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Sector Coverage

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Australia – Canada: Divergent Paths In Praise of Production

Divergent Paths

In Praise of Production

- ☞☞ Some think we are just being ornery, but we continue to see the companies with a serious approach towards moving to production as the most attractive investment option
- ☞☞ The universe of Latin American mining is dominated by Canadian names with a few AIM-listed stocks thrown in. We have come to divide the universe into those which one can believe are dedicated to eventual production and others who claim that they are but are really just dressing up their resource in the hope of an eventual trade sale.
- ☞☞ This is a dramatic contrast to the Australian mining industry where even the smallest companies hope to move rapidly to production as soon as the minimum requirements for profitable extraction are satisfied.
- ☞☞ The Australian (and UK) investment communities want to see production ASAP as it signals eventual dividends. Endless expansion of reserves is not seen as an end in itself.
- ☞☞ This approach means that financings in Australia are generally pitched towards moving the production ball forward or they run into shareholder opposition.
- ☞☞ While we can understand (and admire) the upfront approach of groups like the Lumina Copper “spin-offs” that openly admit their goal of a trade sale, we are unimpressed by companies that profess to eventually seek production but do everything they can to stave off “the evil day”.

Here comes grumpy!

Our little pitch of the equities world is the LatAm mining space. The world seems to have been subject to a form of spontaneous staking of claims with Canadians getting the upper-hand in Latin America. This pretty much restricts us to Canadian companies with a smattering of AIM-listed entities in our range of coverage. First we should say that we shall make some generalizations here, and yet there are some very admirable exceptions. However, recently when we sat down with a Canadian mining veteran and popped the “production question” he knew that Australians always tended to ask this.

When we go to meetings with those who have met us before they know that it is almost inevitable that we shall ask this question, unless they start off the presentation with a photo of a gleaming ball-mill (and it better be theirs!). Why the question? Because we want to see production. It shows a project is serious, it shows it is a viable economic entity. It shows that they most probably won't be coming back asking shareholders for more cash. It shows that there is a timeline around which we can gather our expectations of payback.

And yet, Canadian (and US) corporations seem to think that “payback” comes when you sell a stock, not when you hold it. It is this philosophy that has made the US pension industry subject to the swings and roundabouts of outrageous fortune in the stockmarkets while the UK and Australian industries are much better funded by seeking to match obligations against revenues rather than the possibility that a stock in a pension fund portfolio may have shown outsized appreciation (to make up for all the ones that don't).

So the attitude we encounter is that investors and analysts should be happy to see lots of numbers on reserves and be content in this alone. Alas, we are not so easily gulled. We eventually have to start asking what is the matter with these fantastic reserves if they are destined to stay in the ground. Why should we mark a stock up or down in our estimation as the price of its guiding metal moves if it does not really matter what is in the ground. It could be 3 million ounces of cotton candy instead of silver.

Build it and they will come?

Well, not really. It is more like “find it and they will come” in the estimation of many of these companies. Happy is he who has not seen and yet believes.. yeah! Some companies are upfront about this attitude. The most admirable and most successful in this group is the old Lumina Copper crowd who sliced and diced their assets and have done some nifty asset sales with a clearly stated goal of never producing. In fact they are expediting the process of bringing things to production. They essentially deliver a resource like Northern Peru Copper to the Chinese with a bow on it and probably bring it to production faster by having the Chinese with bottomless pockets and vertical integration of demand move the project further faster than if it had to wait for the paralytically tedious process of bankable feasibility studies (and we would note, these are starting to look increasingly unreliable in the days of rampant mine inflation).

The opposite of the Lumina policy is the Northern Orion (of fond memory) approach. They claimed they were serious and were anything but. They spent years babbling about Agua Rica in Argentina and never showed even the slightest intention of moving it forward even as Alumbrera swelled in size and importance and afforded a skilled local workforce and infrastructure. What were they waiting for? For Alumbrera to close down and the skillset to be dispersed? Eventually Yamana came along and Northern Orion threw off its skirt and petticoat and assumed the position.. What's more they seemingly felt they needed to pay Yamana their enormous cash-hoard to expedite the ravishing.

