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Does KFx really want you to know about Kennecott?

On April 4th, 1996 KFx, Inc. (AMEX: KFX, \$14.40) entered in to an agreement with Kennecott Alternative Fuels ("KECC") to form K-Fuel L.L.C. ("KFL"). KECC was a wholly owned subsidiary of Kennecott Energy and Coal ("Kennecott"), a subsidiary of Rio Tinto, PLC (NYSE: RTP \$155.21). At the time the joint venture was formed, KFL became the worldwide exclusive license holder for all K-Fuel technology. In accordance with the terms of the agreement, Kennecott assumed a 49% interest stake in the venture, and KFx assumed the remaining 51%. For its stake in K-Fuel, Kennecott paid KFx a \$1,000,000 joint venture fee in 1996, and agreed to pay all research and development fees up to \$4,000,000.

But until 2001 Kennecott was engaged in testing KFx's new technology, which is now incorporated into KFx's plant at the Fort Union mine site in Gillette, Wyoming.

The process Kennecott tested was a semi-continuous coal drying process that uses saturated steam as its heat source and employs a feed lockhopper to load the coal in to a pressurized vessel and a product lockhopper to unload the coal. Thusly, expanding the water in the coal while applying pressure to the coal particles to "squeeze" out the water hopefully without causing spontaneous combustion or dusting problems.

This is exactly the process that KFx's plant at the Fort Union mine site in Gillette uses and exactly the results that KFx is telling investors that they will produce.

KFx has given much credence to the Kennecott's testing. It is referenced to in a "Technical and Business Analysis" report dated June 24, 2004 authored by KFx consultant Richard Wolfe. In Wolfe's writing, the Rio Tinto memo is referred to as an "independent technical report" and is called "commendable".

Funny enough, Kennecott was not an "independent" party at the time of the memo, but became one soon enough. Two years after concluding its testing it opted out of the KFx joint venture giving up its 49% interest in KFx's new technology. As a result KFx retained a 100% ownership of KFL.

To opt out of the joint venture, KECC exchanged its 49% equity in KFL, for KFx's 65% equity stake in Pegasus Technologies, LTD.

KFx had acquired a 60% interest in Pegasus, in March of 1998, for \$2,200,000.

Kennecott may still have some rights to build and operate K-Fuel plants and market K-Fuel from those plants but it does not appear that it has exercised any of those rights or given any indication they will in the future.

Judging by Kennecott's decision to leave after five years of testing KFx's latest scheme (its had several in its 30 year history), and by Mark Sexton's empty-handed return to KFx, it appears that KFx is going to need to squeeze its coal a little harder and more gently at the same time before it can squeeze short sellers out of its stock.

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