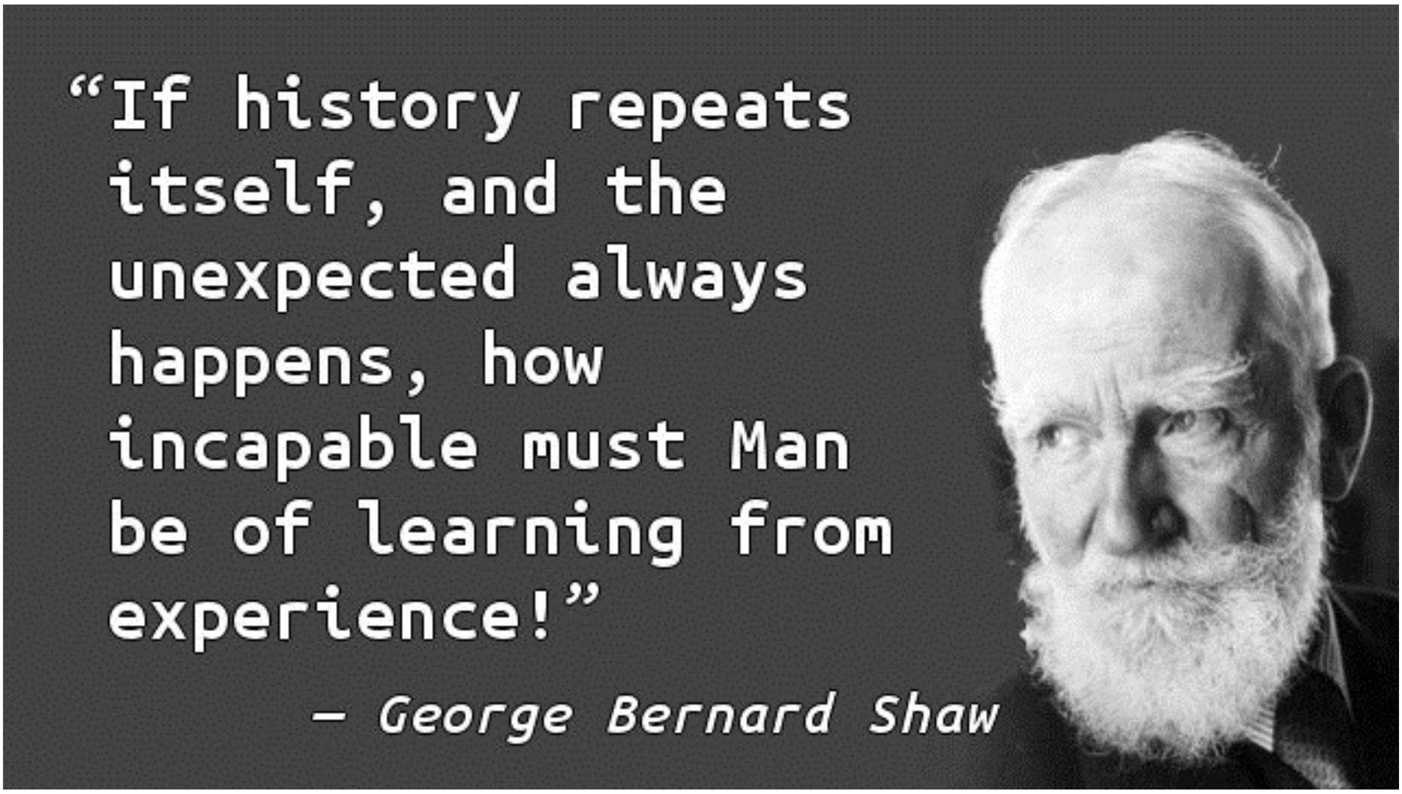