Then we meet the companies with 100 million ounces of silver in indicated resources that want 300 million under their belt before they make a move on production. Why? *Garimpeiros* they are obviously not. They can trot out logical-enough sounding excuses for not moving forward with what they have, until one meets other producing companies (ECU Silver, or Fortuna for example) which have reasonable resources to get going on with and moved forward gradually proving up more as they go along. Not all Canadian companies are ditherers. Then again, ECU has their top guy living in Mexico and most of Fortuna's management is Peruvian. Is it a truism that the closer one gets to the site and farther from Vancouver, the more likely there is to be some action?

The Vegemite-powered Approach

We can't help thinking of Australia as we sit there listening to the excuses on why production can't happen. The contrast is the almost indecent haste that Australian miners have to get some production out the door and cash in. After all cashflow means less financing need and that implies less dilution, so what is not to like about that? Metal prices are the same in a global market and have been since either Australia or Canada first put pick to rock. Why then are Australians driven to produce and Canadian miners content to dally in the whole process. We can see logic in small companies wanting to expend their resource to give them economies of scale. But that does not explain why some companies with enormous reserves still hunt for more putting off indefinitely the evil day when they need to become miners. Then there are the serial offenders who accumulate and accumulate reserves and projects like antique thimble buyers on EBay. Cardero Resources is a particularly notorious example. The company has sat on a magnetite deposit that is so big it can be seen from outer space for four years while its stock price has gone down 80%. To mollify (obviously unsuccessfully) the shareholders it adds more and more projects in a virtual frenzy of collecting. It recently decided to fake the look of doing something by getting a 40-ton plant in to test a pile of ore that is 15 kms long and two kms high. Good luck to them.

Second guessing your underlying metal

Both Canadian miners and Australian miners have been the same travails over the decades with regard to metals prices. The idiocy of \$35 gold for so long, then the fantastic prices of the 1960s followed by the great inflation of the 1970s, then the great deflation of the “can't even give it away” period from the early 1980s until 2002 and finally the commodity reflation of the Supercycle. The lesson to be learned from all these spikes and dumps is that if you dawdle too long is getting to production you may be staring at a

price downturn just as you finally start to ramp up. The virtually annihilation of the once great US copper industry in the late 1980s to early 1990s should be a salutary lesson, if one needs any more than a glance at historical prices to tell one that prices rise and fall and “time and tide” in the metals markets wait for no man. Clearly some of the current batch of miners we get to talk to think they have the luxury of time. Far be it for us to dismiss the Supercycle for we are believers like the next man, but... Stuff happens.. and what that “stuff” might be could result in metal left in the ground staying there for the next player to come along in a future time. The Australian approach is to get it out ASAP as you never know what might happen next. The approach we find in our wanderers is a disturbing insouciance amongst the Canadian miners in LatAm that if they wait, it will get even better! The solution to this is seemingly to create feasibility studies based upon \$15 silver or \$650 gold because that is the safe way to handle things because its going to take another 3 years before anything comes out of the ground.

Australians too err on the side of caution but when silver is \$20 they would rather get it out now and sell it now for the \$20 than cover their posteriors with a low estimate to ensure against their interminable crawl towards production.

Here we could be subject to accusations of generalization but lets look at two examples. There is Alumbreira the copper/gold mine in Argentina developed by MIM (now subsumed by Xstrata). Copper was very much in its mid-1990s doldrums when MIM soldiered on and got the project up and running in what was almost a virgin territory for mining with no infrastructure and no local skills base. Lets segue forward ten years and there is Northern Orion sitting on Agua Rica not doing anything and yet copper is more than twice what it was when the button was pushed on Alumbreira and gold is three times higher. The difference, MIM operated under the imperatives that had driven it for 100 years, Northern Orion, in contrast was finding the “For Sale” sign hanging heavily around its neck but not enough to stir it to action.

Then there is Minera IRL. We stumbled on this AIM-listed stock by accident and wrote it up last December. They’re a score or more of Canadian look-alikes fossicking around in Peru. The difference is that IRL found what they found and developed it *pronto*; it then got itself a Lima Venture listing and has risen 60% since December while all about it have languished or been badly beaten up. Why? Australian management, in fact one of the few small miners in LatAm that still represent the Lucky Country south of the Rio Grande.



