

## Metals & Mining

### Buy

8 December 2009

#### Upcoming Events:

1 More Sight to be Held in 2H09  
Tucson Gem Fair (Jan-10)  
HK Gem Fair (Apr-10)  
Resource Update for Tsavorite (1H10)

|                               |             |
|-------------------------------|-------------|
| Price (p)                     | 13          |
| Target price (p)              | 39          |
| Ticker                        | TNZ LN      |
| Market cap (US\$m)            | 22.7        |
| Cash in hand (US\$m)          | 5           |
| <b>52-week (p)</b>            |             |
| High                          | 24.0        |
| Low                           | 10.5        |
| 3M-avg daily vol (000)        | 179         |
| 3M-avg daily val (£000)       | 27          |
| <b>Shares</b>                 |             |
| Basic (m)                     | 106         |
| Fully diluted (m)             | 111         |
| <b>Top 3 Shareholders (%)</b> |             |
| Michael Adams                 | 9.5         |
| Nicholas Sibley               | 4.2         |
| Other Directors               | 5.8         |
| <b>Total</b>                  | <b>19.5</b> |

#### Share Price Performance (p)



Source: Fidessa

***Ambrian acts as Broker to and as a Market Maker in this company***

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# TanzaniteOne

## Operational Update

Following a robust recent operational update we continue to maintain that TanzaniteOne offers good equity exposure to a recovery in the luxury goods markets. The recent update (1 December) details that revenues total US\$11.2m so far this year. We forecast that full-year EBITDA (for December 2009) would be a loss of approximately US\$1m. This needs to be considered against its peers, many of whom are much deeper underwater. We conclude that TanzaniteOne is well positioned for profitability in 2010.

The new JV (*TanzaniteOne CuttingEdge*) has already borne fruit, leading to a pricing increase of 40% for the lower-grade material it focuses on. The JV's focus is on the marketing of a new classification grade of the stones (the top 20-30% of what was all previously C-grade), alongside different cutting strategies.

We model 1x NPV<sub>10%</sub> for the tanzanite operation of 29p/share, add a nominal value for the tsavorite project at 0.1x NPV<sub>10%</sub>, and add cash at face value to derive our valuation of US\$67m, or 39p/share. Given where the share price is today, we maintain our BUY recommendation and target price of 39p.

#### Sum-of-the-parts Valuation for TanzaniteOne

|   |                              |
|---|------------------------------|
| Tanzanite mine<br><i>1.0x NPV<sub>10%</sub>, LT tanzanite price US\$12/ct by end-2011 E/US\$ 1.64</i>                 | US\$50m/29p per share        |
| Nominal value for future Tsavorite Project<br><i>0.1x NPV<sub>10%</sub>, LT tsavorite price US\$12/ct E/US\$ 1.64</i> | US\$12.4m/7p per share       |
| <b>Operations</b>   | <b>US\$62m/36p per share</b> |
| Cash  | US\$5m/3p per share          |
| <b>Total NAV</b>  | <b>US\$67m/39p per share</b> |

Source: Ambrian estimates

We feel that the positive news contained in the company's Operating Update has been ignored by the market. TanzaniteOne has a market cap that is the same size as that of most low-end exploration companies on AIM. The fact is that this is a company that has a producing mine that washes its face on an operating profit basis appears to have been overlooked. Also, we note that the cash from the May 2009 equity raise will be spent on exploration of the tsavorite project, potentially adding value by leading to a resource estimate.

#### Financial Forecasts for TanzaniteOne

| Yr to Dec          | 07A  | 08A   | 09E   | 10E  | 11E  |
|--------------------|------|-------|-------|------|------|
| Revenue (US\$m)    | 42.6 | 26.9  | 12.0  | 27.9 | 41.7 |
| EBITDA (US\$m)     | 13.5 | (6.2) | (1.0) | 3.2  | 14.9 |
| PAT (US\$m)        | 9.5  | (9.4) | (3.0) | 2.0  | 9.6  |
| EPS (US¢)          | 9.0  | (8.9) | (2.9) | 1.9  | 9.1  |
| P/E (x)            | 13.4 | N/A   | N/A   | 11.5 | 2.3  |
| EV/EBITDA (x)      | 5.6  | N/A   | N/A   | 5.4  | 1.2  |
| Dividend yield (%) | 8.4  | 34.5  | 0.0   | 0.0  | 0.0  |

Source: Company data, Ambrian estimates

## The Operational Update

In addition to the US\$1.82m realised from the third sight of the year, US\$2.48m was made from sales outside the formal sights. Taking into account the second sight's proceeds, this means that so far in this half of the year US\$6.3m has been made (1H09 witnessed a turnover of US\$4.9m).

We forecast that the outlook for the company's year-end results will probably see an EBITDA of negative US\$1m. This is a position that compares favourably to its peers (many of whom are suffering from more significant losses) and should ensure the company is well poised to stage a substantial recovery – in line with a pick-up in demand in the luxury goods market.

The news that the new JV (*TanzaniteOne CuttingEdge*) managed to realise pricing increases of 40% (over traditional sales routes) for the lower-grade material it focuses on is very positive. The strategy's success at this stage demonstrates that over time (as the market still needs building in Asia – where the marketing of this product stream is focused), higher revenues are likely to be realised over a larger portion of the mine's overall product stream.

