commodityonline

HD Are some commodities seeing increased investor interest despite market conditions?

WC 2,963 words

PD 7 November 2014

SN Commodity Online

SC HTCOMO

LA English

LP

India, Nov. 7 -- an analyst with brokerage firm DJ Carmichael in Perth believes select junior resource companies will outperform the broad markets as macro-level events impact certain commodities. In this interview with The Gold Report Adams suggests that strong demand fundamentals in nickel zinc and uranium could mean better years ahead for equities with exposure to those commodities. Adams also discusses DJ Carmichael's new investment strategy and several companies that fit into it.The Gold Report: Mining in Australia is dominated by coal and iron ore production much of which is controlled by large players like BHP Billiton Ltd. (BHP:NYSE BHPLF:OTCPK) and Rio Tinto Plc (RIO:NYSE RIO:ASX RIO:LSE RTPPF:OTCPK). Please give our readers an overview of the state of the junior mining sector there.

TD

Paul Adams: Like many companies in the junior space in North America and Canada in particular junior miners in Australia have suffered from the downturn in commodity markets. Here in Western Australia the fall in the iron ore price has not only affected the large miners it's affected the juniors even more. Some miners have already ceased production at high-cost operations. Many jobs have been cut in both large and small mining companies and in the service companies that supply them.

A general feeling of gloom hangs over Western Australia even though 2013 and 2014 have been relatively good years for the general market. It's certainly a different story for many of the small- to mid-cap miners especially the exploration companies. Since Aug. 19 the Small Resources Index has fallen to 1 786 from 2 340 a decline of 23.6%. I dare say it's going to be hard for many companies in this sector for a while yet.

TGR: Where is the light in that tunnel? Is there investor sentiment that sees the value at these levels?

PA: There is obviously value in the market. The institutions are starting to talk resources again. It's a question of timing. The markets need to feel more settled. The CBOE Volatility Index (VIX) recently rose above 30. That definitely affected the mood of fund managers and their willingness to enter this sector.

TGR: Are some commodities seeing increased investor interest despite market conditions?

PA: Yes. There are good prospects for nickel and zinc. From a fundamental supply and demand point of view the scales are likely to be tipped in the favor of price rises in 2015 2016. In precious metals the rise of the U.S. economy and the American dollar has meant a fall in our Australian dollar. The gold price in Australian dollars has cushioned our domestic gold producers. That has helped but there's still too much uncertainty.

Another commodity with good prospects is uranium. The general consensus is that we've seen the bottom in the spot uranium market and we ought to see much more activity in that commodity in first half of 2015 especially if Japanese nuclear reactors come back on-line.

TGR: For mined commodities no other country in the world feels the impact of Chinese demand greater than Australia. Where is Chinese investment in all of this?

PA: I don't think Chinese interest in Australian commodities has waned. As assets become distressed as commodity prices fall we see Chinese companies still taking a keen interest in Australian assets. We don't really see that waning.

TGR: At the end of 2013 you stopped covering a number of companies. Was that part of a yearly purge or was there more to it?

PA: Sometimes things don't work out in the mining exploration business. That's exploration but we've also undertaken a deliberate change in strategy to focus on higher market-cap high-growth companies with liquidity that are either in production or quite close. We have become more choosey when it comes to where companies are in their lifecycle but that's not to say that we've completely moved away from small explorers. But the conviction on the assets has to match the increased market sector risk.

TGR: Is that basically the outline of your investment thesis?

PA: The macro trumps the micro in the resource sector. From oil and gas through diamonds and everything in between we've seen the effect of the macro on our markets. That 23% fall in the Small Resources Index indicates that. Going forward we have to make sure that the supply demand fundamentals for a specific commodity make sense. If the fundamentals make sense we would be much more willing to look at a small company that has exposure to that commodity.

TGR: Australia's conservative government headed by Prime Minister Tony Abbott repealed the mining or "Super Profits Tax" on Oct. 1. Will investors notice the difference?

PA: The tax did not raise anywhere near the revenue that it was expected to. I suppose its repeal has taken away some negativity toward investment in the sector. We're better off without it but I don't think it will necessarily change the view of Australia as an investment destination. Australia is always going to be seen as a relatively safe jurisdiction for mining projects.

TGR: What are the three or four things you look for in junior mining equities in this market?

PA: We look at management teams and their delivery on expectations. We'd much rather work with a management team with a track record in promising just enough to garner sufficient investor interest and then over-delivering. Nobody likes surprises but we can all live with a surprise or two on the upside. I love going back to our clients and saying "I was a bit wrong on that it actually turned out to be better than we thought it would be." That's a really important point.

Second we definitely want to see that the asset could turn into a profitable mining operation. Our best calls have occurred when we identified those opportunities as early as possible. Then we try and stick with a company over a number of years as it realizes its vision.

The timing in the lifecycle of a company is very important. Investor interest in long-dated capital-intensive projects is just not there. But if there's a company with a short-dated timeline to production where an obvious value uplift should occur then that's a much better position in these markets.

