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# HALLGARTEN & COMPANY

**Think Piece**

Christopher Ecclestone  
[cecclestone@hallgartenco.com](mailto:cecclestone@hallgartenco.com)

## JORC vs NI 43-101 Going to the Wires

# JORC vs NI 43-101

## Going to the Wires

- + Canada's system NI 43-101 reports cleaned up the Augean Stables of resource reporting in that market and revived confidence of investors
- + The Australian JORC system though has come to rule the ROW
- + The Australian market had its own massive scandals in the late 1960s after which it has been relatively trouble free
- + The Australian system allows the companies to keep commercially sensitive information to themselves (or to share with their financiers)
- ✗ The NI 43-101 system has allowed dilatory companies, not dedicated to production, to string things along constantly putting mining action at some point "over the horizon"
- ✗ The system has created vested interests in the consulting geologist field for whom the instrument is a massive source of income.
- ✗ The never quantified cost of the rule over other alternatives would appear to be a massive burden upon mining companies, particularly smaller ones
- ✗ It remains unclear whether the NI 43-101 rule has been the reason that Canadian mining companies take so long to bring projects to fruition, if at all..

### Order out of Chaos

Those of us that spend our time immersed in Canadian mining stocks can easily slip into the mode of thinking that the whole construct of NI 43-101 reports is normal. Normal in Canada maybe.... The NI 43-101 though has started to look like the Canadian mining version of "mom and apple pie". The instrument "keeps 'em honest" and you need worry no more that you are going to be ripped off by unscrupulous financiers. The first error here is to think in Orwellian terms that "financiers bad, geologists good". No such self-delusion exists in the London, South African or Australian mining markets. In those places it is taken that almost everybody in mining, regardless of job title, is of dubious provenance. Thus Canadian regulators converted geologists into Ayatollahs in the mining space that can hand down *fatwas* on deposits. The price of this decision is paid daily by investors in Canadian mining stocks.

### Blame it on Bre-X

The NI 43-101 is the result of Canada's mining epiphany, ergo the Bre-X scandal.

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 but rather 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 kaffuffle. Interestingly the Canadians decided that financial types were guilty of the Bre-X crime and that thus it would be safer if boards/managements were populated with geos and mine engineers. This flew in the face of the evidence that Bre-X had geos quite blatantly with the hand in the cookie jar. The industry has been paying the price ever since with amateur managements being the rule rather than the exception.

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 also slow down the production process to something one can hope the grandchildren get to see.

### **The Musings of John Kaiser**

While we are constantly struck by the shortcomings of the NI 43-101 process, we have been prompted to revisit the theme in this instance by two events. Firstly were some observations made by a commentator on the frustrations of one of the Rare Earth plays. The other was a comment made by one of the Australian presenters at our recent Lithium Symposium in New York.

We were reading a recent piece by [John Kaiser](#) on the subject of Avalon Rare Metals. He noted that management had expressed puzzlement as to why Avalon does not get as much media attention as other advanced Rare Earth projects.

Kaiser commented, “Avalon has the misfortune of being a groundbreaker in the rare earth sector, which means that its prefeasibility level disclosures have removed considerable blue-sky from the upside of its story. To some extent this is unfair, because the Australian listed rare earth juniors such as Lynas and its siblings Arafura, Alkane and GMEL have published only summaries of their prefeasibility studies which makes it very difficult to assess the plausibility of the valuations that a discounted cash flow model can generate using their general parameters. The Australians do not have a 43-101 style disclosure system because it was a Canadian listed company which served up Bre-X and its Busang gold hoax onto an unsuspecting public in 1995-97 which prompted a complete rewriting of Canada's reporting and disclosure system in the form of NI 43-101”.

Let us dust off the history books here.. maybe we are dating ourselves but Australia had the scams of the Nickel Boom of 1968-69. These events made Bre-X look like some naughty schoolgirls cross-dressing their Ken dolls. Poseidon and Tasminex (amongst others) will live in infamy and created an odious association in the London market for Australian mining equities from which it has never recovered. Scandinavians were even drawn into the morass and we have met Swedes who in the current decade still refused to invest in any Lundin family vehicle because of the “sins of the father” at Tasminex. The Australian mining market paid the price with most stocks wallowing through the whole decade of the Seventies due to the excesses of the Nickel Boom. However, in the intervening 30 years, scams in the mining sector in Australia have been few and far between since 1969. Name us some?