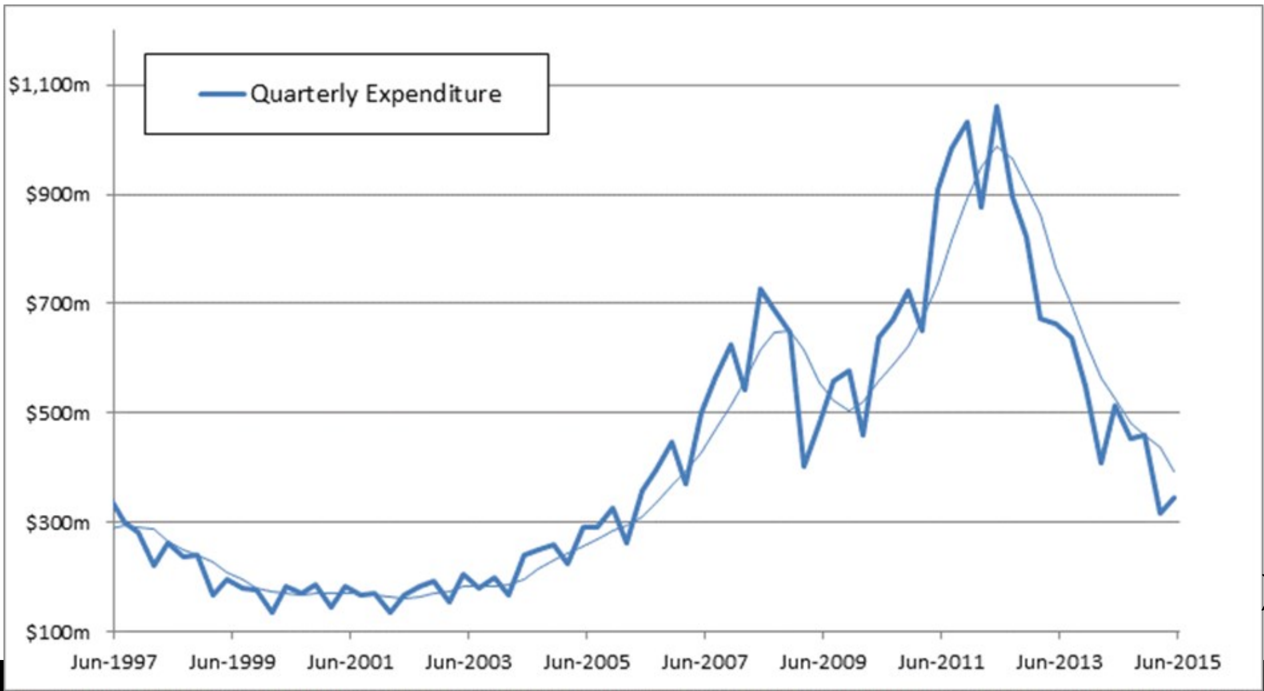


