

Resources Rising Stars  
Gold Coast Conference 2015

**Junior Resources**  
**The State of Play**  
*or*  
**The Hangover Part IV**

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# *Presentation Outline*

- Breakaway Investment Group/Lime Street Capital Overview
- Juniors – a Brief Introduction
- 20:20 Hindsight – A Short History of the Cycle
- 20:0 Foresight – Where to From Here?
- Where Are The Opportunities?
- Assessing The Opportunities

# ***Breakaway Investment Group***

***www.breakawayinvestmentgroup.com***

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## **Breakaway Research:**

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+50 companies over 5 years and growing  
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## **Breakaway Mining Services:**

- Project evaluation and execution.

## **Breakaway Private Equity:**

- Focused on pre-IPO or direct project investments.
- Investigating setting up an overseas strategic metal fund.

# Notes Released in 2015 and Ongoing Coverage



# *Junior Resources – An Introduction*

- **Who are they**
  - Companies with no (or little) revenue stream to support their exploration activities
  - Largely rely on equity financing to fund exploration activities
  - ~800 listed on the ASX
- **Why do we need them?**
  - Committed, motivated explorers
  - 53% of non-bulk Australian discoveries 1994-2003, 66% 2004 – 2013
- **Challenges**
  - Tough markets ~50% of companies effectively dormant
  - Bureaucracy in some jurisdictions
  - Community activism

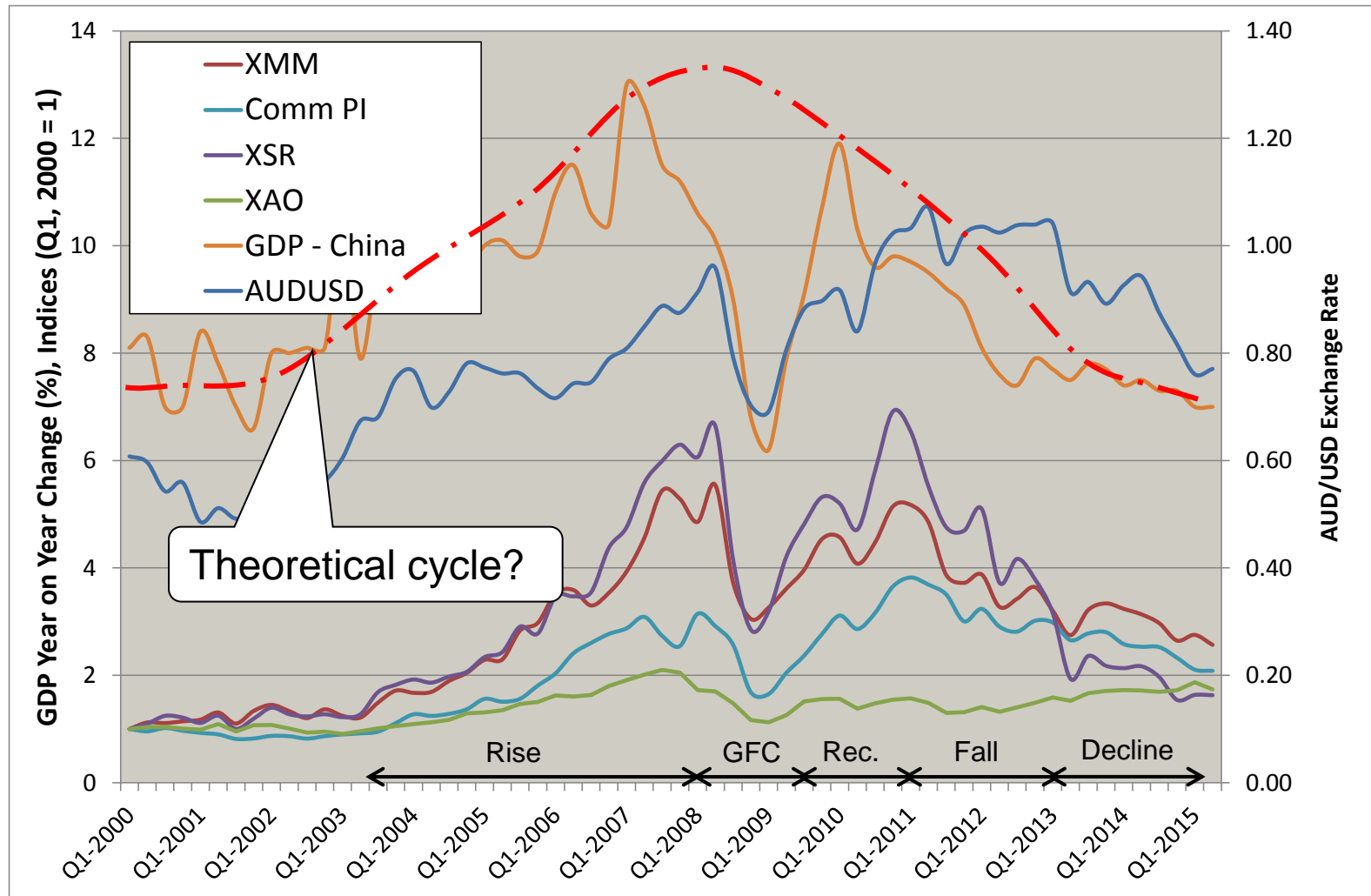
*20:20 Hindsight - A Short History of  
the Cycle  
or:  
What we Know*

