May you live in interesting times

Although called the "Chinese curse", no definite Chinese source has been found for this apocryphal saying; however we are indeed living in interesting times. This has been demonstrated by continuing falls in metals prices and indices over the last quarter, with the following table summarising these changes.

Index and metal prices movements – September quarter 2015

	30/09/2015	1/07/2015	Change
All Ordinaries - XAO	5,059	5,506	-8.12%
Metals and Mining - XMM	2,181	2,539	-14.12%
Small Resources - XSR	1,211	1,662	-27.14%
Gold Stocks - XGD	2,531	2,476	2.60%
Dow Jones	16,285	17,758	-8.30%
US/AU Exchange Rate	0.7018	0.7648	-8.24%
Gold	$1,115	$1,168	-4.56%
Silver	$14.49	$15.52	-6.67%
Copper	$5,177	$5,766	-10.22%
Lead	$1,658	$1,767	-6.18%
Zinc	$1,671	$2,041	-18.13%
Nickel	$10,366	$11,982	-13.49%
Tin	$15,710	$14,544	8.02%

Source: IRESS

As can be seen on the opening page's graph, with the exception of tin and the ASX Gold Index, there have been significant falls in all of the measures over the quarter, led by the ASX listed small resources index.
However from an Australian producer's perspective this has been partially offset by the continued devaluation of the Australian against the US dollar.

Bucking the trend over the last few years has been the ASX Gold Index, with a generally flat trend, and oscillating around 2,500 since mid-2013, although this has lifted over the last twelve months as shown in on the following page's graph.

What this graph clearly shows is the appreciation in the Australian denominated gold price when compared with the US denominated one, due to the depreciation of the Australian dollar. This, allied with anecdotal evidence that contractor rates in Western Australia have fallen by around 25%, means that now should be a good time to look at gold stocks in Australia, or other countries that have seen their currencies depreciate against the US, for example Brazil.

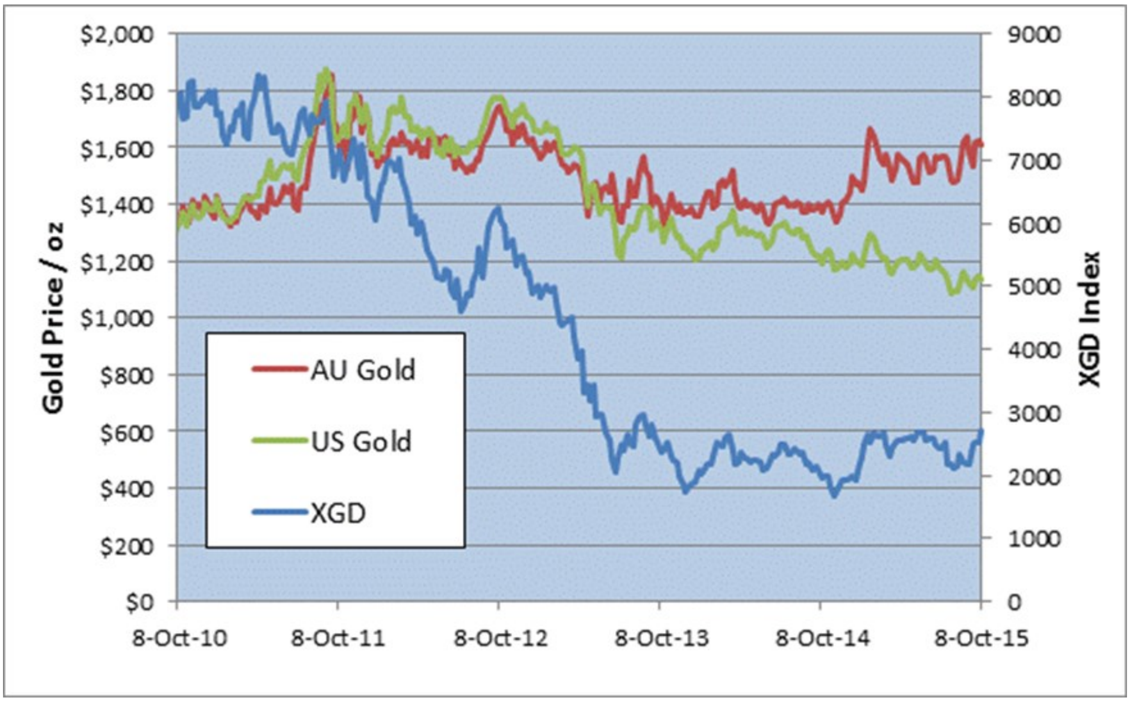
The M & A activity in the Australian gold sector has been fairly active of late – recent transactions include the US$550m sale of Lake Cowal by Barrick to Evolution Mining (ASX: EVN), making Evolution the second largest listed gold producer on the ASX behind Newcrest Mining (ASX: NCM). Evolution's FY15 production was 427koz, with production expected to be ~750koz in FY16 following the Lake Cowal purchase, with Newcrest producing around 2.4Moz per annum.