Bre-X – the memory lingers on

Everybody has their market scandals. Sleaze in the Australian mining industry dates back to when the first syphilitic sailor jumped ship in Melbourne in 1850 to try his luck on the Ballarat goldfields. “Seeding” in Australia doesn’t mean starting up a hedge fund it means liberal distribution of high-grade samples around a mine site before going and spreading a rumour at the Long Bar of the pub in Kalgoorlie. Maybe the Canadians are just “too nice” as the Americans would have it as the Canadians are still in trauma over the Bre-X kerfuffle. The solution chosen to remedy sleazy doings in the Indonesian jungle (hadn’t they ever read any Joseph Conrad?) was to put in force mind-numbingly ponderous reporting and reserve assessment requirements that not only cost an arm and leg but slow down the production process to something one can hope the grandchildren get to see.

Show me the money

When it comes to comparing Icy Waste Mines Inc. listed on the Toronto Venture to Tinpot Mining NL listed on the ASX it is useful to ponder the trajectory of both companies. Both start out as the twinkle in some geologist’s eye while he is driving home from doing work for somebody else. An outcrop is spotted, pegged and put into a corporate vehicle. Icy Waste begins the eternal cycle of brokered placements while its produces enough paperwork to sink a bulk freighter in its pursuit of NI43-101s, scoping studies, press releases, prospecti and bankable feasibility studies. If it ever starts production, its price might or might not go up. It gets some cash flow and immediately goes looking for other prospects (though usually already has a fistful of them) and starts spending all the loot from Mine One on doing the paperwork thing for Mine Two. By the time Mine Two is ready to start, Mine One has started to peter out or maybe Icy Waste has been snapped up by Dumb & Ugly Consolidated in an all-stock deal. The cash pile at Icy Waste gets to go to Dumb & Ugly. Shareholders in at day one have been diluted to hell (except the execs who got to participate in every placing) and nary a dividend has been seen.

Around at Tinpot Mining, the execs of the company convince the brokers and institutions (instos as they are known Down Under) in Melbourne and Perth (by handing over their grandmother’s glass eye as collateral) that the mine will be up and running within 18 months without anything more than a few drillholes having been executed since the geologist stumbled on the aforementioned outcrop. If there is no talk of production (and no surrendering of granny’s eyeball) then the hapless executives are shown the door without as much as a tea and biscuit to sustain them on their way up and down Collins Street. In any case, they might as well ring a bell and shout out “Unclean, unclean” like the lepers of old as continue seeing brokers because “no production= no-go”.

Why? The instos wants dividends, the private investors want dividends and the brokers want companies that somehow, somewhere will provide them. Equally, if they have any hope of selling the stock to UK or New Zealand investors, they will also need to cough up a dividend. Tough, ain’t it... Investors want a retirement scheme for themselves as much as the *company promoters* do.

Then once Tinpot is up and running, it evolves its reserves ASAP, finds some old equipment from a mine that is closing down (i.e. unable to be milked for dividends any more) and gets it trucked around faster than you can shout “cooee”. To fund this production, there is a rights issue. Most of the shareholders sign on for this, as this is the event they were waiting for. If they don’t have the readies they sell their rights and book it down as part of their capgain. They don’t sell out as soon as production is announced, unlike Icy Waste’s shareholders (“because we only invest in explorers”). Another interpretation at Icy Waste could be that its “game over” by the time production comes around.

Spot the difference??

The quality of the investor base

A key difference between the Australian investor base and that in Canada is the participation of the very heights of the investment community in the very depths of the mining industry. For a long time the massive mutual life office, AMP, was the biggest shareholder in everything. Thus one could find AMP or National Mutual, T&G etc on board at Tinpot Mining NL and usually the largest shareholder after management. Why? Well it was a case of throwing money at everything and seeing what stuck. Some would be winners, some losers and some also-rans. It didn't mean these mega-institutions were passive shareholders. In fact they were very pro-active and usually had the home phone number of the top execs to voice their displeasure should it be stirred to anger. The key difference again, is that any Tinpot Mining NL could become the next up and coming miner (e.g.Oxiana). Institutions didn't want to be buyers when the story had evolved. They wanted to be in at the ground floor. Nearly everyone was dedicated to production and should the production pan out, then the institutions knew there would be dividends. And as life insurance companies or pension fund managers, these dividend flows were music to their ears and gave their actuaries the only thrill in their otherwise humdrum lives.

