Fear

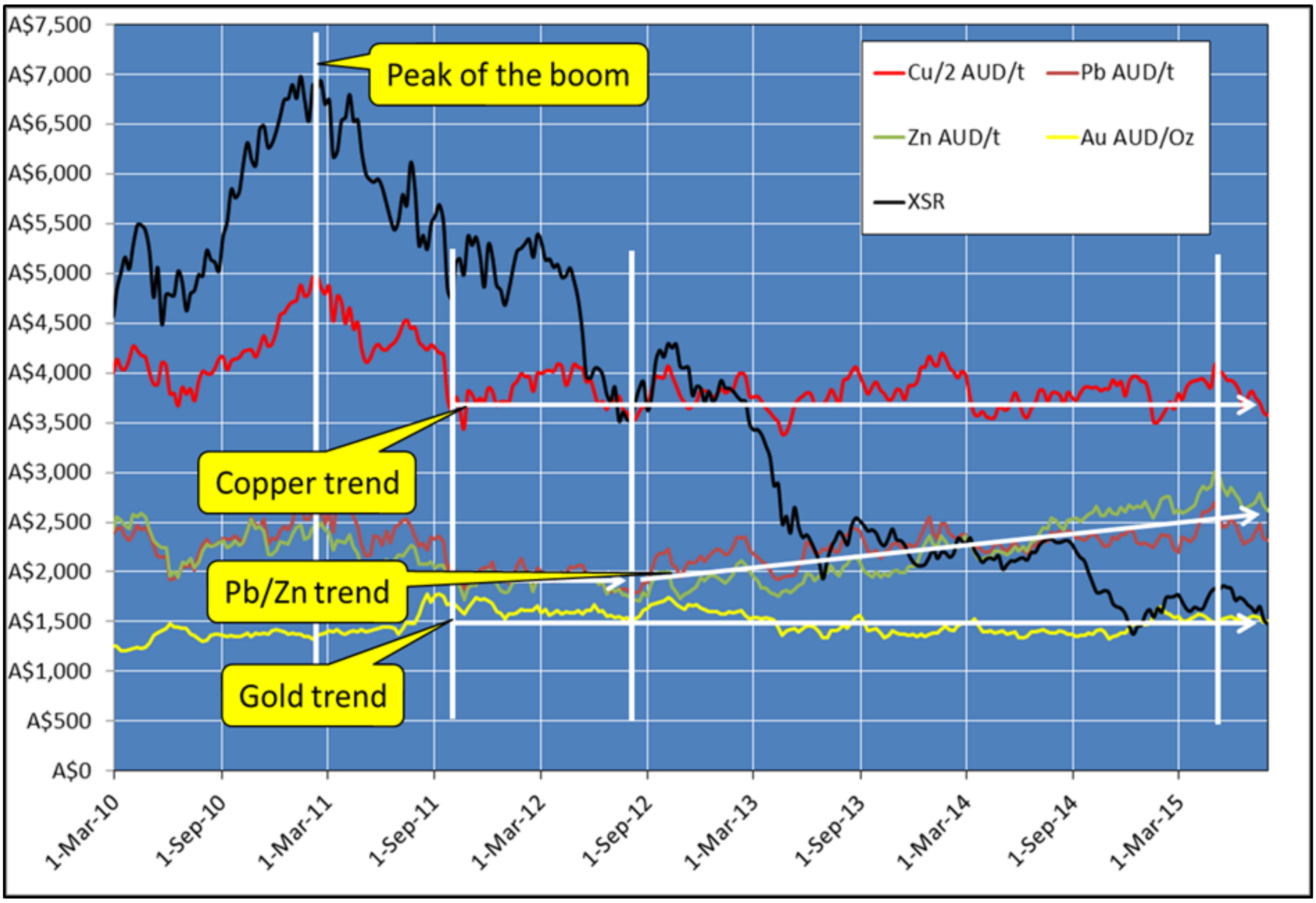
&

Loathing

Or an OPPORTUNITY?

As a follow on from last months column, I will offer a few observations on the current state of both the stock and commodities markets, and also share some thoughts about what is being looked at.

Firstly, please have a look at the following chart.



This shows major metals prices and the ASX Small Resources Index (XSR) from early 2010. Note here, however, that I have plotted metals prices in Australian Dollars, rather than US Dollars in which prices are denominated, and most people react to and base their judgements on. Also, so as the graph is easier to read the copper price shown is actually half of the actual price.

What does the graph tell us? In Australian Dollar terms, as I mentioned last month, major metal prices have stayed stable else increased in nominal terms over the last four years. In real terms knock off around 7% to take into account Australian CPI increases. So why all the doom and gloom, as shown by the XSR?