# 20:20 Hindsight

- **The Rise – 2003 to 2007**
  - Start of the “Super Cycle” in 2003 – driven by growth in demand from China
  - Sharp increases in commodities prices due to demand increases
  - In addition to commodity imports, China ramped up domestic production in a number of commodities
  - Market euphoria, “mining the market”, caution thrown to the wind
  - Once in a lifetime event?
- **GFC and Recovery – 2007 to 2011**
  - External shock – GFC, (2007 – 2009) – truncated the peak
  - Recovery back to the cycle (commencing early 2009)
- **Rapid Fall - 2011 to 2013**
  - Slow down in Chinese growth
  - Investors panic, brokers won’t take meetings with companies
- **Steady Decline - 2013 to present**
  - Most commodities in a slow decline in USD terms
  - However relatively flat in AUD terms, reflecting depreciation in the AUD/USD exchange rate - now heading back to historically average levels
  - Investors returning, however selective and prudent in their investments

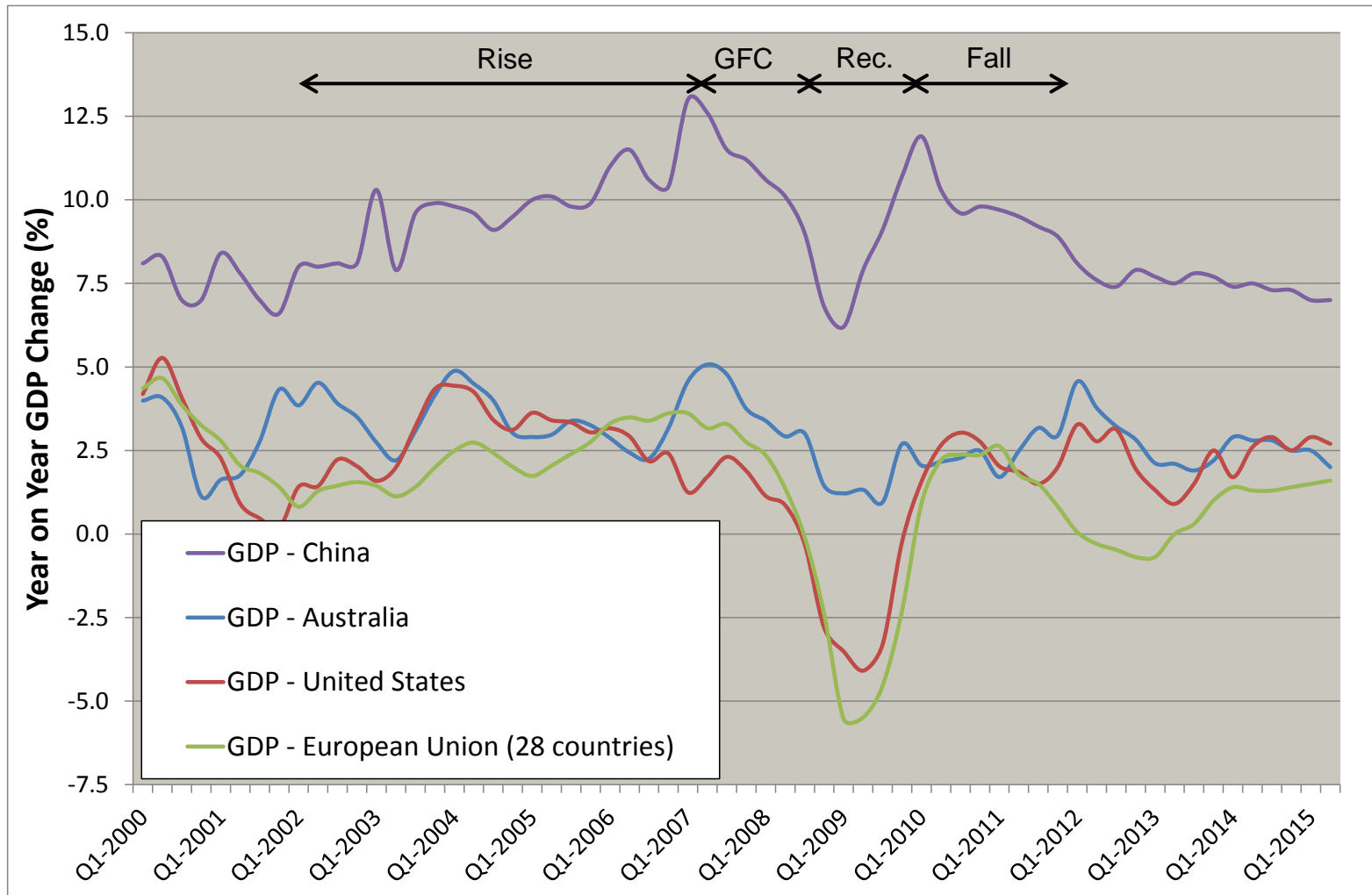