The Perpetual Financing Rounds

As we have mentioned Tinpot Mining is doing everything on the cheap, or as cheap as they can get away with. They only have their shareholders to keep satisfied not a bank that holds them by the short and curlies. If they do have a bank, the bank is mollified by production being imminent which means repayment being imminent.

Meanwhile around at Icy Waste they are on their third private placement in the twelve months. They have one whenever they can. Nickel ticks up 5 cents per pound and they have a placement. Why not? They have a pile of cash, but shareholders have marked the stock down, as they got bored with waiting for the scoping study while three Christmases have passed. So executives see an opportunity to do a brokered/non-brokered with the non-brokered portion being taken by them at a 10% discount to the market plus warrants equivalent to the 65%-8% placing fee, which they receive for having placed the stock with themselves. Yeehaa!

Preemptive rights

Around at Tinpot Mining the rights issue is used with caution. The shareholders aren't too hot on them. They don't like companies rattling their begging cup at them Down Under. And of course the key difference in Australia and the UK is shareholder's pre-emptive rights. Executives hate that. Reduces the chances they have to scale up their holdings while scaling down instos that might sell out to a raider. Issues usually need to be done at a discount and if they are then the rights have value when they start to trade and the shareholder's get to realize some value.

Latin America: the Antipodean blindspot

Once upon a time there was a colorful character called Alan Bond and in the late 1980s he discovered Chile. It helped that he had also bought a copper behemoth down on its luck called St Joe. Getting acclimatized to Chile he went on to snap up the Chilean phone system in the privatization rounds and made it run like a bat out of hell (Chileans still pine for those days pre-Telefonica). As colorful characters do (particularly those from Perth) he crashed and burnt. His excursion into LatAm mining had led a flock of other Australian miners into the breach, dear friends. However, without their fearless leader and lacking the social graces to get used to Latin corruption they gradually packed up their reverse drills and headed off to South East Asia and Africa (where at least the corrupt local officials spoke English). So now we have the world divided up (with a few exceptions). The AIM-listed companies largely play ex-Soviet Union, Africa and a bit of LatAm. The Canadians play Latam and some West Africa. The Australians play South East Asia and all over Africa.

The Australian retreat from LatAm was a big mistake. Whatever was going on in Laos was not worth the candle, and officialdom in Indonesia makes Latin shakedowns look positively amateur. IRL is Australian managed but AIM-listed. In Brazil there are two companies that are in production (funny that!) or on the verge thereof, Mirabela and Troy. Otherwise not much more of note, besides the behemoths of BHP and Rio Tinto, which resemble the brontosaurus not just in size but brain capacity.

The Canadians grabbed the prizes in LatAm, however, the fact that sitting and watching the cows go by is the main activity for so many players, the scope for Australian miners to snatch up bargains and get them into production before flogging them off to the Chinese is still evident.

Conclusion

What point are we trying to make here? Well in recent years Canadians have been despairing that their best assets are getting snapped up and whisked away by foreigners. It's all about value-added and "finding it" does not alone add enormously to value-added. Some companies seem determined to do whatever contortions possible to avoid ever having to produce anything. Once upon a time the production task might have been passed along to another bigger miner via an outright sale or a JV to production. Increasingly the Chinese are snatching the asset when it gets sufficiently ripe and then moving it ahead with their own infinite resources.

The companies only seem to encounter opposition in the form of this stropky Antipodean because other investors are not putting on the pressure. The Canadian miners are uniquely positioned in LatAm mining but very well may be blowing it with extreme torpitude. If they won't shape up of their own accord then it's up to investors to apply the thumbscrews. Hopefully we are not alone out there.

Important disclosures

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