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► **Explorers hit hot spots**

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Mirroring recent falls in the Australian S&P/ASX 300, the All Ordinaries Gold Index and the S&P/ASX Emerging Companies Index, miners down this year include Perseus Mining, Ampella Mining and Gryphon Minerals, leading investors to ask, where next in the resources sector? Angus Geddes at Fat Prophets likes Catalpa Resources, Gold Road Resources, Mt Isa Metals and Cerro Resources; Grant Craighead at Stock Resources likes copper, Tiger Resources and Discovery Metals; Exploring company Hot Chilli board member and CRU Group consultant Allan Trench likes Mongolia and North Africa; MineLife founder Gavin Wendt likes Africa-focused stocks such as Middle Island Resources, and also Horizon Oil, but is wary about central Asia.

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EXPLORERS HIT HOT SPOTS

A recent sharemarket correction has changed the landscape for speculation in junior miners in emerging nations.
Report: Tony Featherstone

● What a difference a few months makes. Junior explorers were all the rage early this year. Investors snapped up stock in placements and dozens of explorers floated, some with little more than a PowerPoint presentation and sales pitch. Many with operations in mining hot spots promising “elephant-size discoveries”, such as Africa, Mongolia and South America, were in demand. Then came a 10 per cent fall in the Australian sharemarket, a technical correction that belted speculative exploration stocks. The S&P/ASX 300 metals and mining index is down almost

6 per cent this year and 11 per cent in the past three months. The All Ordinaries Gold Index is off 11 per cent this calendar year, despite a higher gold price. And the S&P/ASX Emerging Companies Index is almost 11 per cent lower in the past quarter.

It gets worse at a stock level. Last year’s market darlings, West African gold explorers, are falling amid general risk aversion and civil unrest in some African countries. Perseus Mining has shed 85¢ from its \$3.55 high; Ampella Mining has dropped 45 per cent from a 52 week high; and Gryphon Minerals is off 15 per cent. A handful of Mongolian-focused explorers are well down on their recent highs, as are many Australian explorers with South American operations.

Which raises the question: is it time to buy better quality explorers with emerging-market operations?

As always with the sharemarket, there is no simple answer. Financial markets have rarely been as polarised. One camp says current global economic weakness

Inner Mongolia prospects: There are conflicting views on returns from small explorers

will pass and growth in commodity and share prices will resume later this year. The other camp believes the global economic recovery is fading, central banks have run out of ways to boost growth, and sovereign risk in emerging markets will increase as higher food prices lead to more civil unrest and revolts. If the second view is correct, investors should run a mile from emerging-market stocks.

Fat Prophets chief executive Angus Geddes, a long-term resources bull, took profits in several small exploration stocks earlier this year. They had run too far, too fast. Now he is selectively buying producers and explorers at lower prices. “If you think there’s a long bull market in commodities, as I do, then the resource sector will run again before too long,” he says. “But you need to buy the best resource companies when their prices are well down, and be prepared to take profits and reinvest.”

Geddes still favours gold stocks. “Gold is going higher over the medium to long term. We’ve seen many Australian gold stocks massively underperform gains in the gold price this year. This has created some opportunity to get set in-better quality explorers and producers.”

He was an early investor in Catalpa Resources, and likes Gold Road Resources.

Other leading mining experts are less convinced about gold. Stock Resource’s Grant Craighead believes a rising currency will continue to weigh on the gold price in Australian-dollar terms, and that gold stocks generally will struggle. “Gold has nowhere to go in non-US-dollar terms,” he says. “We expect the premium paid for gold stocks, especially those with offshore operations, will continue to pull back in line with conventional stocks.”

Craighead believes growth in emerging economies will continue to underpin higher commodity demand and a bull market in resource stocks in the medium term. He also says investors will focus more on India than China in the next few years as a source of new demand for

CHASING ELEPHANTS: SIX EXPLORERS TO WATCH

BRW asked mining experts for their top ideas on emerging-market exploration stocks.

Angus Geddes, Fat Prophets:

1. Mt Isa Metals

"Its strong tenement position in Burkina Faso in West Africa has potential for a big resource. We bought the stock at 30¢, sold at 60¢ and watched it go to 90¢. Now it's back at 30¢ and there is more value again."

2. Cerro Resources

"An interesting Mexican silver project and we like the record of its management with other companies. We wanted to balance gold exposure in our portfolio with some silver and it was hard to go past Mexico, which still has potential for large, stand-alone silver projects."

Grant Craighead, Stock Resource:

3. Tiger Resources

"Strong pricing conditions [for copper] will coincide with ramp-up of low-cost production at Tiger's recently developed Kipoi copper operation and provide a strong financial foundation. Tiger appears inexpensive relative to peers, based on near-term measures of value,

and has good growth potential. Partly offsetting these attributes is sovereign risk associated with the Democratic Republic of Congo."

4. Discovery Metals

"After Tiger, we prefer Discovery Metals for African copper exposure. Its Boseto project is targeting production in the first half of next year. Like Tiger, Discovery gives exposure to near-term production at a time when we expect higher copper prices."

Gavin Wendt, MineLife:

5. Middle Island Resources

"Shares in the West African gold explorer have gone as high as 70¢ and are back to 34¢ [they were issued at 25¢ in December]. A nice asset, experienced management and it is not far away from a decent resource."

6. Horizon Oil

"It has an offshore oilfield in New Zealand and two emerging projects in China and Papua New Guinea. Horizon has a nice mix of production and exploration assets that require relatively lower-risk drilling. A growing company that will generate a lot of production and cash in coming years."

metals. "China is at the point where it needs steady, rather than spectacular, growth to ensure middle-class incomes can rise at a sustainable pace," he says. "India is different. It will need lots of cheap power and copper."

He is most bullish on copper. "The copper market will get tight in the second half of this year," he says. "There is not a lot of new copper supply coming on. There's a lot of global money looking to invest in copper companies, but choice, in Australia at least, is limited. Copper is a good example of where you need to invest in emerging markets to get the leverage to explorers."

Allan Trench, associate consultant with independent global metals adviser CRU Group, believes South America is the next hot spot for junior explorers. "In the next 12 months, it will become what West Africa was in 2009-10," he says. "Chile leads the pack as a stable mining jurisdiction in South America, with mid-tiers and juniors making inroads, acquiring second-tier copper and gold projects that require further work to assess their economic potential."

Trench, who is on the board of well-performed junior explorer Hot Chili, also likes Mongolia's prospects and believes north Africa's Nubian Shield is another emerging mining hot spot.

MineLife founder and mining analyst Gavin Wendt still likes the outlook for African-focused exploration stocks. "I regard the recent pullback in share prices as a buying opportunity in better-quality companies," he says. "You need to stick to the more-established mining nations, such as Ghana, Botswana and Tanzania. It's very risky to chase projects in less developed African mining nations."

Wendt likes prospects for Mongolian exploration, but believes it may become the preserve of global mining giants that have funds to deal with the country's poor infrastructure. "It's a huge, under-explored market on the doorstep of China and Russia," he says. "But there are massive infrastructure challenges. I'm wary about exploration in Central Asia – there's just too much political risk, even by emerging-market standards."

The message is clear: the sharemarket correction is providing better value for exploration stocks in emerging markets. Stick to those in established mining nations and focus on key commodities, including coal, copper and gold. Most of all, buy when others are selling, and recognise that emerging-market explorers come with huge risk, should only be a tiny part of a portfolio and suit experienced speculators. **BRW**