TGR: Do you think brokerages in general no longer form sufficiently long relationships with these companies?

PA: That's an interesting question. Our model has been to identify probably sooner than most companies with really good assets. Obviously you're going to get investors with different risk profiles and some will want to take some money off the table on a successful exploration event for instance. If you can afford to have a long-term investment horizon you often form good relationships with the companies involved and help them through their lifecycle. We've always tried to establish those relationships early on. And as long as the asset keeps delivering we keep supporting those companies. For instance we've been in Hot Chili Ltd. (HCH:ASX) since seed capital raising back in 2008 2009 and we're still one of the biggest players in that stock today. That's a pretty good model if you can get it right.

TGR: What are some companies under coverage that are either exploring or developing assets in Australia?

PA: We recently initiated on Poseidon Nickel Ltd. (POS:ASX). Poseidon had an amazingly transformative second half of 2014. It acquired two major nickel projects in Western Australia from Norilsk Nickel (GMKN:RTS NILSY:NASDAQ MNOD:LSE). First was the Black Swan project which is near Kalgoorlie. The second one was the Lake Johnston project which includes the Emily Ann nickel project west of Kalgoorlie.

These acquisitions were completed for A$2.5 million (A$2.5M) and included all of the surface infrastructure (power camp facilities offices tailings dams waste dumps) and underground development and doubled Poseidon's contained nickel resources in the ground to around 400 000 tons. The acquisition reduced the company's timeline to production by about 12 months and changed the company from a one-asset capital-intensive developer to a three-asset company with production flexibility and one of the lowest capital intensity costs of any new nickel company. That's really exciting.

TGR: Poseidon has finally worked out an offtake agreement with BHP Billiton for nickel ore from Mt. Windarra. Is that a game changer for the junior?

PA: When you put that with the new acquisitions it's been a tremendous game changer for the company. The agreement with BHP really facilitates an early ramp up to Mt. Windarra which was its flagship project before Poseidon made those two acquisitions.

TGR: In a presentation on Poseidon Nickel's website CEO and Managing Director David Singleton compares the potential of Lake Johnston to what Australian nickel producer Western Areas Ltd. (WSA:TSE FX9:FRA WSA:ASX WNARF: OTCMKTS) had in the early 2000s. Is that a reasonable comparison?

PA: There appears to be similar geology between the two deposits in that both the nickel-sulfide ore bodies were masked by granite on top of the nickel-sulfide zones which is relatively unusual. At the end of the day it is still exploration but being aware of a geological model like that could fast-track further exploration and lead to faster discoveries. Only time will tell.

TGR: What is your price target on Poseidon?

PA: Our price target for Poseidon is A$0.67 and it is currently trading at A$0.16. That's quite a big value uplift. We're anticipating a staged ramp-up in production from various projects. It is going to be Australia's next nickel producer.

TGR: What are some other companies under coverage there?

PA: The last time we spoke I mentioned Northern Minerals Ltd. (NTU:ASX) and it has done well since. The company recently received its environmental approvals for the Browns Range Heavy Rare Earth Elements (HREE) project in northern Australia. That removes a major risk in the project's development. Northern Minerals has added to the resource through exploration during the last year or so and should sign a binding offtake agreement with Sumitomo Corp. (8053:TKY SSUMF:OTCPK) once the Browns Range feasibility study is completed later this year. Northern Minerals should be the world's next major dysprosium producer outside of China. We think that's pretty important.

TGR: What other HREEs are in that ore?

PA: There is a lot of yttrium which is considered a critical metal. Ytterbium and erbium too. There are light rare earths but the basket of metals in the Browns Range project is heavily weighted toward the HREE and critical metals.

TGR: What is the timeline to production?

PA: If Northern Minerals is able to secure project financing the company plans to be in production in 2016. The capital cost for Browns Range is about A$200M (plus A$35M for the beneficiation plant) which is not that onerous because the xenotime host mineralization is one of the most benign minerals to process. And Browns Range has a relatively small footprint because it's going to likely be a high-grade underground operation after a relatively small open pit.

TGR: What are some companies that you're covering with projects outside Australia?

PA: Last time we spoke I mentioned Kingsrose Mining Ltd. (KRM:ASX) which had a terrible year after its gold-silver mine went offline. Interestingly Kingsrose's share price remained relatively stable at around A$0.35 whereas many other gold companies took bigger hits.

The company just released the results from the September quarter. In July Kingsrose received a forestry permit that allowed the company to reestablish production at its Talang Santo mine in eastern Sumatra. The company had a reasonably good quarter given that it is in ramp-up mode and treating mostly stockpiled and development ore. Kingsrose produced roughly 6 000 ounces (6 Koz) gold and 23 Koz silver at a grade of almost 10 grams per ton. I had anticipated high cash costs given that the company was in ramp-up mode and spending a lot on development. Cash costs came in at US$660 oz and all-in sustaining cash costs of just under US$1 000 oz.

