We had increased the strip ratio when the capacity was increased from 2 to 3 Mtpa but we had not taken it high enough.

We have also increased the equity component of the funding for the project. At the presentation it was suggested that this would be between US\$30 and 50M, but the preference was to maximize debt. We have therefore assumed that US\$30M of equity will be raised at A\$0.80/share. Also, despite the timing of production being unchanged, the target being the December quarter of 2011, we believe that what with commissioning etc., even if a concentrate sale is made in that quarter, it will be the first quarter of 2012 before the mine is declared commissioned and expenses cease to be capitalized. This is a one quarter delay on our original schedule.

Recommendation

We retain the Buy recommendation with a reduced target price of £0.90/share., previously £1.04/share.

Key Metrics

Shares Outstanding (M): 230.3
 Current Price (GBP): £0.35
 Fully Diluted Shares (M): 273.3

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FYE Jun	2008	2009	2010E	2011E	2012E
Revenue (A\$M):	0.3	0.0	0.0	0.0	151.1
EBITDA (A\$M):	-5.3	-3.1	-0.9	-4.6	101.9
NPAT (inc significant items):	-4.8	-2.0	-0.8	-8.2	85.4
EPS (AUc):	-3.5	-1.0	-0.3	-2.3	25.1
Cash Flow/Share (AUc):	-3.8	-0.7	-0.3	-1.1	30.3
Copper Price (USc/lb):	314.5	233.9	314.6	340.0	347.5
Nickel Price (USc/lb):	963.6	664.1	907.2	1150.0	1200.0

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The Shareholders

There have been some substantial changes to the list of significant shareholders. Macquarie bank now tops the list with 11.5%. Following the award of the concentrate contract to Transamine, for an initial period of 5 years, Trafigura has left the share register with an orderly sale of its shares. Resource Capital has also exited the register and the new major shareholder is Citi Group Global Markets. The last issue, part of which was placed in London was deliberately placed with the view of improving liquidity.

The Project

There have been some major changes to the project. There has been a complete rethink on the processing plant. Instead of a primary crusher-coarse ore stockpile-SAG mill circuit, the current plan includes secondary and tertiary crushing followed by a ball mill circuit.

Further, with the economies of scale brought about by increasing the throughput from 2 to 3 Mtpa, the stripping ratio has increase. It was around 10:1, but will now go higher, probably to 13:1. In order to avoid poor recoveries when the plant is commissioned, it is planned to stockpile about 3Mt of the near surface oxide ore and process it at the end of the mine life. However, it will yield poor recoveries of around 30%. Originally, thought had been given to heap leaching the oxides, but much of the host rock is carbonates, which means that acid consumption would be very high. The main oxide layer is approximately 10m thick, but there are significant amounts of oxides down to 30m. As a consequence, we have lowered the recoveries in our model for the first year of operation.

In Botswana, capital expenditures can be recouped before a company commences paying tax. It is forecast that Discovery will not pay tax for the first three to four years and we have modelled this as 3 years. Tax rates are between 25 and 55% in Botswana, but the company forecasts it will be paying between 28 and 32%. For ease of modelling purposes, we have straight lined the tax at 30%.

The decision has been made to go with owner mining at Boseto. Contracting is very expensive in Southern Africa, and the Discovery management does not want to give away the contractors profit margin. The key reason for this is that the project is very sensitive to waste stripping.

Underground mining is expected to commence in year 5 of the mine life. The mining method will be sub level open stoping without fill, serviced by two declines from within the pit. Dilution is not expected to be a major problem as in the hanging wall grades slowing drop to about 0.25% copper. Therefore any dilution is expected to be mineralised.

Initially, the mine will operate using diesel generated electricity. However, the Botswana Government has being busy with infrastructure for the country. Unfortunately, this is unlikely to benefit Discovery in the short term Thought is being given to building a 25 to 30MW coal fired power station at site. There is plenty of reasonable quality thermal coal available in the country and it may be possible to back load it on the concentrate trucks. The other option would be to build a transmission line from site to Maun and connect into the grid when it arrives.

There is plenty of water available. A bore field has been found with saline water. Whilst this makes it unsuitable for human consumption without being treated, by mine standards it is relatively good and will provide sufficient water for the mine and mill.

Exploration

There has been no real exploration for several years. What has passed for exploration has essentially been infill drilling, and investigating the underground potential at Zeta. In the current presentation there is a map of tenements and prospect locations. It clearly indicates that there are at least 18 named prospects. Although Discovery has to give up some of its tenement holdings, it can achieve this whilst maintaining its prospects. It is planned to spend around \$5M pa on exploration going forward. The game plan, once the first mine has been established, is to build a second and perhaps more mines down the Ghanzi-Chobe fold belt where there is a 140km wide zone of deformation associated with the Central African Copper Belt, where Discovery has over 100km of strike length

The Zeta deposit has only been explored to a depth of 350m, but it is known that the ore body extends to a depth of 650m. Plutus and Petra have only been drilled to a depth of 175m.

Research Disclosures

Peter Rose

Peter Rose has 20 years experience in equities as a resources analyst, most recently having spent 11 years with Deutsche Bank in Australia. Prior to this he spent three years with Prudential Bache and five years with James Capel. Peter's industry experience includes 16 years as a metallurgist, three years with De Beers in South Africa and eight years in the uranium industry, five of which were spent at the Ranger Uranium mine. Peter holds a BSc degree in Applied Mineral Science from Leeds University UK and a Bachelor of Commerce from the University of South Africa. Peter is also a member of the Institute of Mining & Metallurgy and a chartered engineer.

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Research disclosure as of 07 July 2010

Company Name	Disclosure
Discovery Metals (DME)	7

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Mining					
African Barrick Gold	ABG LN Equity	HOLD	05.07.10	£6.16	£5.82
Angel Mining	ANGM LN Equity	BUY	03.03.10	£0.16	£0.06
Antofagasta	ANTO LN Equity	BUY	28.05.10	£10.33	£8.14
Atlantic Coal	ATC LN equity	BUY	21.01.10	£0.025	£0.004
Discovery Metals	DME LN Equity	BUY	07.07.10	£0.90	£0.35
EMED Mining	EMED LN Equity	BUY	05.07.10	£0.34	£0.08
Exco Resources	EXS AU Equity	BUY	05.07.10	A\$0.77	A\$0.245
Gippsland Limited	GIP LN Equity	BUY	06.10.09	£0.02	NA
Hambledon Mining	HMB LN Equity	BUY	20.05.10	£0.18	£0.07
Highland Gold	HGM LN Equity	BUY	05.07.10	£1.71	£1.18
Hochschild Mining	HOC LN Equity	BUY	05.07.10	£3.68	£3.07
KEFI Minerals	KEFI LN Equity	Spec. BUY	06.10.09	NA	£0.01
Kryso Resources	KYS LN Equity	BUY	21.04.10	£0.14	£0.14
Lydian International	LYD CN Equity	BUY	05.07.10	C\$1.5	C\$1.27
Minera IRL	MIRL LN Equity	BUY	05.07.10	£1.28	£0.58
Oxus Gold	OXS LN Equity	BUY	21.04.10	£0.30	£0.07
Randgold Resources	RRS LN equity	BUY	05.07.10	£74.65	£61.60
Stratex International	STI LN Equity	BUY	03.03.10	£0.07	£0.03

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