EQUITY RESEARCH
Corporate Advisers | Stockbroking & Research | Special Situations Financing
www.argonaut.com PERTH +61 8 9224 6888 HONG KONG +852 3557 4888

Tuesday, 14 April 2015

Argonaut Metals and Mining

Who Moved My Cheese?

Analysts | Patrick Chang | Matthew Keane | Helen Lau

Quick Read

The announced Alamos and AuRico merger and Agnico Eagle's recent bid for Soltoro reinforces Argonaut's view that M&A in the gold space is likely to step up in the near future. Key supporting themes include Reserve depletion across the majors / mid-tier space (see below, and Page 2 Figure 1), a general lack of exploration success and funding, relatively modest asset pricing, scarce risk capital and mediocre balance sheets.

On the ASX, the Australian domiciled producers, including NST, IGO, EVN and MLX are in a strong position for further inorganic growth. They are benefiting from a softening AUD cost base and increasingly competitive contractor / wage rates. With multiple assets understood to be up for sale (see page 3), near term M&A activities are inevitable.

Considering these themes, genuine green-fields discoveries should be rewarded (PIR, OBS, etc), particularly for assets that offer geographic synergy (e.g. Soltoro). Given size, favourable geometry, safe sovereign jurisdiction and multi-million ounce discovery potential, Gold Road Resources (GOR, SPEC BUY, $0.60 Target Price) remains a key pick in this space. Other Australian domiciled juniors with the potential to deliver on this front include ABM Resources (ABU, SPEC BUY) and Dacian (DCN, SPEC BUY).

Event & Impact

Reserve drop: Argonaut has compiled Reserve movements from gold stocks incorporated in Van Eck's GDX index (as at 10/04/2015, see methodology on Page 2). These companies reported, on average an 7.7% decrease in Reserve positions from CY13 to CY14 (see Page 2, Figure 1). These companies delivered a total of ~40Moz in CY14, which accounts for a significant ~40% of global mine production during this period. The remaining Reserve could support, on average, 16.1 years of mine life, assuming similar production levels. Key reasons accounting for this figure include depletion from production and change in economic and mine design parameters.

Significant discoveries are rare and quality projects are scarce: The decrease in Reserve across the sector highlights the scarcity of genuine discoveries, which has been in decline for the past five years. The findings are consistent with Argonaut's observation that the gold industry has gradually transformed to a model where majors and mid-tier producers are reducing green-fields exploration efforts. The green-fields exploration 'arm' of these businesses, is often 'outsourcing' the green-fields exploration to juniors, where meaningful discoveries then become targets to be acquired. Effectively, inorganic growth through M&A has been the path of least resistance. A recent trend is quality deposits (e.g. Fekola, Natougou) often receive bids prior to the completion of a full Feasibility Study and a Reserve statement. Considering the current themes in the gold space, genuine discoveries should be rewarded.

Reserve depletion a key feature

Methodology

Argonaut has compiled changes in Reserve positions…

Argonaut has compiled changes in Reserve positions by companies in Van Eck's GDX index. The comparisons are made on Reserves stated at 31st December 2013 and 31st December 2014. These companies in total produced ~40Moz in CY14, which equates to ~40% of world mine production.

…of GDX gold companies, excluding royalty companies

In this analysis, Argonaut has excluded royalty companies (Fanco-Nevada, Royal Gold and Osisko), as well as silver producers (Silver Wheaton, Pan American, First Majestic Silver and Tahoe). Companies yet to report updated Reserve statements have been omitted. Where possible, we have neutralised the effect of asset acquisitions and divestments.

