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Cheap and cheaper

Pretium Resources (PVG in both New York and Toronto), the development-stage, Vancouver-based owner of a world-famous gold deposit in northwest British Columbia, derives its value from the monetary asset that's lately been losing its value. Which facts make the stock doubly cheap.

Now under way is a follow-up to our analysis of Pretium dated Jan. 25, in which we likewise contended that the stock was cheap. "Cheapening" would have been a better choice of word. Since we wrote, a share of PVG has fallen by 40%, to C$7.15 on Tuesday (the low was C$5.52 on April 18), for a market cap of C$731 million, down from C$1.15 billion (all dollar values, except the gold price and the New York-listed share price, refer to Canadian money; henceforth, you may assume the presence of the capital "C," which stands for "Loonie," in front of the dollar sign). At that, the disappointed bulls can thank their lucky stars that they were holding Pretium instead of, say, shares in the Market Vectors Junior Gold Miners ETF (GDXJ), down by 56% over the same six odd months.

Hopes and fears of a timely return to positive inflation-adjusted interest rates have thrown an interesting monkey wrench into the competition between gold and the weightless competition. Gold, as you know, is the legacy monetary asset, government-issued scrip is the ostensible modern upgrade to the original. Money, by its nature, is non-yielding; a dollar bill is as sterile as a Krugerrand. What's different about the post-2008 monetary environment is the sterility not only of currency but also of short-dated credit instruments. Bears on gold seem to be taking the Federal Reserve at its mumbled word that the next order of business is a painless "exit" from QE and the restoration of yield in the short end of the curve. Perhaps. But we judge the chances remote that the Bank of Bernanke, or of Yellen, or even of the genius Summers, will carry off that feat without making the kind of waves on which a gold bull—and, even more, a Pretium bull—can profitably surf.

Except for the collapse in the value of all things gold-related, Pretium has had a happy and constructive spring. You will recall that the company is developing a gold deposit in the Valley of the Kings' zone of the Brucejack field near Stewart, B.C., population 494. In May, Pretium's management announced that it had completed the tunneling and infrastructure required to conduct what is known as bulk-sample testing. It hired Strathcona Mineral Services to extract and analyze 10,000 metric tons of mineralized rock from a section of the deposit intended to be representative of the whole.

"We selected an area that would have the average amount of drilling," Robert Quartermain, CEO and president of Pretium, tells colleague Charley Grant. "It would have the average amount of high-grade hits in it, it would have the average amount of low-grade hits, the average amount of zero value within it. So the plan would be to take the results from the sample and apply them back towards the whole model. Because if it works here, then it's basically confirming the model, and we can apply it back throughout the deposit." Extraction of the bulk sample is expected to start next month with results to follow in October.

There was some good news last month in the shape of a feasibility study of gold and silver deposits in the high-grade zone of the Valley of the Kings. The study estimated probable gold reserves at 6.6 million ounces and probable silver reserves at 5.3 million ounces. Further to the west are lower-grade deposits earmarked for development at a later date. In this region of Brucejack, the study found another 700,000 proven and probable ounces of gold as well as 30 million proven and probable ounces of silver.

The distinction between "proven" and "probable" is a subtle one. "Proven" indicates a higher degree of certainty regarding economic feasibility than "probable" does. A "reserve" is more certain than a "resource." Resources can be classified as "measured" (the most certain kind), "indicated" or "inferred" (the most hopeful). Pretium says it expects that more probable ounces will be reclassified as proven once the bulk samples are available.

The feasibility study, according to Quartermain, "showed that we could produce about 425,000 ounces of gold annually, at least in the first 10 years, 7.1 million ounces over the 22-year life of the mine. Good average grade, about 14 grams, the average gold grade in the first 10 years about 12 grams over the life of the mine. I think, most importantly, that the all-in sustaining costs are going to be about $508 an ounce, and the capital was kind of where we thought it was going to be in that $600 million to $700 million range; it came in at $663 million." In January, *Grant's* used an estimate of $436 million, but that was based on a projected processing rate of 1,500 metric tons a day; the revised rate, new and improved, is up to 2,700 metric tons a day.