Unfortunately, even over four years after peak of the “super-cycle”, investors are still gun-shy, and the XSR basically reflects investor sentiment. As can be seen, it is less than a quarter of what it was at the peak. Remember any investments in the sector are risky, and investors are continuing to pull and keep their heads in, largely given the uncertainty in the global economy, particularly regarding China and the Eurozone, but also due to the fact that a number did lose money in the boom, and have lost faith in the sector.

Investors are now correctly being more prudent in their investments, but does this mean that they should ignore the sector completely? There are good medium to longer term investment opportunities to be had. However, a lot of potential investors still think of the exploration game in terms of the short term stag (as promoted by the pumpers and dumpers in the last and preceding booms) rather than a patience game. This lack of funds is particularly affecting earlier stage exploration – even companies with quality exploration ground are still finding it extremely difficult to source the equity required to fund effective exploration.

Another key issue is the lack of funding for project capital, which is affecting how some companies are operating, and also critically affects valuations in the sector. Most companies that have advanced projects that may need significant development capital in the short to medium term are being heavily discounted. I say most– there have been examples, most notably Sirius with the Nova-Bollinger discovery, that, given the nature of the project have suffered no discounting. Also, where funding can be sourced, a question that the relevant company may need to ask is “how far would you like me to bend over?” There have been some particularly onerous funding deals done where the only beneficiary is the financier.

Another factor that is coming into play is project scale. We are seeing a number of smaller projects being promoted and developed – these are ones that would have been ignored during the euphoria and, dare I say it, megalomania of the boom, where capital was freely available for large scale projects with forecast shareholder returns and economics predicated on metals prices that were going to increase for ever. In hindsight, the failure of a number of these projects comes as no surprise. Unfortunately a lot of money was lost, leaving a lot of gun-shy investors!

Small start-ups are also being looked at as a way to fund exploration without having to raise pure risk equity at sub-optimal prices.

These smaller projects have lower capital requirements, and can be candidates for a number of different funding options, in addition to the standard debt/equity funding. Such options include production sharing arrangements. What however has to be taken into account are economics of scale – these projects will cost more, both in regards to capex and opex, per unit of production than their larger cousins.

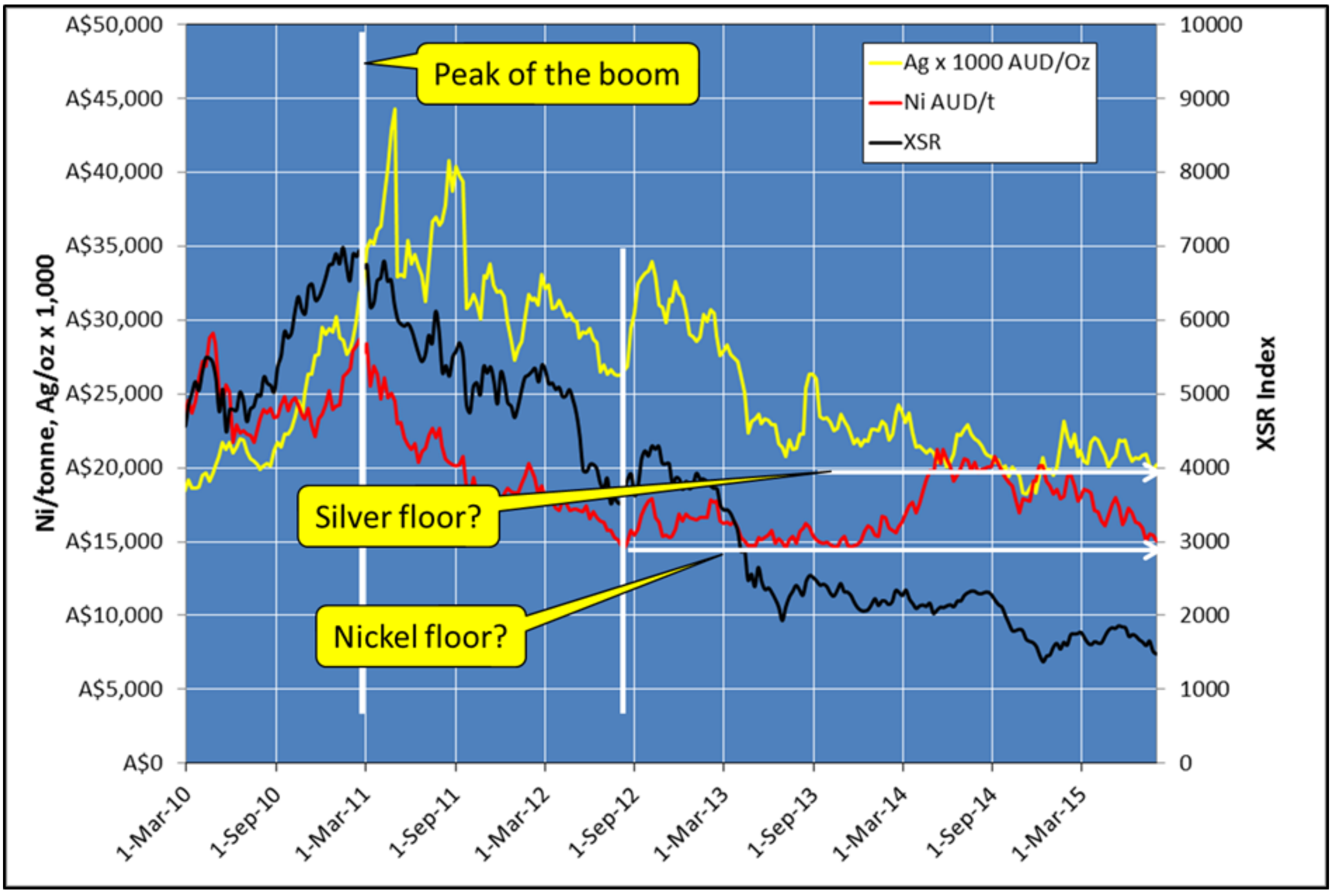
However, a successful small start-up, although not immediately generating multiple returns on share prices can form the basis for longer term expansion, fund exploration and give the board and management team market kudos.

