Back to the future or forward to the past — what does the future bring, and how to approach it?

As you may well know, there is an old curse, purported to be Chinese, but with no definite Chinese source, “May you live in interesting times”.* And what interesting times the past year or so has brought to the junior resources industry, on top of the slide that started in early 2011.

However, have we seen the worst of the market for junior resources? Anecdotal evidence and conversations I have had with people shows at least a glimmer of optimism. Any interest though is largely in the more advanced or quality projects — there is still more winnowing of the chaff to come, which, all things said and done may not be too much of a bad thing.

Overall, we may expect some more “bouncing along the bottom” for a while, which has been happening now since early 2013, when the worst of the decline in the small resources index finished. Following this we bounced around between 2000 and 2500 until mid-last year, followed by an extremely interesting last six months of 2014, with the index plummeting down to its nadir of 1370 in mid-December. Over the following six months it recovered to 1860, however has retreated to 1670, following falls in US denominated base metals prices.

So, why should there be any cause for optimism? There are a number of reasons.

With the falls in the Australian dollar, Australian denominated metal prices are generally quite healthy, with, for instance gold near all-time AUD-denominated highs. When this is coupled with expected falls in operating and capital costs, we can see increased margins on Australian projects, hence making some companies more attractive investment propositions.

Also, there has been significant recent M&A activity, including the announced (but not yet completed) A$1.8Bn Sirius-Independence Group merger, and the US$550m sale of Barrick’s Lake Cowal operation to Evolution Mining. This sort of activity generally marks the bottom of the cycle.
There are people who would have made a fair bit out of some deals, and they will therefore be looking for new opportunities to put their cash into.

Brokers are actually seeing junior resources, indicating a renewal of interest in the sector – there was a period where it was almost impossible for companies to get a meeting.

However, don’t expect a sudden boom as per the mid-2000’s China driven mining boom. Any recovery will be slow and steady, and for the time being at least investment will be driven by quality. Unfortunately it is still hard to get money for grassroots exploration (with some exceptions, such as projects in the Fraser Range) – it is the more advanced, and hence partially de-risked projects that are getting the attention.

Also, conventional capital markets for development are still tight, so any project that does require a big lick of capital to build a mine down the track may still find it hard to get traction. Companies now are looking at different and innovative funding strategies, which I have seen in a number of those that I have covered recently, particularly if the proposed operation has a reasonably modest capital requirement.

The words above take me back to some of last year’s columns explaining what I actually do, and what I look for in a company. These haven’t changed. The two key points I look for in a company are:

A. Good board and management, and,

B. A technically and potentially financially robust project

Point (A) is vital – bad management can destroy the best project. Another key here is having personnel that have experience relevant to the stage the project is at. For example, I like to see, where a company moves say from exploration to development, personnel changes that bring in people with the necessary development experience.

The second part covers a broad range of aspects, including project stage and what commodity is being looked for. I am often asked what commodity or commodities do I favour. My general answer is any, as long as any project I am looking at stacks up – I am agnostic when it comes to commodities. However we do see short term gains in commodity “bubbles”, where euphoria kicks in, and money can be made in “mining the market”.

For quality investments good due diligence does need to be done on the company and projects. Factors to consider depend upon the stage of the project, commodity being looked for, and ultimately the investors’ risk profile. A different set of criteria will be applied when looking at a grassroots project than one with a published resource for example, and for bulk commodity projects (basically infrastructure plays) and gold projects.

An investor with a high appetite to risk may look at early stage exploration, whereas this would not be suitable for an investor with a lower appetite for risk.

Due diligence on an advanced project may include DCF modelling to give an idea of the potential returns a project may make (and whether in fact it has a good chance of proceeding). This modelling may only be to a scoping study level of accuracy (+40%), but will give a reasonable idea of how a project stacks up. This is also where the financial robustness of a project can be judged - I like to see the ability for a project to absorb at least 20% adverse movements in key parameters, including metal prices, exchange rates, grades/recoveries and costs.

The investment risk factors play out into the potential rewards – below is a favourite graph of mine, showing value (share price) vs project stage and risk profile for a junior. This does show that the best returns are made on the initial discovery, at the higher risk end of the company’s life.
The final point here is to take a portfolio approach to investment for risk mitigation. It is better to have $1,000 in each of ten projects than $10,000 in one. Also, it is worthwhile to spread the risk over at least a few commodities and project stages.

In summary, a number of factors are pointing towards a gradual recovery in the sector, after a fairly dismal four years. Good due diligence however does still need to be carried out on any investment decision, with quality being the key. Last, but not least, take a portfolio approach to investment.

Onto My Soapbox

Only a short section this month,

Greece, taxes and pensions. Need I say more?
From My Bookshelf

Having too many books in not a problem; not having enough shelving, now that’s a problem.

That explains my library perfectly……..

I have something different this month, being an individual paper in the Society of Economic Geologists Special Publication 18.

The paper is:

Building Exploration Capability for the 21st Century

I came across this whilst writing up Rumble Resources in June, and although concentrating on Sirius’ Nova-Bollinger discovery, the risks, and sometimes luck involved in mineral exploration are presented in an excellent exploration case history. This is available for purchase and download on the Society of Economic Geologists website – the link to the relevant page is given below.


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