So true, especially for those who expected the super resources boom to go on forever! Never the less we all know that one side of the demand/supply equation is commodity supply which largely comes from producing mines. These producing mines at one time represented exploration discoveries – with the discoveries being made now likely to affect supply in 5 – 10 years. Hence, reviewing exploration trends and which may itself lead to potential discoveries, can provide a crude forecast as to the future new supply of commodities.

Using non-seasonally adjusted data, the regular intra-cycle falls reflect drop off in activity in the March quarter of each year, largely due to suspension of field activities in tropical Australia during the wet season.

Quarterly Australian exploration spending – June 1997 to June 2015



Source: ABS

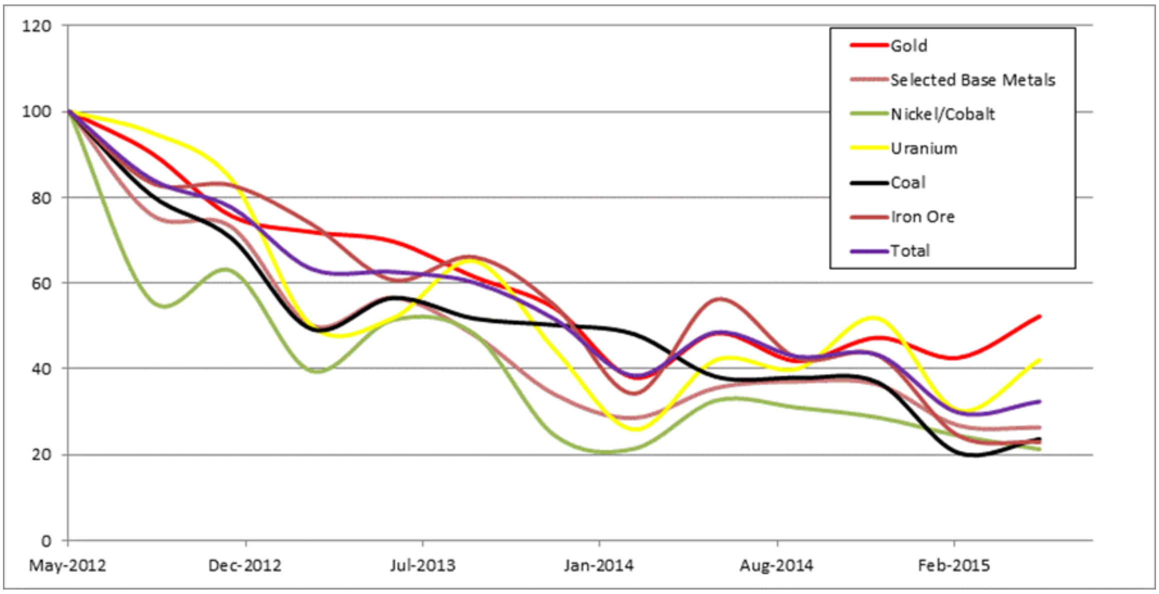
The State of the Australian Exploration Industry

We are currently in a very severe downturn, with exploration expenditure now at 30% of its June 2012 quarter post -GFC peak of $1,061m. The magnitude of the downturn however has to be viewed in the context of the magnitude of the China driven boom, which has had no historical precedents. The China boom commenced in 2004/2005 (following the previous low part of the cycle), and continued through to 2012, albeit being interrupted by the GFC in 2008/9.

The following graph also shows the different effect that the downturn has had on various commodities, shows a flattening out of the downturn from early 2014.

As expected, the bulk commodities have been hit the hardest with current expenditure at around 20% of peak. The other commodity to be hit hard is nickel, reflecting changes in the nickel price over the period. The star performer has been gold, possibly reflecting the Australian denominated gold price which has remained around $1,400-$1,600/ounce for four years, and which provides many gold producers with an attractive A$ margin.

Indexed expenditure by commodity – June 2012 = 100



Source: ABS

So, what does it all mean?