# 20:20 Hindsight – Anatomy of the Cycle



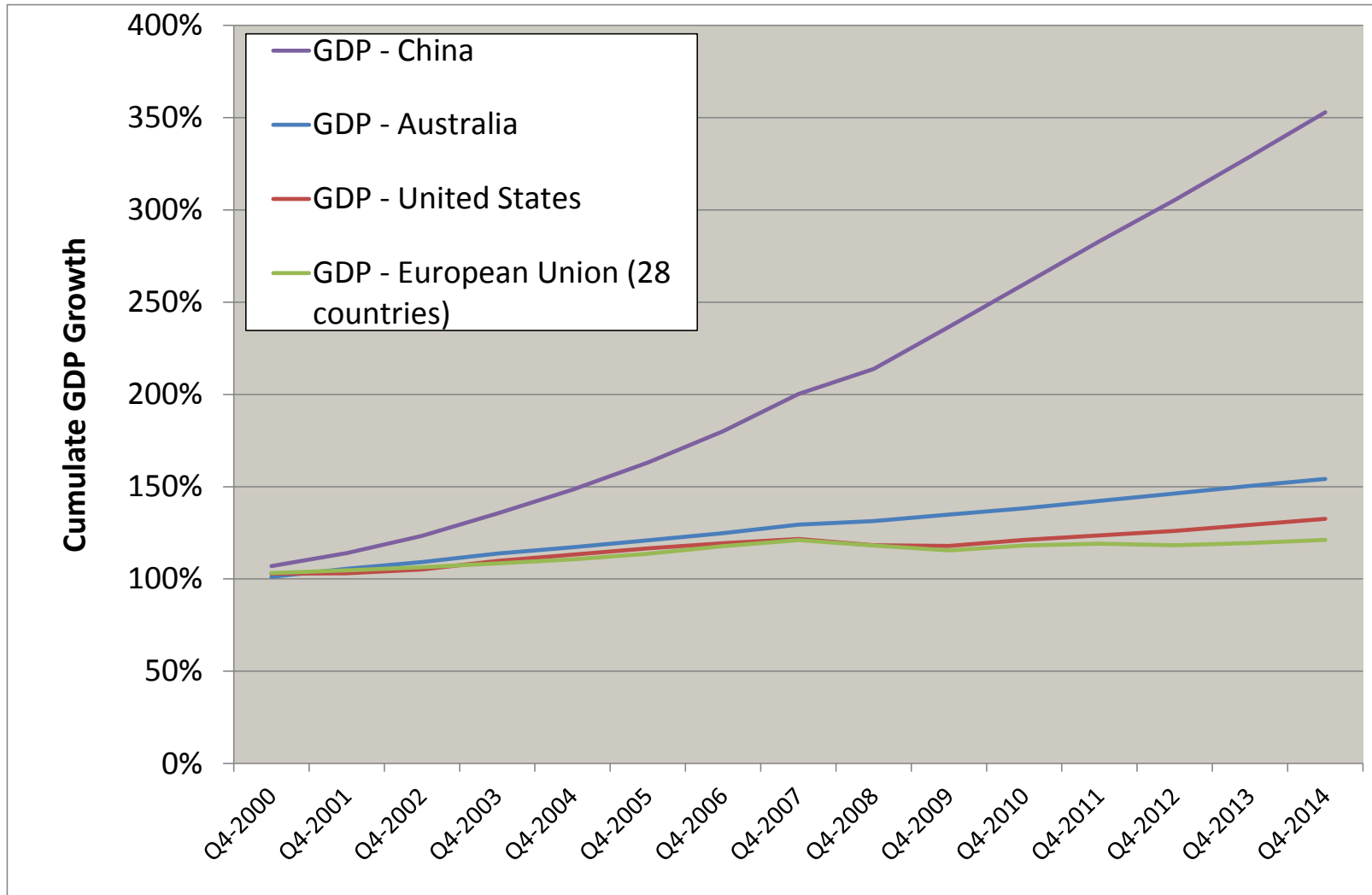
Source: IRESS, IMF, OECD

# 20:20 Hindsight – Y on Y GDP



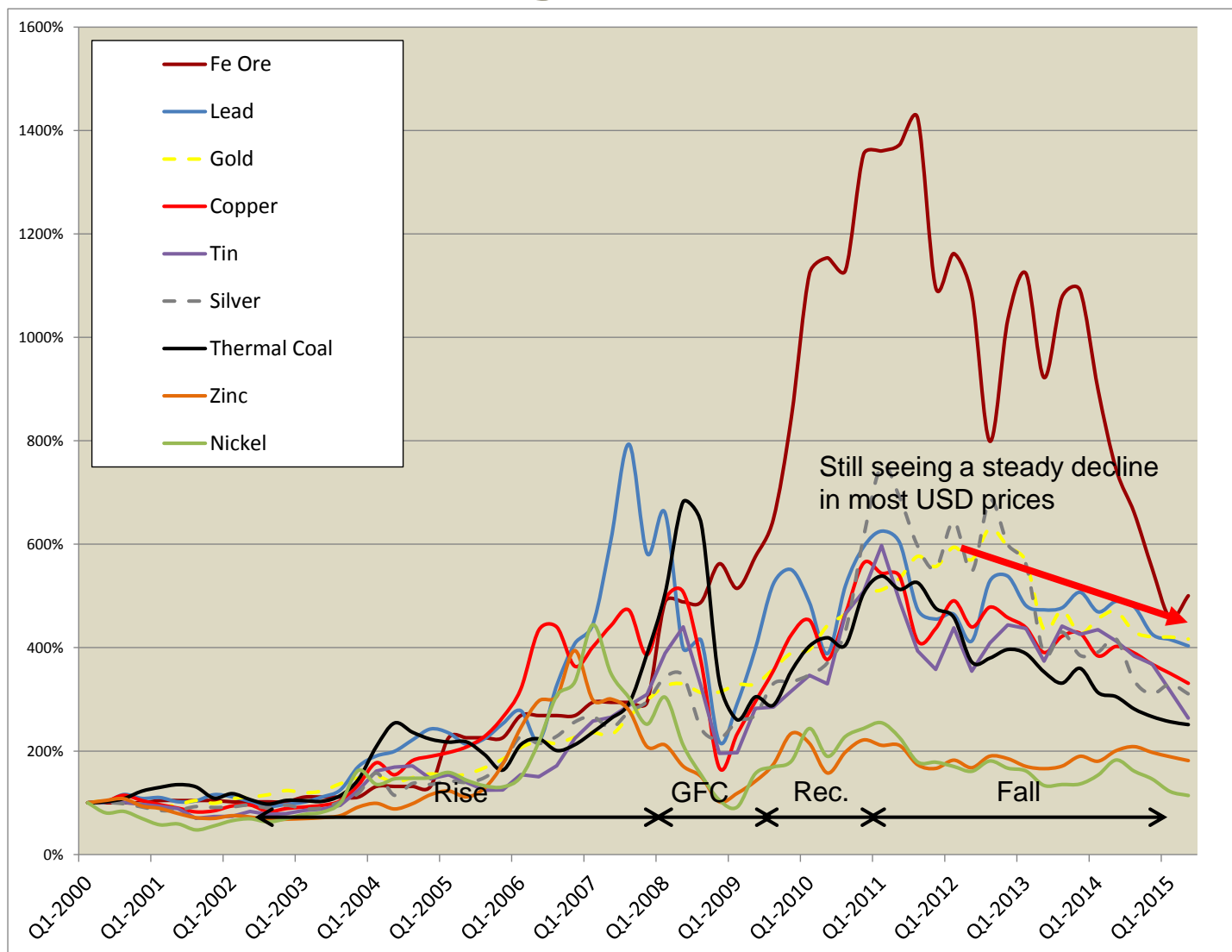
Source: IMF, OECD

# 20:20 Hindsight – Cumulative GDP



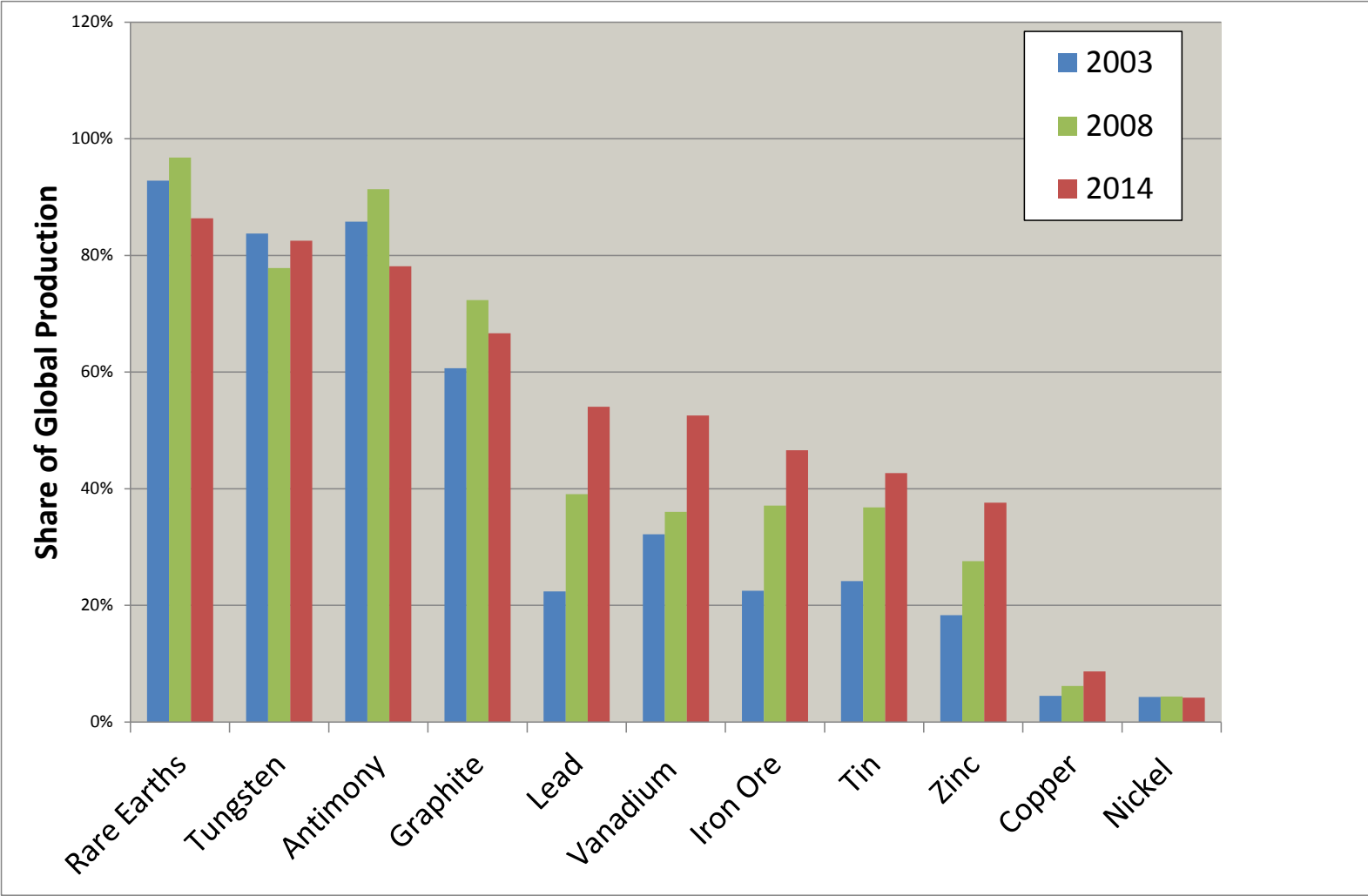
Source: IMF, OECD

# 20:20 Hindsight – Commodities



Source: IRESS, IMF, OECD

# Chinese Share of Production



Source: USGS

*20:0 Foresight – Where to From Here?  
or:  
What Model Crystal Ball is That?*

# 20:0 Foresight

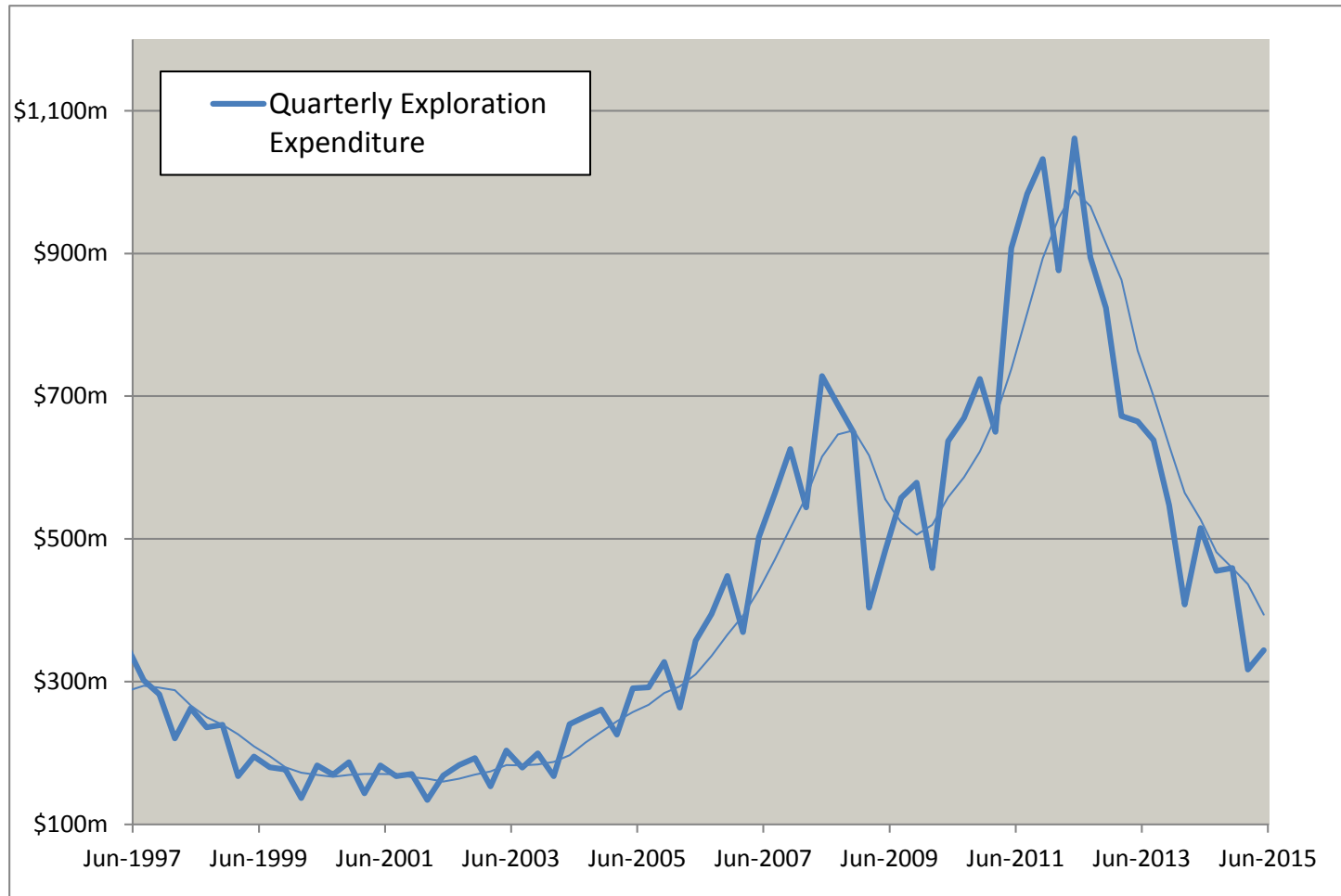
- **We are now in a market characterised by declining USD denominated commodity prices – are we near bottom?**
- **Increase in supply generated during the boom should be able to largely handle expected demand increases for major commodities for the next few years – note iron ore and coal**
- **However prices near the marginal cost of production may result in some supply being withdrawn**
- **There is the potential for some minor and strategic commodities to experience significant demand increases/supply contractions**