Findings

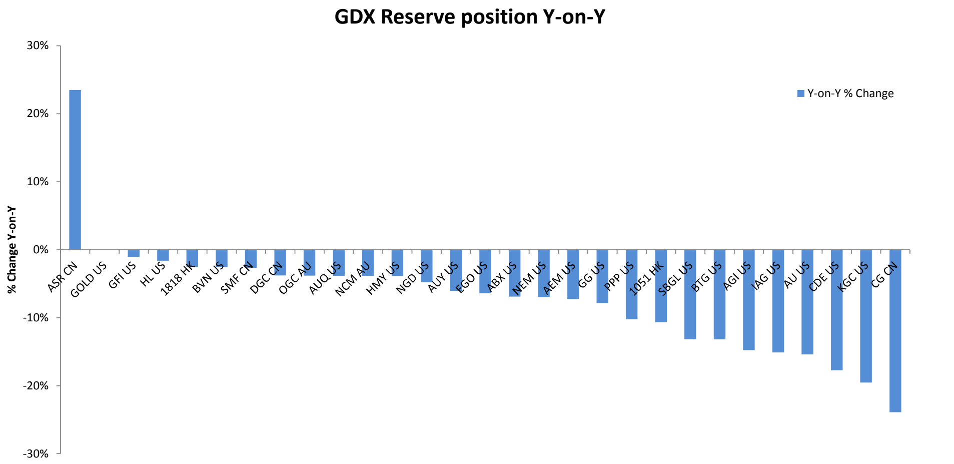
On average, Reserve positions shrank by 7.7%…

GDX gold companies recorded, an average, an 7.7% decrease (~58Moz drop, compared to mine production of ~40Moz) in Reserve positions from CY13 to CY14. Key reasons accounting for this figure include:

- Depletion from production
- Change in economic parameters
- Change of mine design parameters, including slope angles

…significant contributors include depletion, change of economic parameters and change of mine design

Figure 1: GDX Reserve position changes, CY13-CY14



Source: Argonaut, Company reports

The remaining Reserve could support ~16 years of mine life

The remaining Reserve in this group could support, on average, a 16.1 years of mine life, assuming an overall 90% metallurgical recoveries.

General lack of exploration success

This result, in part, suggests the lack of exploration success by these miners, particularly at green field exploration. Understandably, discretionary spending, including green-field exploration, is under elevated scrutiny from an investment community that demands increasing FCF and dividend. Longer term, a diminishing Reserve should translate to the support of a higher gold price.

ASX gold M&A expected to heat up

Australian gold producers, including NST, IGO, EVN, and MLX…

On the ASX, the Australian domiciled producers, including NST, IGO, EVN and MLX are in a strong positive for further inorganic grow. They are benefiting from a softening AUD cost base and increasingly competitive contractor / wage rates. With generally healthy balance sheets and multiple assets understood to be up for sale, near term M&A activities are inevitable.

…are benefiting from a strong AUD gold margin…

…in a prime position to take advantage of the assets for sale

Table 1: Producing assets that could be potentially divested in Australia

Asset	Owner	Ownership	Attributable Reserve	Grade	Year	Attributable Production	Implied Mine Life	Cost	Divestment potential
		%	koz	g/t		koz pa	yrs	US$/oz	
Sunrise Dam	AngloGold	100	1290	1.87	2014	240	5.4	1200	Moderate
Tropicana	AngloGold	70	2240	1.99	2014	350	6.4	750	Moderate
Cowal	Barrick	100	1555	1.17	2014	265	5.9	758	High
Fimiston	Barrick/Newmont	50/50 JV	6964	1.22	2014	645	10.8	928	Moderate
Telfer	Newcrest	100	4800	0.83	2014	535	9.0	780	High
Cadia	Newcrest	100	28000	0.49	2014	630	44.4	250	Very Low
Boddington	Newmont	100	12170	0.62	2014	725	16.8	975	Low
Tanami	Newmont	100	3310	5.26	2014	405	8.2	915	Low
Agnew/Lawlers	Goldfields	100	865	7.44	2014	260	3.3	950	Low
Darlot	Goldfields	100	85	7.36	2014	83	1.0	1130	Moderate
Granny Smith	Goldfields	100	872	6.02	2014	290	3.0	840	Low
St Ives	Goldfields	100	1803	3.14	2014	350	5.2	1040	Low
Frog's Leg	La Mancha	100	971	2.93	2013	160	6.1	1000	High
Peak Mines	Newgold	100	375	3.51	2014	90	4.2	1025	High