Kaiser went on to observe that, “There probably is nothing wrong with the procedures and practices of the Australian system, but it is pathetic that the ASX and associated Australian regulators do not give the public access to the kind of technical reports taken for granted by investors who follow Canadian

resource stocks. For these reasons it is wise to treat any mine development plan pursued by an Australian listed company on a "believe it when we see it" basis".

Hmmm... the curious paradox of this is that Australian miners are far more likely to get a mine into development than a Canadian miner these days. Why is this? In fact the paperwork shuffle provides a convenient cover for many Canadian miners that want to obfuscate the move to a production schedule. If Novagold did not have the cover of eternal new NI 43-101 reports, PEAs and the rest it would be seen as an Emperor with nothing more than the fig leaf of a sheaf of papers from Qualified Persons.

In an interesting observation, Kaiser states: "Avalon, however, is not just upset by the minimalist disclosure system of the Australian stock market, but it is also upset by the attention the market is bestowing on Canadian juniors producing preliminary economic assessments (PEA), or scoping studies as they used to be known. A PEA is based on an inferred resource and involves a lot of educated guesswork by mine engineers about recoveries and costs whose true nature is not discovered until \$20 million plus has been invested in a prefeasibility study which requires a measured and indicated resource. As a rule, as a project progresses from PEA to PFS the costs will be higher, the resource smaller, and the recoveries poorer, which means, in the absence of infill, geotechnical or condemnation drilling exposing a whole new positive dimension to the deposit, the NPV tends to get smaller even when the same discount rate is used. In theory, the greater uncertainty about the inputs, the higher the discount rate one should use".

We would take exception to the word *minimalist*. Australian miners keep the "good stuff" for the Bankable Feasibility Study, to which only they and the bankers are privy. This is where the other spur to this note comes in. At our recent Lithium Symposium in New York, the Australian spodumene producer Reed Resources (RDR.ax) was asked what their upcoming mine's cash cost per tonne would be. Much to the audience's surprise the response was that the company did not comment on that because it would be ammunition for the company's potential clients in China and elsewhere (not to mention competitors) to push back if they had an idea of what the company's margins were going to be. This was a very valid point that had never crossed our mind. As analysts we want as much information as possible, however when one is in the position of being an executive of a commercial operation negotiating offtakes then commercial secrets are one's stock in trade. The precious metals space is entirely different and an Australian gold miner that was cagey on its costs could not use the arguments Reed could employ. Everyone knows the market price of gold and a gold producer that refused to say what their cash cost would be suspect of having one that was unacceptably high. The same could be said of the Rare Earth space or indeed any less than crystal clear pricing of a product. Paradoxically we think back to the very thin excuses that Thompson Creek (TC), the Moly producer trotted out to talk down the onset of Moly trading on the LME. In that case it was the sale price that the company wanted to keep obscure rather than the production cost.

As for Avalon's other gripe that advanced reporting shrinks the size of their resource... Hmmm.. hazard of the profession, we guess!

In conclusion, Kaiser notes: "On these grounds one would expect the market to treat Avalon's Nechalacho project with greater respect than other projects with less rigorous and detailed level of disclosure, but in the special arena of rare earths Avalon's advantage is not quite as large as management believes because it has yet to conduct a pilot plant scale study which confirms to what

extent the recovery process works and how much it will cost. As a groundbreaker, however, Avalon has had to work harder than its less advanced peers to raise the capital needed to advance its project, and judging from what I am hearing, it will become even easier for latecomers to raise large amounts of money ..... No wonder the rare earth sector is rife with so much bitterness”.

Kaiser is absolutely right here in pointing out that Avalon does not have a pilot plant and as such, cannot be considered in the same breath as Lynas or Molycorp. The former is well on the way to production and the latter has a proven past-producing mine. Avalon is not an apples-to-apples comparison with either of these. We would also note that Avalon far predates the Rare Earth upsurge. Thus the company has had years to put up a pilot plant. We note a distinct reticence on the part of Canadian miners to put in pilot plants. We can only suspect that a pilot plant is the ultimate litmus test of whether a mine’s chemistry will work (and REE are all chemistry) and to put one in and have the tests come back with a poor result would be a definite buzzkill (somewhat like falling out of a helicopter into the jungle). Avalon is not alone though in dragging its feet on getting a pilot plant on the ground.