- **Investment in the sector now needs to be planned around these factors**
- **What will stop the decline?**
  - Consistent recoveries in the US and European economies
  - China stabilising
  - Pick up in growth in other under-developed economies

# *20:0 Foresight - Juniors*

- **Crunch time for a number of juniors – limited cash, limited sources of funding, low share prices**
- **This is especially the case where significant up front capital is required for companies approaching development – these companies are heavily discounted by the market**
- **Funding for exploration and project development is much tighter than during the boom – only quality projects are likely to get funded**
- **Quarterly Australian exploration expenditure is now at only 30% of its post GFC peak of \$1,061 million in the June 2012 quarter**
- **A number of junior exploration companies are effectively inactive – analysis by Austex Mining indicates that around 46% of the 799 listed resources companies fit this bill**
- **Companies now looking at alternative sources of funding for development**
- **Small scale, low capex startups are also being seen more – easier to finance, and provides revenue for funding ongoing exploration**
- **These would have been ignored in the boom**
- **Companies however can still raise funds with the right projects and market exposure**



# 20:0 Foresight – Exploration Expenditure



# Non-Market Challenges

- **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
- Overall Australia is a reasonable and transparent destination, but average Fraser Institute rank of 7 states has declined recently – now 34/122. worst 51/122 (NSW), best 5/122 (WA)
- Technical support (e.g. geological surveys, online services) first class throughout Australia, as well as financial support for drilling



- **Community Activism**

- Often ill-considered, poorly informed, emotive
- Vocal minority – unfortunately governments and the general public can seem to listen to and base decisions and viewpoints on these groups

