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Very Promising New Cobalt Story with \$55 million cash

Formation Metals (FCO.T \$0.48)

www.formationmetals.com

52wk High \$2.76 / Low \$0.47

Last Financing: \$80 Million in March at \$1.50

Industry: Cobalt (strategic industrial metal to the United States)

This appears to be an exceptional opportunity for 2012 so we will follow into the new year. First take a look at their financials filed last week for the period ending August 31st.

Shares Outstanding: 91 million

Cash \$54.7 million (\$0.60/share)

Silver & Gold Inventory \$4.6 million (\$0.05/share)

Property, plant and equipment at book value: \$20 million (\$0.22/share)

Capital expenditures spent on mineral properties: \$62 million (\$0.68/share)

Deferred tax assets: \$4.3 million (\$0.05/share)

Accounts Payable: \$4.2 million (\$0.05/share)

Deferred Tax liabilities: \$7.6 (\$0.08/share)

Six month refinery revenue: \$7.9 million (operating income \$934k)

Liquidity is good near this 52 week low of \$0.48. We are buying cash only that is discounted 20% at this price and paying nothing for the cobalt reserves or operational refinery. Cobalt is a strategic metal used in super alloys like all plane engine turbines (and many other uses). The United States is the world's largest consumer but has no domestic production. This would be the only producer of pure cobalt on U.S. soil.

Formation is currently working to raise \$80 million through a debt facility to complete capital requirements necessary to put the mine into production (described near the

bottom). Two scenarios will emerge short term.

1) The money will be successfully raised before year end. Mine development work continues and the company will supplement this with existing cash reserves (obviously retaining some for working capital). Like any new startup, risks will exist and we hope they do not have too many operational hiccups along the way. The stock should bounce on a positive financing but then stabilize pending operations. Once in production, the stock price again should be re-rated to the upside and longer term value based upon whether they are profitable or not.

2) They are unable to close this \$80 million financing before year end and work on it continues into Q1/12. Under this scenario they will preserve the large cash position and continue to operate the refinery processing regional gold and silver for 3rd parties. Once the Cobalt mine is financed and in production, this same refinery is then used to refine the cobalt for resale.

Either way this also becomes a pure cobalt play. If the commodity price recovers this next year (or in subsequent years), the stock would do extremely well.

Jennings Capital Analyst Report

Their target 12 month target may be too high given the correction we have seen in the market since May but we can use this for reference. **Jennings Capital issued a Buy Rating on Formation May 19th with a 12 month target of \$2.60** (the stock was then trading at \$1.07). The report was prepared by two MBA analysts and I have included the most relevant excerpts below. I had a lot of due diligence from the company's public filings, their website, and overall research but the Jennings report I found did a good summary so we will use that for now.

Summary - We are initiating coverage on Formation Metals Inc., a Canadian junior mineral exploration and development company, whose key assets include a 100%-owned cobalt property in Idaho and a 100%-owned hydrometallurgical complex situated approximately 200 miles from the cobalt mine site.

Cobalt is classified as a critical metal by the European Union and deemed a strategic metal by the United States Government. High purity cobalt is vital to the aerospace industry and used in the manufacturing of rechargeable batteries and as catalysts for the petroleum and chemical industries. Approximately 76,000 tons of refined cobalt was produced globally in 2010, representing an estimated market value of US\$3 billion. Two grades of cobalt have quoted prices: 99.3% and 99.8%. High purity cobalt exceeds 99.99%, with extremely low impurities, and is very difficult to produce.

Formation will be the only cobalt producer in the U.S.A. and one of a handful of high-purity, superalloy grade cobalt producers in the world. The U.S.A. accounts for approximately 60% of global high-purity demand.

Valuation

We are initiating coverage on Formation Metals Inc. with a SPECULATIVE BUY recommendation and 12-month target price of C\$2.60. Our target price is based on an equal blend of: (1) NAVPS of C\$2.35; and (2) a 6.0x multiple applied to our 2013 CFPS estimate of US\$0.47.

Our NAV model for the Idaho Cobalt Project (ICP) is based on a Bankable Feasibility Study completed in 2008, with FCO expected to produce 3.3 million pounds annually (1,525 tons) of cobalt metal at an average life of mine (LOM) cash cost of approximately US\$6.00 per pound (including copper and gold credits) and using an average cobalt price of US\$21.95 per pound. We have also ascribed a nominal value for the Saskatchewan uranium assets and the Mexican gold/silver assets.