Source: Argonaut, Company reports

Genuine discovers should be rewarded

Given the current themes in the gold space…

Considering the current themes in the gold space, genuine discoveries should be rewarded. Stocks with assets in Australia and the potential to deliver on this front include:

Gold Road (GOR, SPECULATIVE BUY, 60c Target Price): The 3.8Moz Gruyere's potential scale, geometry, long life, and favourable metallurgical properties combined with a low sovereign risk jurisdiction, will ensure the asset attracts market and corporate attention. With ~5 rigs drilling at Gruyere and deposit remaining open, Argonaut anticipates Resource upgrades which could translate to boosted production and AISC parameters in the upcoming PFS.

…genuine discoveries should be rewarded…

ABM Resources (ABU, SPECULATIVE BUY): The high grade Old Pirate deposit, current being mined, is one of the highest grade open pit operations in Australia. Regionally, ABM has an >40,000km^2 package of in the Tanami region, which is receiving increased corporate attention and remains one of the final frontiers in Australia where the discovery of shallow, Moz gold deposits is still possible. ABU's alliance with IGO on the Lake Mackay project further reinforces this view.

Dacian Gold (DCN, SPECULATIVE BUY): Improved geological understanding and systematic exploration at DCN's Mount Morgans Project has enabled the Company to significantly expand its inventory to 1.4Moz @ 4.2g/t. Argonaut anticipates further Resource growth at both Westralia and Jupiter. The upside of the project is the delineation of multi-million ounce, syenite hosted deposits similar to the nearby >7Moz Wallaby.

RESEARCH:

Ian Christie | Director, Industrial Research
+61 8 9224 6872 ichristie@argonaut.com

Philipp M-O Kin | Analyst, Oil & Gas Research
+61 8 9224 6864 pkin@argonaut.com

Patrick Chang | Analyst, Metals & Mining Research
+61 8 9224 6835 pchang@argonaut.com

Emily Reilly | Analyst, Industrial Research
+61 8 9224 6809 ereilly@argonaut.com

Matthew Keane | Analyst, Metals & Mining Research
+61 8 9224 6869 mkeane@argonaut.com

Helen Lau | Analyst, Metals & Mining Research
+852 3557 4804 hlau@argonaut.com

INSTITUTIONAL SALES - PERTH:

Chris Wippl | Executive Director, Head of Sales & Research
+61 8 9224 6875 cwippl@argonaut.com

John Santul | Consultant, Sales & Research
+61 8 9224 6859 jsantul@argonaut.com

Bryan Johnson | Director, Institutional Research Sales
+61 8 9224 6834 bjohnson@argonaut.com

Damian Rooney | Senior Institutional Dealer
+61 8 9224 6862 drooney@argonaut.com

Ben Willoughby | Institutional Dealer
+61 8 9224 6876 bwilloughby@argonaut.com

INSTITUTIONAL SALES – HONG KONG:

Travis Smithson | Managing Director - Asia
+852 9832 0852 tsmithson@argonaut.com

Glen Gordon | Institutional Research Sales
+852 3557 4874 ggordon@argonaut.com

CORPORATE AND PRIVATE CLIENT SALES:

Glen Colgan | Executive Director, Desk Manager
+61 8 9224 6874 gcolgan@argonaut.com

Kevin Johnson | Executive Director, Corporate Stockbroking
+61 8 9224 6880 kjohnson@argonaut.com

James McGlew | Executive Director, Corporate Stockbroking
+61 8 9224 6866 jmcglew@argonaut.com

Geoff Barnesby-Johnson | Senior Dealer, Corporate Stockbroking
+61 8 9224 6854 bj@argonaut.com

Rob Healy | Dealer, Private Clients
+61 8 9224 6873, rhealy@argonaut.com

Cameron Prunster |Dealer, Private Clients
+61 8 9224 6853 cprunster@argonaut.com

James Massey |Dealer, Private Clients
+61 8 9224 6849 jmassey@argonaut.com

Important Disclosure

ABU – Argonaut acted as Joint Lead Manager & Bookrunner to the Placement that raised $5M and Joint Underwriter to the Entitlement Offer to raise $7.7M in February 2015. Argonaut received fees commensurate with these services.