# Non-Market Challenges – Fraser Rankings

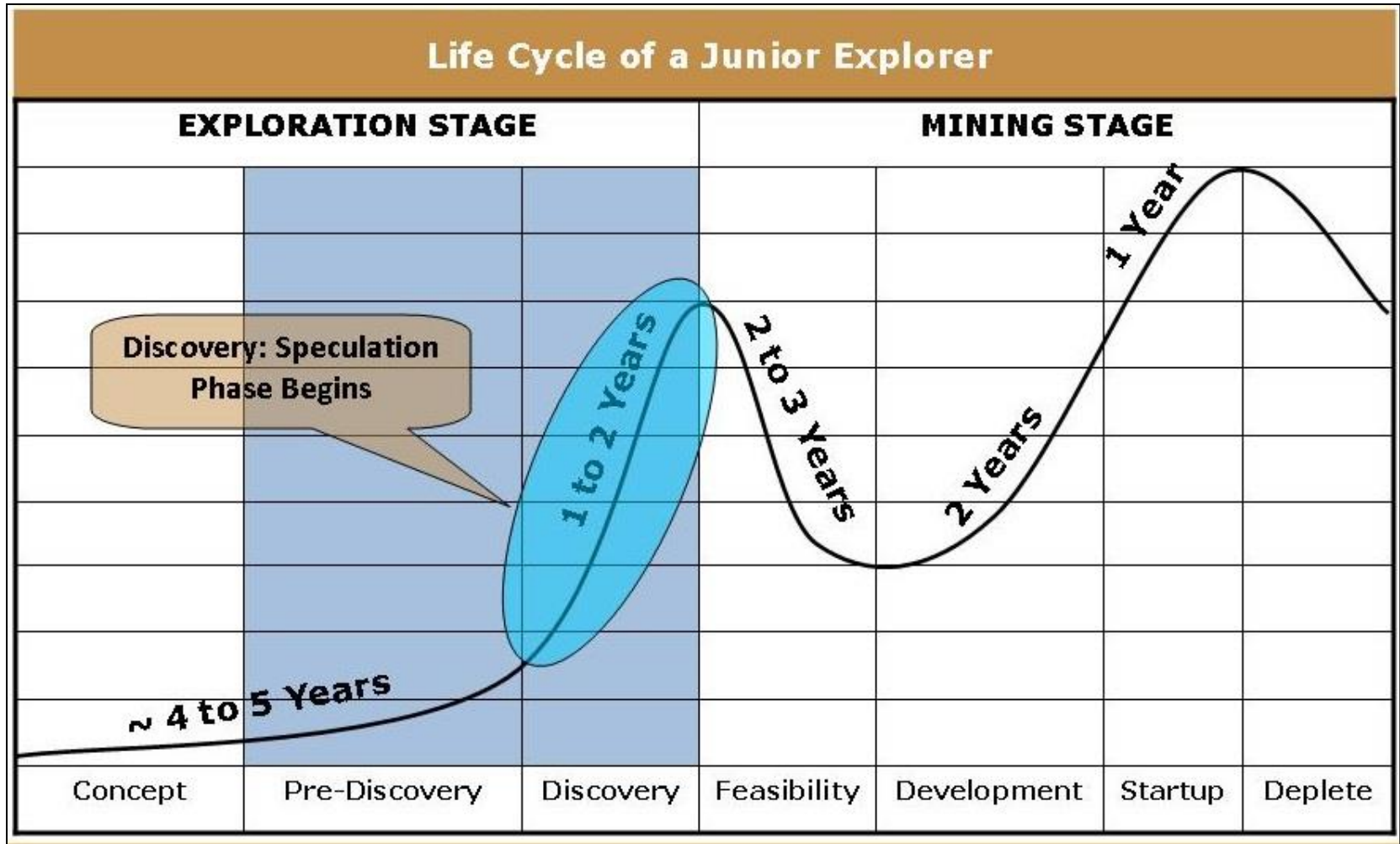
	<b>2014 Ranking - 122 Jurisdictions</b>	<b>2014 Relative Ranking</b>	<b>2013 Ranking - 112 Jurisdictions</b>	<b>2013 Relative Ranking</b>
<b>New South Wales</b>	<b>51</b>	<b>42%</b>	<b>39</b>	<b>32%</b>
<b>Western Australia</b>	<b>5</b>	<b>4%</b>	<b>1</b>	<b>1%</b>
<b>Tasmania</b>	<b>39</b>	<b>32%</b>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

*Where Are The Opportunities?*  
*or:*  
*Where is Money to be Made?*

# *Where Are The Opportunities?*

- **There are still good opportunities**
- **Finding them requires more due diligence than before – the euphoria and speculation of the boom is well and truly gone**
- **Only projects with a reasonable chance of discovery or eventual exploitation are getting market attention**
- **There have been a number of good stories over the last few years, particularly new discoveries**
- **Best capital returns are from the exploration stage when a discovery is made**
- **Also returns where funding is approved or offtake agreements (especially for non openly traded commodities) secured**
- **Commodity price leverage investing not recommended – declining prices now, and forecast to continue**
- **Look at the exchange rate hedge – particularly with gold**
- **Australian denominated gold price (and also base metals) is healthy**
- **Also applicable in other countries depreciating against the USD, for example Brazil**
- **Potential from “strategic” metals**
- **Portfolio approach – mitigates risk**

# The Value Cycle



Source: Phoenix Copper Corp (TSX-V:PHC)

# *Examples of Opportunities/Drivers - Company*

- **New Discoveries**

- Invest in exploration companies with good technical teams. Depending on your risk appetite this can be greenfields or brownfields

- **Resource expansion – part of the initial upward trajectory**

- Companies continuing to drill, and getting results that will add to the current resource
- However just adding resources for the sake of it when a critical mass has been reached (particularly in bulk commodities) potentially doesn't add significant value

- **Funding/offtake agreements**

- **Infrastructure agreements/solutions – bulk commodities**

- **Projects which compare favorably with their peers**

- How do potential revenues and costs stand up when compared to similar projects?
  - it is a competitive world out there