The mine development capital costs pushed the all-in costs up slightly because Kingsrose needs to develop along its narrow high-grade veins. That was very positive considering the company is reinitiating production.

TGR: The biggest red flag with Kingsrose is that it's operating in Sumatra Indonesia. Should investors be concerned?

PA: It's not for everybody. Institutions have a view one way or the other on Indonesia. Some will look at it and some won't. Indonesia has a lengthy mining history. Many companies operate there and the new government is pro-business. For us it doesn't represent a big risk.

TGR: What about another name or two that you're following outside Australia?

PA: There's always an exception to an investment thesis and in this case it's Inca Minerals Ltd. (ICG:ASX). We like the Inca story. We visited the Chanape project in Peru in 2013 and it was pretty raw. Not much work had been completed but there were signs that something interesting could be there. Since then Inca has indentified scores of breccia pipes containing relatively high-grade epithermal gold-silver and copper mineralization and a mineralized porphyry sitting underneath.

A recent reinterpretation of the geophysics seems to indicate that the drilling into the deeper parts of the porphyry system is coincident with a chargeability anomaly that reaches the surface. And the company has found some high-grade material in recent channel samples. Inca has what looks to be an almost complete epithermal porphyry system at Chanape which is quite exciting.

TGR: Do you think Inca will develop Chanape on its own?

PA: It is a small company that has an asset with considerable potential. I don't think Inca will be the one to develop Chanape. At some stage management will recognize that it needs a big brother to advance the project. The company recently announced that it has signed confidentiality agreements with several major mining houses.

TGR: Perhaps one more story before we let you go.

PA: The analyst team here recently launched coverage on a company called Newfield Resources Ltd. (NWF:ASX) which has a diamond project in Sierra Leone. Now I know that some people will shake their heads and wonder: "A diamond project in Sierra Leone where there is an Ebola outbreak?"

It's an interesting company that fits our investment thesis. Management is very conservative and the company's announcements are driven by technical data rather than prose. It has secured a potential alluvial diamond project south of where most of the diamonds in Sierra Leone originate. The interesting thing is that the alluvial field does not contain diamonds that come from the cluster to the north they appear to be from a proximal source.

It also identified a diamondiferous kimberlite on its land package. Generally speaking kimberlites occur in clusters that are either pregnant with diamonds or barren. That bodes quite well.

TGR: So the possibility exists not just for an alluvial operation but an open-pit or underground mine?

PA: Yes whatever the future economics dictate. The company acquired a dense media separation plant that will be used in part as an exploration tool because with alluvial diamonds you need to use bulk samples to determine grade. When it's not being used to take bulk samples it will be used as a commercial sorting facility to find diamonds that will provide cash flow. The company's market cap is around A$104M. Over the next three or four months we should have a sense of the grade in carats per hundred tons. Our price target is A$0.92. Most of that valuation is based on an alluvial diamond operation and does not include much value for Newfield's discovery of a diamondiferous kimberlite.

TGR: We're getting close to the end of 2014. What's your general outlook for the junior sector in 2015?

PA: It's still going to be quite hard but certain commodities are going to do better than others. This comes down to what your views are on the macro. For instance the supply demand fundamentals for nickel suggest that nickel prices should start to rise as Chinese stockpiles of Indonesian nickel ore get depleted. That means in 2015 nickel companies should perform better than they have in recent years. We're also likely to see zinc producers and developers outperform their peers in other commodities as several large zinc mines shut down.

Overall we're not out of the woods but we're always hopeful that the next year will be better.

TGR: Thank you for your insights Paul.

Paul Adams is a geologist and head of research at DJ Carmichael. He has 16 years of experience in the mining industry in Australia and elsewhere and was previously chief geologist and evaluations manager at Placer Dome's Granny Smith mine. He is a member of the Australian Institute of Mining and Metallurgy and has a Graduate Diploma in Applied Finance and Investment from the Financial Services Institute of Australasia.

Published by HT Syndication with permission from Commodity Online.

CT For any query with respect to this article or any other content requirement, please contact Editor at htsyndication@hindustantimes.com

CO bkhlp : BHP Billiton Ltd | rtz : Rio Tinto PLC | bltplc : BHP Billiton PLC | craaus : Rio Tinto Ltd

IN i211 : Metal Ore Mining | i22472 : Precious Metals | i22 : Primary Metals | i221 : Iron/Steel/Ferroalloys | igoldm : Gold Ore Mining | i224 : Non-ferrous Metals | ibasicm : Basic Materials/Resources | imet : Mining/Quarrying

RE austr : Australia | indon : Indonesia | waustr : Western Australia | india : India | apacz : Asia Pacific | asiaz : Asia | ausnz : Australia/Oceania | bric : BRICS Countries | devgcoz : Emerging Market Countries | dvpcoz : Developing Economies | indsubz : Indian Subcontinent | sasiaz : Southern Asia | seasiaz : Southeast Asia

PUB Commodity Online India Ltd.

AN Document HTCOMO0020141107eab7000b5