Onto metals prices. The above graph shows some developing (or developed) strong trends in AUD denominated metals prices, and, for investments in at least Australia (or countries with a currency that acts like the Australian Dollar) should give some comfort.

On the broad front, tying in prices and the XSR, we saw the peak of the boom in early 2011, and it has generally all been downhill in the sector in the subsequent 4 ½ years since. We note an inflection point in late 2011 – a false dawn so to speak, but one which saw the end of falls in AUD denominated metals prices. This was followed by another inflection in the index in August 2012, coincident with a change to an upward trend in AUD denominated lead and zinc prices. Mid May this year saw yet another inflection, however does this mark a downward change in long term trends (particularly in the case of lead and zinc), or just a typical short term fluctuation?

So what does it all mean? There should be some confidence in investing in the right stories (and I have gone through what I consider criteria to look at ad nauseam in the past). Most metal prices are (at least for the moment) behaving themselves in AUD terms, with prices being the key parameter that a company has no control over.

You may note that I have not included silver or nickel in the above graph and discussion – these are more volatile and haven't behaved as well as the others, as seen in the graph below. However there is possibly a floor on the AUD denominated prices for these commodities that can be used in assessing projects. Silver also has a natural hedge, being both used both in jewellery and industrial applications.



As a wrap up of the above, with anecdotal evidence of Australian costs decreasing, it would appear that the fundamentals are in place for confidence in investing in companies that have quality projects in Australia, else countries that show similar behaviour between exchange rates and metals prices.

Although the overall sector is still depressed, there are good investment opportunities out there, and there is interest in such stories. As I have said repeatedly, good due diligence is required to sort the wheat from the chaff, and patience is required.

Now just to get confidence back into the exploration sector as a whole (and not just the nearology stories, e.g. the companies operating in the Fraser Range that are rightfully holding investor interest) – without exploration there will not be the discoveries that are needed to sustain our great industry, and which Australia needs.

Onto the Soapbox

So what's annoying me this week? Plenty as usual, since I am fast turning into a grumpy not so old man.

Continuing from above on the subject of mining investment in Australia, let's turn to politics and the media.

Firstly, below are some points regarding politics and the bureaucracy I presented in a talk to the RIU conference in Brisbane last year, and re-iterated in a later column, largely relating to exploration companies.

Governments and Bureaucracy:

- Differ widely between jurisdictions
- Can be overly bureaucratic and inflexible – increasing red (and other coloured) tape leads to delays and additional non-productive costs
- Time is money for juniors – still need to "keep the lights on" - ~$500k to $1m per year for a junior including salaries
- Juniors rely on exploration activities and success to boost share price
- Delays in field activities due to statutory requirements can lead to slippage in share price and hence more dilution in equity raising
- Some government decisions appear to be based on short term electoral gain, and not long term benefits
- However, overall Australia is a reasonable destination, average Fraser Institute rank of 7 states 22/153. worst 39/153, best 6/153 *(see table below for subsequent changes in rankings)*
- Technical support (e.g. geological surveys, online services) first class throughout Australia, as well as financial support for drilling

These points still stand, and in some cases are getting worse. And here I am not having a go at the largely competent, helpful and professional personnel who man the frontline, e.g. as in my last point above. Unfortunately most of the time they are doing the bidding of their political masters (why are they termed our political "masters" – this implies some superiority, which given a lot of the current crop they do not deserve).