# *Examples of Opportunities/Drivers – Macro*

- **Niche sections of larger markets**
  - e.g. bulk commodities close to, or within their potential markets
- **New markets for niche commodities**
  - e.g. batteries potentially driving demand for graphite
  - Successful development of vanadium redox batteries may drive vanadium demand
- **Geopolitical issues**
  - e.g. energy in Europe – current reliance on Russian gas
- **Resource nationalisation – supply shocks in some commodities**
  - e.g. Indonesian bans on exporting non-upgraded products may lead to other opportunities in tin and nickel
- **Strategic Metals**
  - concentrated supply, end users want some diversification of supply



# *Which Commodities?*

- **Base Metals**

- Demand will continue, invest for project fundamentals, and not on price speculation
- Nickel generally volatile

- **Gold and Silver**

- \$US remaining strong by default
- Results in depressed gold prices – should result in a downward trend
- However potential for the Yuan as a reserve – China buying gold
- Look for the currency hedge

- **Graphite**

- Appears to be in a consolidation phase following the initial euphoria – price have come off, and now the “wheat is being sorted from the chaff”

- **Bulks**

- Supply/demand imbalances in iron ore and coal, political considerations in coal, however there is some potential **long term** value out there

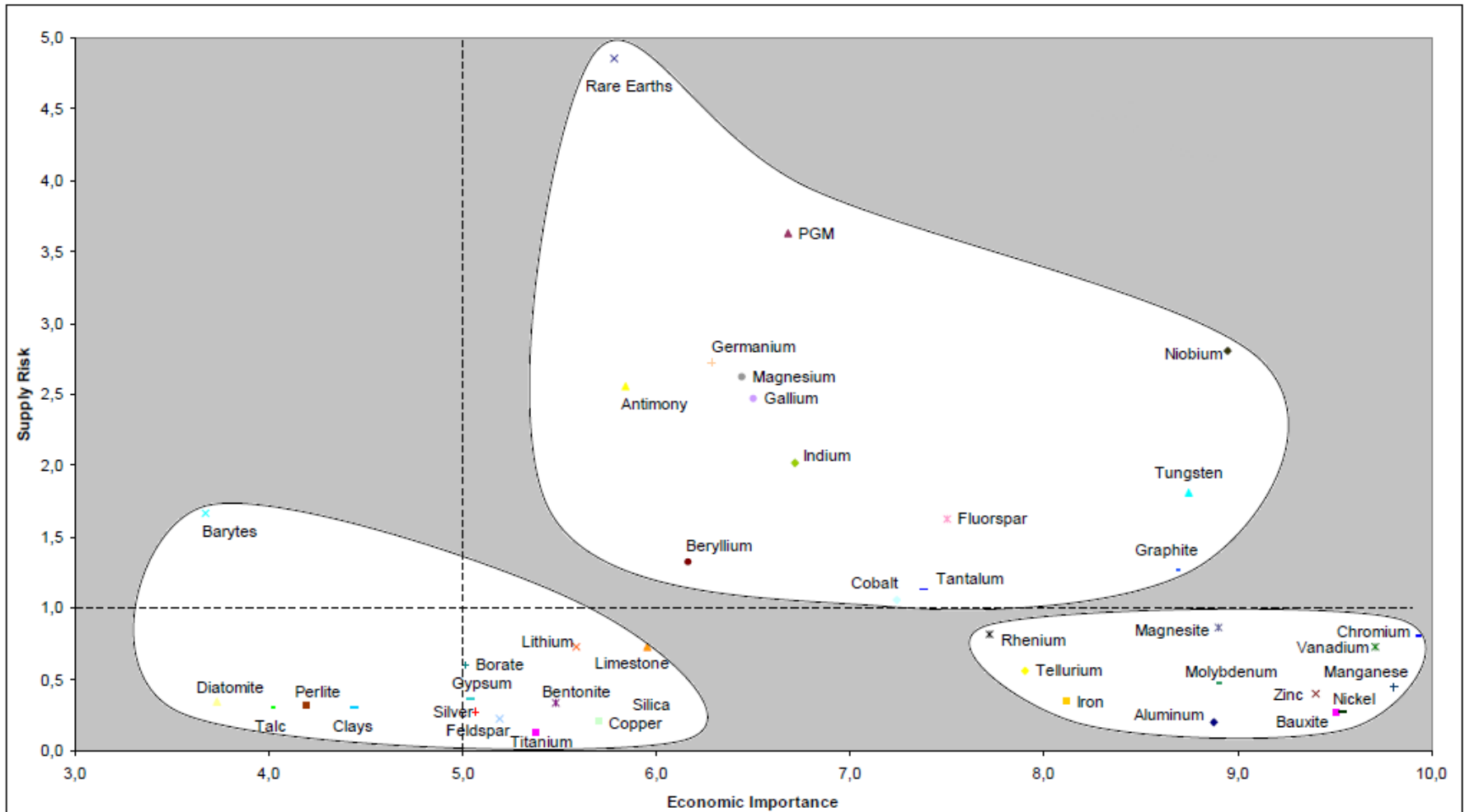
- **Fertiliser Chemicals**

- The world still needs to eat - look for niche opportunities

- **Strategic and Specialty Metals**

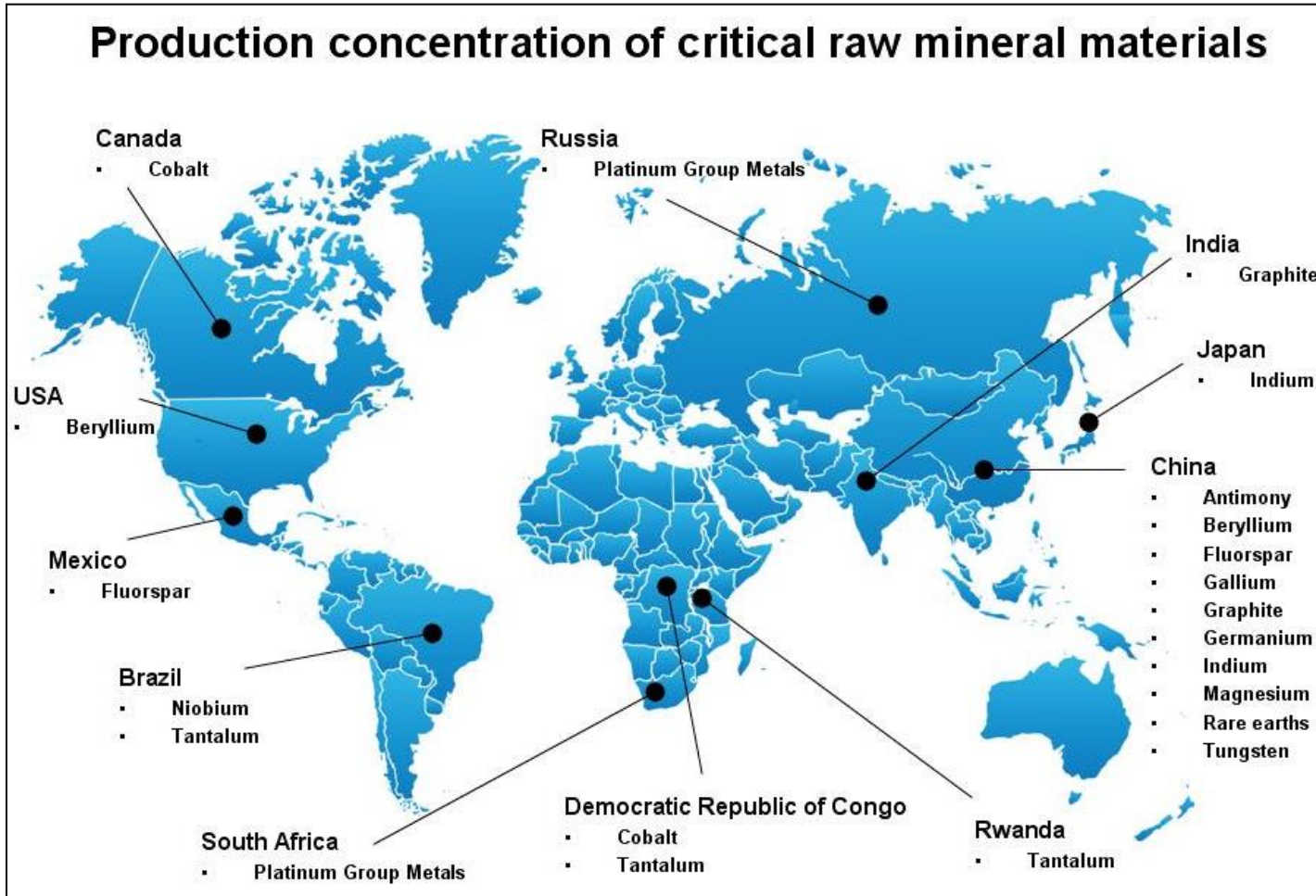
- There are opportunities, with diversity of supply being a consideration amongst users

# EU Metals Grouping



Source: European Commission

# EU Production Concentration



Source: European Commission

\*The Platinum Group Metals (PGMs) regroup platinum, palladium, iridium, rhodium, ruthenium and osmium

\*\*Rare earths include yttrium, scandium, and the so-called lanthanides (lanthanum, cerium, praseodymium, neodymium, promethium, samarium, europium, gadolinium, terbium, dysprosium, holmium, erbium, thulium, ytterbium and lutetium)