Newcrest is also seeing a turnaround, with its share price improving 26% over the last twelve months, albeit from fairly low levels, and with some oscillations along the way.
The company is the lowest cost producer amongst the majors (AISC of US$789/oz at an AUD/USD ER of 0.83), and is actively using cash flow to pay down its debt, currently standing at around US$2.9 billion.

Another bit of encouraging news (particularly when I put on my exploration geologist hat) is the company focussing on early stage exploration and internal development rather than M & A as its growth strategy. However this could also be in response to debt levels and its debt repayment strategy precluding major purchases….

The other Australian producer that has seen substantial growth over recent years is Northern Star Resources (ASX: NST), now Australia's third largest gold producer with a market capitalisation of $1.6 billion, and FY15 production of 581koz. Since the purchase of the Paulsen's mine in Western Australia from Intrepid Mines in 2010 (which was then producing at 75,000ozpa), Northern Star has been highly acquisitive, taking advantage of discounted prices to build its operational asset base.

XGD index and gold prices



Source: IRESS

There have been some notable events in the resources space over the past few weeks. One, which may be seen as a vote of confidence in the sector (and as further evidence that we may be near the bottom of the cycle), is the acquisition of 10% of OZ Minerals (ASX: OZL) by US based private equity giant KKR over the last few trading days. OZ Minerals ($1.1 billion market capitalisation) operates the Prominent Hill copper mine and owns the Carrapateena copper project, both in South Australia and has a healthy balance sheet.
The company however has seen its share price slide in line with falling US denominated copper prices, despite Australian denominated prices staying steady over the last few years.

Some commentators see the KKR investment, which caused OZ Minerals share price to jump around 19% from $3.31 to $3.95/share, as a precursor to a full tilt at the company.

Onto a company which definitely doesn't have a healthy balance sheet – Glencore. Last week saw the share price fall 30% in one day (however which was recovered over the subsequent two days) following releases of analyst notes which warned that the equity value could collapse if commodity prices fell further. This is due to net debt of US$29.5 billion, which the company is looking to slash by a third. Glencore has lost 82% of its value since listing at 530p per share in 2010, currently trading at 95p per share. Half of this fall has been since May 1, 2015, when it traded at 309p per share.

Finally, as I discussed a few weeks ago we do expect more pain to come with regards to the ASX small resources. There are still a number of companies just surviving out there, and there is at the moment only a limited pool of capital to be spread across the 800 or so Australian listed juniors, which will lead to a sorting out of those companies that do not have worthwhile projects. The September quarterly reports are going to be interesting reading – these are due to be released by the end of October, with some analysis through in the first week of November.

However there is value to be had out there – it is a good time to invest for the medium to longer term if proper due diligence is done.

The Soapbox…

On the road to nowhere!

This follows on from previous columns mentioning a moratorium on all onshore gas drilling in Victoria that has been put in place by the Victorian Government. Well it appears that the opposition are calling for the moratorium to be extended to 2020.

There are apparently two by-elections in the west of the state. So it wouldn't be policy made for politics sake would it?

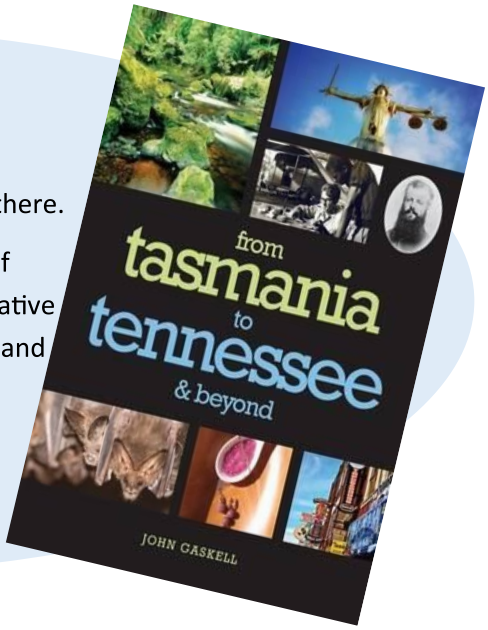
What have we done to deserve this?

From my Bookshelf

John Gaskell: **"From Tasmania to Tennessee & Beyond"**
A Personal Story of Savage Resources Limited with diversions here and there.

This is a very interesting read of one geologist's career and the history of Savage Resources. This includes (for those that can recall) a very informative insider's view of the early 1990's court case between Savage Resources and Western Mining Corporation over the Ernest Henry deposit in North Queensland.

This can be ordered through Connor Court Publishing.



From My Pantry

This is just a shameless plug for a favourite product of mine, and not a regular part of this column! For those of you who like fruitcake, try Yummy Kitchen's "Australian Celebration Cake", usually available at Coles.
Short of my Mum's cooking, this is best fruitcake I have ever tasted. Funnily enough I first found it when I lived in Oman in the early 2000's, and was looking for a Christmas cake.

Mark Gordon