Please see some comments from my February 2015 column below.

And things ain't improving judging by comments from colleagues. Noisy minorities here, in addition to the usual rent seekers and anti-mining groups (who do enjoy the benefits of the industry) include the media who have the potential to affect the majority, and also politicians, who I said are more often than not too worried about polls and

	2014 Ranking - 122 Jurisdictions	2014 Relative Ranking	2013 Ranking - 112 Jurisdictions	2013 Relative Ranking
New South Wales	51	42%	39	32%
Western Australia	5	4%	1	1%
Tasmania	39	32%	36	30%
Victoria	66	54%	43	35%
South Australia	19	16%	20	16%
Northern Territory	31	25%	17	14%
Queensland	27	22%	21	17%
Average	34	28%	25	20%

Need I say more? It is too depressing to contemplate. Talk about strangling the goose. This is a country that has a proud mining heritage, which in recent times has helped support the country through tough times.

I think it is time for state governments (with some notable exceptions) to pull their collective heads out of their collective rear ends, and actually support our industry, instead of being obstructive and listening to the noisy minority.

short term political gain rather the good of the country. Just look at where my own state is heading – I do not look forward to next year's survey, except for in the cases of a few other states rather than what has been called in the past the "Premier State" …….

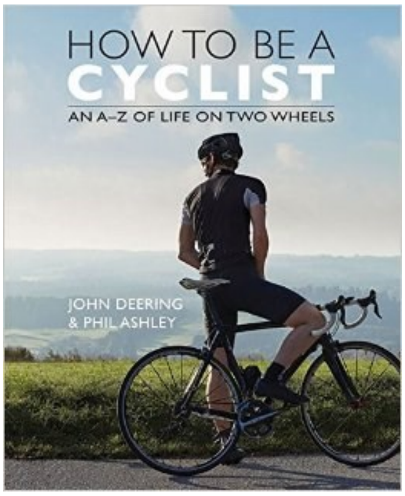
With regards to the media, I do read and listen widely, and am commonly dismayed by the lack of understanding of subject matter reported upon. More critically I see blatantly biased viewpoints that are "supported" by untrue "facts", or more insidiously, introduce bias through omission of key facts. This is in addition to the commonly un-thinking, un-critical pack hunting instincts of a lot of the main-stream media. Anything to get a story and a head-line appears to be a mantra and a path to progressing careers. **Hopefully I am not found guilty of the same sins.**

This is a time where support is needed for the industry. There are a lot of dedicated professionals who have lost jobs, or else are severely under-employed and doing it very tough. If they were factory workers somewhere they would possibly have sympathetic media attention (let us say the car industry?). The fact they have worked for an industry that has a negative opinion in the eyes of a few noisy sectors of the community means that they are largely overlooked. We are looking at a critical loss of skills from the industry.

Now to my bookshelf….

"So many books, so little time" – Frank Zappa

I do have other passions and interests besides the mining industry (and yes, it is a passion and not just a means to an end or to pay the bills). One of those is cycling (and I hope I don't disenfranchise those readers I know who are out there that have a dislike of cyclists – I unlike a lot of riders do not go out of my way to annoy drivers or terrorise pedestrians). Although I don't have many cycling books, there is one I would like to share.



This is "How to Be a Cyclist – an A-Z of Life on Two Wheels" by John Deering and Phil Ashley. No, this is not a "For Dummies" equivalent, but a humorous and informative look at various aspects of cycling, in alphabetical order. Some are instructional chapters (so I suppose there are some "For Dummies" aspects in there), and some that delve into the ethos and traditions of the sport.

Make that two I would like to share – the second is "The Rules – The Way of The Cycling Disciple", published by the Velominati. This is a set of rules and explanations written by hard core cyclists for hard core cyclists to adhere to (more passionate cyclists than I). You know who you are because you know the Velominati website, (which includes the rules, and worth a look at) backwards…..

Whilst on the cycling theme.

I again am riding in the Sydney Ride to Conquer Cancer this year, held on the weekend of October 10-11. As was the case last year I am looking for sponsorship, having to raise $2,500 to ride. All donations go directly to the Chris O'Brien Lifehouse at Royal Prince Alfred Hospital here in Sydney.

This has also got more personal this year – my 15 year old nephew was diagnosed with a brain tumour earlier this year, however hopefully is now over the worst, and currently undergoing physiotherapy.

If you would like to donate please cut and paste the following into your web browser, and it should take you to my homepage.

http://sy15.conquercancer.org.au/site/TR/Events/Sydney2015?px=1284966&pg=personal&fr_id=1220

Thanks in advance for your kind donation.

Until next month. Mark Gordon