## Market Outlook

Demand drivers in the tanzanite market are broadly analogous to the diamond market. We think that a recovery in diamond pricing is likely to be a more protracted affair than the sharp gains witnessed in 2Q09. This is because: a) a recovery in the luxury goods market will obviously lag any global economic recovery; and b) lots of supply that was either idled or forecast to be has come back online. This is in addition to a large Russian rough stockpile overhanging the market. Tanzanite is unlike diamonds in that it does not have the supply overhang that the diamond market has and thus could be poised to recover a little quicker. We summarise some recent events within the market below:

### Positive Elements

- The consumer price index (CPI) for jewellery in the US rose to its highest level since September 1995 during October (gold jewellery down 30% over 3Q09 – so better for rest of jewellery sector?).
- Russian's Central Bank buying US\$1bn of Alrosa's diamonds, which (at least in the short term) should sweep up a portion of a large inventory overhang from Alrosa (as the organisation didn't switch off production during the worst of the downturn). This has pushed up rough prices.

### Negative Elements

- It would seem that a lot of jewellery fabricators/sales outlets are 'sitting on the fence' to gauge consumer demand ahead of Christmas before sanctioning large inventory restocks. To that end, if Christmas retail comes in stronger than expected, there could be a larger portion of buying demand in the post-Christmas sights. If the latter scenario plays out, mid-year 2010 (perhaps at the time of Hong Kong Gem Fair on April) could be a good time for an entrance point into the market – for some equity exposure.

We have modelled up to 1.7Mct full-year production for the tanzanite mine this year, ramping up to a maximum of 3Mct pa production in 2012

## Valuation – Cost Saving Initiative Ups NPV

We model the tanzanite operation on a post-tax DCF basis, presenting an operational and financial summary below. The nominal value we attribute to the tsavorite project is generated by the application of a 0.1x NPV multiple to a forecast operational model (consistent with the discount we normally apply to projects without a feasibility study). For this operation we have used management guidance for operating costs (having observed the similar processing routes in operation in South Africa) and the same LT price (US\$12/ct) as the tanzanite model, which we consider conservative given that tsavorite, on a per carat basis, trades at a considerable premium to tanzanite. We add cash at face value.

Once a reserve estimate and feasibility study for the tsavorite project are released (forecast for 1H11), we will integrate forecast production into the financials and increase the multiple applied to NPV.

| Operational Model for the TanzaniteOne Operation |      |        |       |       |       |       |
|--|------|--------|-------|-------|-------|-------|
| Yr to Dec  | 07A  | 08A    | 1H09  | 09E   | 10E   | 11E   |
| Tanzanite sold (Mct)                             | 2.57 | 1.81   | 0.13  | 0.61  | 2.07  | 2.95  |
| Mined tanzanite price (US\$/ct)                  | 9.0  | 9.0    | 6.0   | 7.0   | 9.9   | 12.0  |
| On-mine cash cost (US\$/t)                       | N/A  | 4.6    | 4.0   | 4.3   | 4.6   | 4.6   |
| Revenue (US\$m)                                  | 42.6 | 26.9   | 4.9   | 12.0  | 27.9  | 41.7  |
| Operating costs (US\$m)                          | 32.3 | 33.2   | 5.0   | 14.1  | 26.2  | 28.8  |
| EBITDA (US\$m)                                   | 13.5 | (6.2)  | 1.0   | (1.0) | 3.2   | 14.9  |
| Finance income (US\$m)                           | 0.3  | (0.0)  | (0.1) | 0.0   | 0.1   | 0.3   |
| Depreciation (US\$m)                             | 1.7  | 2.2    | 1.1   | 1.8   | 1.4   | 1.8   |
| PBT (US\$m)                                      | 12.1 | (8.4)  | (0.2) | (2.7) | 1.9   | 13.4  |
| Tax (US\$m)                                      | 2.5  | 1.1    | (0.8) | (0.8) | 0.0   | 3.9   |
| Minority interest (US\$m)                        | 0.1  | 0.1    | (0.0) | (0.1) | (0.1) | (0.1) |
| Attributable PAT (US\$m)                         | 9.5  | (9.4)  | (0.5) | (3.0) | 2.0   | 9.6   |
| EBITDA (US\$m)                                   | 13.5 | (6.2)  | 1.0   | (1.0) | 3.2   | 14.9  |
| Tax (US\$m)                                      | 2.5  | 1.7    | 0.0   | 0.0   | 0.0   | 3.9   |
| Less: mining capex (US\$m)                       | 2.7  | 4.1    | 0.5   | 1.5   | 2.0   | 2.0   |
| Interest-bearing borrowings (US\$m)              | 0.0  | (0.5)  | 0.5   | 0.9   | 0.9   | 0.9   |
| Attrib FCF from operations (US\$m)               | 8.3  | (11.6) | 0.5   | (2.5) | 1.2   | 9.0   |
| NPV <sub>10%</sub> (US\$m)                       | 50.6 |        |       |       |       |       |

Source: Company data, Ambrian estimates

The numbers shown above are generated by our forecast modelling of the tanzanite operation, which is based on the assumption of a graduated increase in the tanzanite price for mined stones and 'bought stones' (ie, those purchased from the garimpeiro-produced market based around Arusha). For mined stones, this changes from an average of US\$8/ct for 2H09 to our LT forecast of US\$12/ct in 2012. For bought stones, we apply a similar ratio of price increases.

| Target Price Sensitivities to Average LT Tanzanite Prices on Mined Product |            |             |             |             |
|--|------------|-------------|-------------|-------------|
| Discount   | US\$9.0/ct | US\$10.5/ct | US\$12.0/ct | US\$13.5/ct |
| 8%   | 14         | 29          | 44          | 58          |
| 10%  | 13         | 26          | 39          | 52          |
| 12%  | 13         | 24          | 35          | 47          |

Source: Ambrian estimates

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