Based on the annual cobalt production, prices and costs used above, coupled with annual copper and gold production of approximately 3.8 million pounds and approximately 3,900 ounces, respectively, our model indicates that Formation will generate US\$53 million in cash flow or US\$0.54 per fully diluted share.

Some of the major attributes of the project we believe to be key in making Formation a quality investment include:

1) Sulphide Ore Containing Very Few Impurities: The ICP is a unique, primary cobalt deposit containing few impurities and is capable of producing superalloy grade, high-purity cobalt metal. This would therefore position Formation as both a producer of premium-priced products, as well as products for less technically stringent applications, thus ensuring Formation will always have an end market for its product.

2) Ownership of an Existing, Fully Permitted Hydrometallurgical Facility: Formation purchased its Hydrometallurgical Facility out of receivership for US\$1.2 million, by paying a tax bill, and retrofitting is estimated to cost an additional US\$2 million. A new entrant would be faced with paying at least US\$75 million for a comparable facility (as well as substantial permitting hurdles), which would likely render a new high-purity cobalt project economically unfeasible.

3) Location, Location, Location: The ICP will be the only cobalt producer in the United States and one of only three high-purity producers within North America. The United States accounts for approximately 60% of global high-purity cobalt

consumption. Furthermore, the ICP is situated in the heart of the U.S. aerospace industry, which stands to be one of the fastest growing sectors in the coming years.

4) Low Cost Producer: According to a Bankable Feasibility Study, Formation's ICP is expected to produce high-purity cobalt for an average cash cost of US\$7.73, and when we include gold credits, our model yields an average cash cost of approximately US\$6.00 per pound. Gold was not included in the Bankable Feasibility Study because there were insufficient quantities of ore at the time of the study. However, following the Bankable Feasibility Study, Formation completed a multi-million dollar round of pilot work, the results of which satisfied management that gold production estimates will be realized.

ICP Has an Abundance of Exploration Upside We expect Formation's reserves to increase following the release of the final assay results from FCO's 2010 mine plan optimization drill program on the Ram deposit. The drilling confirmed economic ore grade mineralization and an additional 390 feet along strike to the south and 200 feet down dip, representing a 14% increase in the known strike extension of the Ram deposit to 3,200 feet.

The Ram Deposit remains open along strike to the north and south and down dip, and the ICP contains two additional known cobalt deposits.

ICP Provides U.S.-based Companies with a Secure, Dependable Supply of High-Purity Cobalt

We contend that Formation's high-purity cobalt production will be a welcome alternative in the U.S., relative to many existing cobalt supplies. For example, the Democratic Republic of the Congo (DRC) produces 40% of global cobalt as a by-product from copper and artisanal mining, and is home to approximately one-half of the world's known cobalt reserves. The country has recently undergone a civil war and its political landscape remains unstable.

Moreover, China, who is the leading cobalt refiner in the world with approximately 39% of the market, imports approximately 90% of its cobalt ore, and approximately 85% is sourced from the DRC. Moreover, it is very difficult to produce high purity cobalt from the Congo material.

Opportunity to Buy into the Product at a Discount

Cobalt prices (99.8% purity) have stabilized in the US\$18.00 to US\$19.50 per pound range, after plummeting to US\$12.25 per pound in December 2008, but still remain far below the 2007 and 2008 averages of US\$30.78 and US\$39.04 per pound,

respectively. Based on what we believe to be favourable market fundamentals, we expect prices to continue to recover to pre-economic crisis levels. High purity cobalt typically trades at a premium to 98.8% grade cobalt.

Idaho Cobalt Project: Fully Permitted:

Due to a longer than originally expected permitting process, the project progressed at a somewhat slow pace and did not gain meaningful momentum until recently. In 2007, the project received a positive NI 43-101 Bankable Feasibility Study, and in June 2008, received a final Environmental Impact Statement. In early 2009, FCO received a Record of Decision from the U.S. Department of Agriculture Salmon Challis National Forest and a Record of Decision from the U.S. Environmental Protection Agency, as well as a Section 401 Certification from the Idaho Department of Environmental Quality.