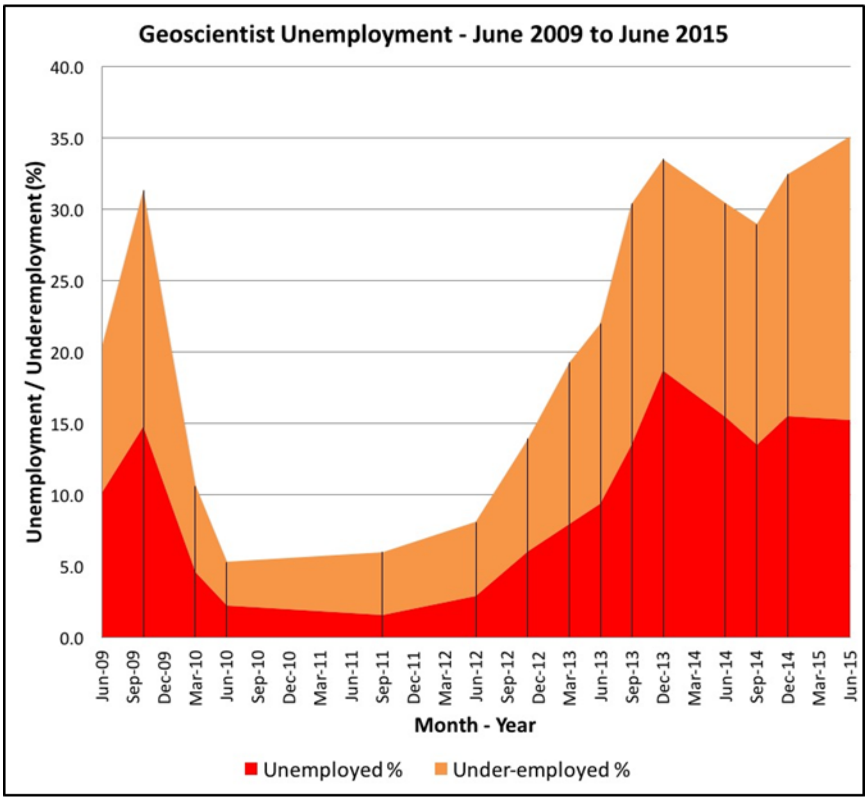
In an ideal world (not taking into account any potential repercussions of the current Chinese slowdown and concurrent metal price falls, or any other future shocks), we believe that we are now very close to the bottom of the natural cycle (similar to 1999?), although this may mean that indicators will "bounce along the bottom" until investor sentiment turns (this could be due to the current high risk favourites, such as IT and biotech again turning sour) and more risk or "hot" money returns to the sector. The other driver could be again, like ten years ago, exceptional growth in an underdeveloped part of the world.

However what we are also experiencing is that quality, advanced projects are gaining greater attention and funding and which form the natural bottom to the cycle. Unfortunately the higher risk greenfields plays that may have merit are being largely ignored with the exception of "hot" areas like the Fraser Range, where exploration companies are being funded.

There is a winnowing out of active companies now, and this has included a number changing their businesses to IT and biotech. We would expect this to be ongoing, also adding to the number of dormant (and potential shell) companies out there. Analysis by Austex Mining of the June Quarter Appendix 5B cash flow reports indicates that some 367 of the 799 listed resource companies could be considered "inactive", having spent <$125k on their projects in the quarter.

Although we have been through these cycles before, Australia does need a healthy exploration sector – we are largely a primary producer, and the slowdown in exploration could lead to a dearth of new discoveries in coming years. Exploration is a long term game, which unfortunately is not attractive to investors which have an increasingly short term focus.

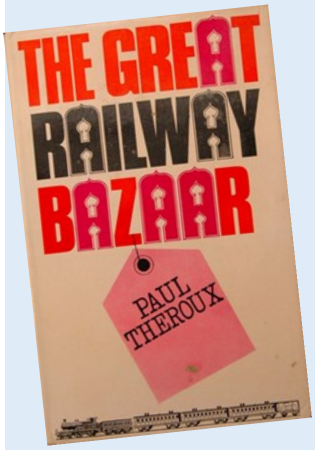
A corollary to the downturn in exploration funding is the downturn in the employment of geoscientists.
This is aptly presented in the following graph reaching levels experienced back in 2009.



Source: Australian Institute of Geoscientists

From My Bookshelf

For those of you who like travel writing, I would recommend any of Paul Theroux's largely rail travel books.



They are always entertaining, and the author's astute and commonly acerbic observations make for a refreshing and entertaining read. In 1972, Theroux set off on an epic journey by train from Great Britain to Japan and back. His account of this journey was published as The Great Railway Bazaar, his first major success as a travel writer and now a classic in the genre. He has since written a number of other travel books, including descriptions of traveling by train from Boston to Argentina, The Patagonian Express. As a traveler he is noted for his rich descriptions of people and places, laced with a heavy streak of irony. He does write a ripping train travel novel.

Until next month.

Mark Gordon