Validation of the bullish gist of the Pretium study was forthcoming in May, when Franco-Nevada bought a royalty interest on the Brucejack project. "That said," Pierre Lassonde, chairman of Franco-Nevada, wrote in an e-mail message to *Grant's*, "there remains to determine what the deposit will actually mine out at what grade. . . . These high-grade deposits are always a challenge to evaluate. Our feelings are that the head grade will come in lower than assumed by mgmt but the question is how much lower. But even under pessimistic assumptions, it will be one of the best deposits around, otherwise we would not have bought the royalty."

Naturally, a great deal rides on the gold price. Management chose $1,350 an ounce as the base case for its feasibility study last year, and a conservative assumption it seemed at the time. On the strength of this evidently lowball value (along with a 1:1 U.S. dollar/Loonie exchange rate and a $20 per-ounce silver price), the project would yield a pretax rate of return per annum of 42.9%.

Naturally, management also plugged in a less advantageous assumption. At an $800 gold price and a $15 silver price, Quartermain relates, the project would deliver a 16.6% pretax, 13.7% after-tax rate of return, "so therefore it certainly warrants us to continue pursuing it."

"How about $300 gold?" our intrepid reporter asked.

"I would think at $300 gold, what we would probably do is we would maintain that asset for the future benefit of our shareholders," Quartermain replied, "because when you look at it, I think in many matrices, it is one of the most attractive projects out there that's yet to be developed. If you look at the cost curve and the challenges we're seeing in the major companies right now, many of them are talking about total all-in cash costs of $1,200 to $1,300. So if gold were to go to that level you're speaking about, then that's problematic for the entire industry. . . ."

One could say "problematic." At $300 gold, people might well be asking, "What industry?"

As a development-stage company, Pretium is, of course, like a yearling, all prospects and no income. On April 26, management completed an equity private placement with Liberty Metals & Mining at $6.92 a share for a grand total of $40 million. Shareholders have a well-honed dread of such dilutive financing, but what are Pretium's alternatives?

On March 31, the balance sheet showed C$38.7 million of current assets, including C$20.7 million of cash and C$17.7 million in receivables (in the form of tax refunds and tax credits), against current liabilities of $16.1 million. Mineral interests were carried at $621.3 million. The projected cost of moving into production, as noted, runs to nearly $700 million. How does the company propose to pay the bills until it has gold to sell in—perhaps—the year 2016?

There's enough on hand to pay the anticipated 2013 bills and a little more, Joe Ovsenek, Pretium's chief development officer, tells Grant. There are options galore to meet the cost of development, he adds: equity (can't do without it, he says), debt, gold or silver royalty streams, convertible bonds. "We have plenty of grade and return on Brucejack," he says, "so I would like to put on a substantial amount of debt on the project, especially at current rates."

At current interest rates and at the current gold price, says Ovsenek, the problem is fending off the would-be financiers and debt peddlers, not scaring them up. Many more 3% down days for the gold price, of course, and the investment bankers might become scarce; Ovsenek guesses that that threshold is somewhere around $700 an ounce. "Well," he says he can imagine the bankers saying at such a critical juncture, "let's not put any more money into that space until we know it's bottomed out." Certainly, we can all imagine it.

"Then, again," observes Grant, "no developments since January have called into question the assertion of Trey Reik, chief investment officer of Bristol Investment Partners, that Brucejack constitutes 'perhaps the highest-grade gold discovery of the past four decades.' And it's worth remembering that under Quartermain's leadership from 1995 to 2010, Silver Standard Resources grew from a development company with essentially no revenues to a producing company with $112 million's worth, and from a market cap of $2 million to one of $1.9 billion."

Skeptics may observe that in those years, Quartermain had the central banks of the world on his side; they were printing money and suppressing interest rates. Bulls will reply that Quartermain still has the central banks of the world on his side. That they may "taper" is a speculation; that they continue to print (and/or to suppress interest rates) is a fact. Pretium and the metal it mines constitutes a hedge against—or, indeed, an investment in—those facts.

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