### **The Proof of the Pudding....**

When it all comes down to it, mining is about mining, not about having infinitely expandable resources. Novagold can dish up more NI 43-101 reports than you have had hot dinners. And yet Novagold would be given short shrift in Australia (and seems finally to be getting the same treatment amongst Canadians). The litmus test is not whether a deposit is there, or even whether it is mineable, but rather whether it is mined.

Even starker is a look at the Lithium space. The entire lithium space in Australia (or the ASX) consists of Talison (a producer), Galaxy (near completion), Reed (slightly less near completion), Orocobre (very advanced with Japanese partners locked in) and Rincon (built). On the Canadian side there are 15-20 names and NONE are advanced or even vaguely near production. Excuses about the Australians having a head start don’t hold water as Reed only bought its virgin property in September of 2009, started construction in March 2010 and will be producing in March 2011. Something is wrong here. We could charitably attribute the torpor to the rigours of the NI 43-101 mechanism but “won’t go there” on whether the managements are serious about production or just doing lip-service. What we can say though is that if one wanted a perfect excuse to dally then one could not have dreamed of a better way to do it than inventing the NI 43-101 regime.

### **Which brings us to the polemics...**

When it comes down to it should a miner be mine-centric or deposit-centric? Is not the paperwork just a treasure map to the mine? The absence of scandals in Australian mining from the late 1960s until the current time shows that having a NI 43-101 regime or not is somewhat immaterial. In any case Australia has the JORC concept that everyone except Canadian miners seems to have taken as the gold standard.

This makes us wonder whether the Canadian securities authorities have not merely passed the parcel on supervision of mining activities to an amorphous army of consultant geologists. The real test is whether investors in Canadian stocks have been losing money or not and unfortunately the Canadian market is littered with hundreds of stocks over the last ten years that have found deposits that according to NI 43-101 reports were meaningful and yet the investors ended up losing their shirts due to poor

management, poor timing or inaction. The uranium space is a good example. A plethora of names, 60-80 depending on your counting, flooded the TSX-V in 2007-8 and all but a handful are now gone. We can argue that this was a fad, but what happened to scores of junior golds that were extinguished over the last few years when the price of gold can clearly not be faulted.

The big questions are:

How much collectively has the NI 43-101 cost the Canadian mining industry? Billions? Conversely how much have consulting geologists made out of the rule?

How much has the measure cost investors and companies in terms of delay in getting to mine?

How much money has it preserved from being lost that would not have been lost if a JORC regime had been employed instead?

Has the NI 43-101 measure created an “establishment” with a vested interest in its perpetuation?

## **Conclusion**

So, are Canadian investors living in a paradise of frankness and professionally generated resource information while Australians are wandering in a vale of darkness? We would beg to differ... Australians don't feel like they are being ripped off or deceived. Just because Australia's indiscretions are not in recent memories does not mean they are not branded into market memories or blithely passed over (as would happen in the US). Australia's mining markets are the accumulated experience of 160 years of mining which produced the likes of BHP-Billiton and RTZ (through its predecessor, CRA). We do not hear anyone who has to rely upon JORC reporting complaining of the fact. Neither do we hear any complaints of Australians rushing precipitously into mining ventures. Just because the corporate boards are not stuffed with geos does not mean that the management's don't know what they are doing.

Being a mining company is not all about reporting deposit resources. The resource is not, in the first instance for investors, it is for the company to decide whether to explore more or to move to mining. If the reporting satisfies that information need then excessive extra information (particularly release of commercially disadvantageous secrets) is unwelcome.

In physics the rule is “action and reaction”. The NI 43-101 regime was pushback against excesses, we are tempted to say that the reaction has been excessive and it has most certainly been excessively expensive.

How much money has gone into the NI 43-101 process that would not have been spent if it had not existed? How much money has been saved? Shareholders of the metaphorical Hot Potato Gold with \$100K in the bank, a \$600K market cap and \$13mn in drilling and NI 43-101s behind them might well wonder!

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444 Madison Ave, 40th Floor, New York, NY, 10010