*Assessing the Opportunities  
or:  
Looking for Skeletons....*

# *Assessing the Opportunities – Need To Maximise Chance of Success*

- **Quality management and technical team**
- **A balance sheet being managed according to prevailing conditions, with as much money as sensibly possible being put into the ground**
  - You cannot find something without looking for it!
  - However the lights do need to be kept on
  - In operations, actively managing costs
- **Potentially viable and robust project, or quality exploration ground**
  - Dusted off dogs or moose pasture are not attractive propositions
- **Rolling over of projects where a position of diminishing returns is reached**
  - Do not “flog a dead horse”
  - Look for other ways of value adding – sale, JV, or in better conditions consider a spin out

# *Management Criteria*

- **Pro-active, shareholder interests foremost**
- **Good reputation – this is a small world**
  - Although at times it seems investors have short memories
- **Past experience relevant to the projects they are working on, or else effectively utilising personnel with the applicable experience**
- **What are they being paid – is remuneration matched to the position and balance sheet?**
- **Does it appear to be a “lifestyle” company?**
- **How much “skin” in the game – more motivated if they own part of the company**

# Project Criteria

- **Project Stage – exploration, scoping/feasibility, development, production**
- **Commodity – is it readily marketable?**
  - Will it meet specifications, and if not what are the penalties?
  - Is it openly traded, or negotiated with the buyer?
  - Is world supply cornered?
- **Money in << money out**
  - Look at your potential unit revenue and overall costs (not just C1)
  - Can the potential project comfortably absorb a 20% drop in revenue (i.e. due to falling prices, rising exchange rates?)
  - Rule of thumb – is the minimum project NPV  $\geq$  upfront capital cost
  - Remember infrastructure on bulks
- **Jurisdiction**
  - Permitting
  - Sovereign risk
  - Social issues
  - Environmental



Thank-you...



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