DCN – Argonaut currently holds or controls 94,000 DCN shares.

GOR – Argonaut acted as Sole Lead Manager & Exclusive Bookrunner to the Placement that raised $23.2M in September 2014 and received fees commensurate with this service. Argonaut currently owns and/or controls 150,000 GOR Shares

NST – Argonaut acts as Corporate Adviser to NST and may receive fees commensurate with these services.

Information Disclosure

Each research analyst of this material certifies that the views expressed in this research material accurately reflect the analyst's personal views about the subject securities and listed corporations. None of the listed corporations reviewed or any third party has provided or agreed to provide any compensation or other benefits in connection with this material to any of the analyst(s).

General Disclosure and Disclaimer

This research has been prepared by Argonaut Securities Pty Limited (ABN 72 108 330 650) ("ASPL") or by Argonaut Securities (Asia) Limited ("ASAL") for the use of the clients of ASPL, ASAL and other related bodies corporate (the "Argonaut Group") and must not be copied, either in whole or in part, or distributed to any other person. If you are not the intended recipient you must not use or disclose the information in this report in any way. ASPL is a holder of an Australian Financial Services License No. 274099 and is a Market Participant of the Australian Stock Exchange Limited. ASAL has a licence (AXO 052) to Deal and Advise in Securities and Advise on Corporate Finance in Hong Kong with its activities regulated by the Securities and Futures Ordinance ("SFO") administered by the Securities and Futures Commission ("SFC") of Hong Kong.

Nothing in this report should be construed as personal financial product advice for the purposes of Section 766B of the Corporations Act 2001 (Cth). This report does not consider any of your objectives, financial situation or needs. The report may contain general financial product advice and you should therefore consider the appropriateness of the advice having regard to your situation. We recommend you obtain financial, legal and taxation advice before making any financial investment decision.

This research is based on information obtained from sources believed to be reliable and ASPL and ASAL have made every effort to ensure the information in this report is accurate, but we do not make any representation or warranty that it is accurate, reliable, complete or up to date. The Argonaut Group accepts no obligation to correct or update the information or the opinions in it. Opinions expressed are subject to change without notice and accurately reflect the analyst(s)' personal views at the time of writing. No member of the Argonaut Group or its respective employees, agents or consultants accepts any liability whatsoever for any direct, indirect, consequential or other loss arising from any use of this research and/or further communication in relation to this research.

Nothing in this research shall be construed as a solicitation to buy or sell any financial product, or to engage in or refrain from engaging in any transaction. The Argonaut Group and/or its associates, including ASPL, ASAL, officers or employees may have interests in the financial products or a relationship with the issuer of the financial products referred to in this report by acting in various roles including as investment banker, underwriter or dealer, holder of principal positions, broker, director or adviser. Further, they may buy or sell those securities as principal or agent, and as such may effect transactions which are not consistent with the recommendations (if any) in this research. The Argonaut Group and/or its associates, including ASPL and ASAL, may receive fees, brokerage or commissions for acting in those capacities and the reader should assume that this is the case.

There are risks involved in securities trading. The price of securities can and does fluctuate, and an individual security may even become valueless. International investors are reminded of the additional risks inherent in international investments, such as currency fluctuations and international stock market or economic conditions, which may adversely affect the value of the investment.

The analyst(s) principally responsible for the preparation of this research may receive compensation based on ASPL's and / or ASAL's overall revenues.

Hong Kong Distribution Disclosure

This material is being distributed in Hong Kong by Argonaut Securities (Asia) Limited which is licensed (AXO 052) and regulated by the Hong Kong Securities and Futures Commission. Further information on any of the securities mentioned in this material may be obtained on request, and for this purpose, persons in the Hong Kong office should be contacted at Argonaut Securities (Asia) Limited of Unit 701, 7/F, Henley Building, 5 Queen's Road Central, Hong Kong, telephone (852) 3557 48000.