In December 2009, the final approval allowing construction to commence was granted, when FCO and the Forest Service signed the "Forest Service Evaluation".

The Company's mineral processing business consists of a hydrometallurgical facility in Northern Idaho. This facility was originally purchased by the Company in order to process the cobalt concentrate. It will have to be refurbished to process the cobalt concentrate to meet the supply from the Idaho Cobalt Project when the mine is put into production. The facility also contains a precious metals refinery, which the Company has refurbished to process third party precious metals materials. Material is refined into high purity silver and gold bullion.

----- END OF JENNINGS EXCERPTS

2011-10-06 15:02 ET - News Release

FORMATION METALS' BOND ISSUERS EXTEND DATE FOR IDAHO COBALT PROJECT CREDIT FACILITY

Formation Metals Inc.'s bond issuers have extended the date to provide letters of credit to back the \$77.7-million (U.S.) raised in Federal Stimulus Program Recovery Zone Facility bonds from Oct. 6, 2011, to Nov. 21, 2011 (see news release dated Dec. 30, 2010). Proceeds raised from the issue of the bonds are to be used exclusively for the development of Formation's 100-per-cent-owned Idaho cobalt project (ICP).

The boards of directors of the bonds' issuers, the Industrial Development Corporation of Lemhi County and the Industrial Development Corporation of Shoshone County, Idaho, both met in special sessions on Tuesday to approve the extension. The original indentures are amended effective Oct. 5, 2011, to provide that the facility must have an effective date not later than Nov. 21, 2011. The investment banking firm Thornton

Farish Inc. is acting as the remarketing agent for the bonds.

Per the company's news release dated July 29, 2011, the facility being arranged by BNP Paribas contemplates two letters of credit totalling \$79.5-million (U.S.) that will support the payment of principal and interest accruing on the bonds: (1) a project financing letter of credit, which is currently being syndicated by BNP Paribas on a best-effort basis, consisting of \$58.5-million (U.S.) in support of the Lemhi County bonds for the construction and development of the ICP mine and mill facility, and (2) a \$21.0-million financial letter of credit, in support of the Shoshone County bonds for the retrofitting of the ICP hydrometallurgical plant and construction of the cobalt beneficiation plant.

It is now contemplated that the project financing letter of credit will be supported with a charge against the ICP, and the financial letter of credit will need additional support. Formation is currently reviewing its options to secure the additional support required for the facility for the Shoshone County bonds.

Current estimates indicate that the total remaining capitalization expenditures for the ICP are expected to be on the order of US\$141.9 million which includes the reclamation bonding costs. This new cost estimation consists of US\$88.4 million for the mine concentrator, infrastructure and bonding, and US\$53.6 million for the retrofitting of the hydrometallurgical plant. These costs include mechanical and electrical equipment, construction materials, labor and labor supervision, and contracted direct and indirect costs for these facilities.

The mine life is expected to be longer than the minimum ten years outlined in the Technical Report, as the primary deposit remains open along both strike directions and at depth and including inferred material would add an additional 4 years to the mine life. In addition, numerous other targets remain to be explored and developed on the property.

There are 7 engineering companies fully engaged and working on finalizing different aspects of the engineering plans for the mine and the cobalt production facility. This includes engineering work on site, roads, portal bench, tram layout revisions, power line layout, tailings and waste rock storage facility final design and concentrator site layout and design. Between now and October 2012, the Company expects to hire a total of 52 employees for the Salmon operation and an additional 41 employees for the Kellogg facility totaling 93 new jobs in Lemhi and Shoshone Counties, Idaho. These additional jobs are expected to have a very positive impact on both local economies.

On the company's website there are two videos showing the project construction work and also the refinery in operation

<http://www.youtube.com/watch?v=zWEuyXqZp5g>

<http://www.kereport.com/2011/09/10/formation-metals-precious-metals-refinery/>

Also some interesting insight from a September 23rd MIT publication. It makes reference to the strategic importance of cobalt to the United States.

"In a diplomatic cable released by **WikiLeaks** last year, there was mention of a cobalt mine in the **Democratic Republic of Congo**. **The document revealed that the U.S. Department of Homeland Security considered this mine so vital that its "incapacitation or destruction ... would have a debilitating impact" on U.S. security or the national economy.** That's because the U.S. is the world's largest consumer of cobalt, but mines none of it."

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