STOCKS DOWN UNDER

10 DECEMBER 2020

Resources Stocks Down Under

“If you really believe in something, yet you were heavily ridiculed for it, well just cop it.”

- Andrew Forrest (b. 1961), Former CEO of Fortescue Metal Group

ORION MINERALS

Northern Cape excitement

Stocks Down Under rating: ★★★★

ASX: ORN
Market cap: A$ 99M

52-week range: A$0.01 / A$0.04
Share price: A$ 0.03

Things are looking up for the Melbourne-based Orion Minerals. Not only is the company's flagship Prieska Copper-Zinc Project in South Africa the subject of a favourable Bankable Feasibility Study, but as of August 2020 the project is fully permitted. Importantly, the prices of copper and zinc have been running hard since late March. At the moment, however, you can get Orion Minerals for only a fraction of the NPV suggested by the Prieska BFS. There's four stars in this one for the patient investors out there.

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AUSTRALIS OIL AND GAS

One good shale play deserves another

Stocks Down Under rating: ★★★★

ASX: ATS
Market cap: A$ 60.1M

52-week range: A$0.007 / A$0.10
Share price: A$ 0.059

The early 2020 meltdown in the oil price was not good for the shareholders of Australis Oil and Gas. This Perth-based company has been betting heavily on oil leases onshore Louisiana and Mississippi, on the conviction that the Tuscaloosa Marine Shale is the next frontier in US shale oil. That next frontier didn't look valuable, however, when West Texas Intermediate was minus $37.63 a barrel on 20 April and when Australis had borrowed some of the money for its 2018/19 drilling campaign. Now, however, oil is back and so is Australis stock.

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The Lazarus-like resurrection of iron ore in 2020 has a number of iron ore project developers back in favour. One of them is Magnetite Mines, which has been working on its Razorback Project in eastern South Australia since 2009. That project covers 3.9 billion tonnes of the stuff, not far from Adelaide, but more importantly, with a very high iron content north of 68%. A Preliminary Feasibility Study is in the works.

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Share price chart

Source: Tradingview

Orion's keel is still there

If you've ever been in South Africa and driven up that country's N10 national route from Port Elizabeth to the Namibian border you will have passed through the Northern Cape settlement of Prieska, population 14,000, on your way over the Orange River. The country around Prieska, pronounced 'pree-ska', is mostly sheep and cattle farms and the nearest big town is Kimberley, Northern Cape's provincial capital, around 240 km to the northeast. However, Prieska also used to have a copper and zinc mine that the once mighty AngloVaal brought into production in the early 1970s.

The Prieska deposit was nowhere near exhausted in the late 1980s when AngloVaal decided to shut it down, in part due to South Africa's political problems at the time and in part because copper and zinc prices were lousy. By 1989 AngloVaal was only down to the 1,000 metre level at Prieska, so the entire 'keel' of the deposit was left untouched. In 2020 Orion Minerals, whose stock trades on the JSE as well as the ASX, now has the data to suggests it can bring Prieska and its keel back to life.

A great Feasibility Study

Orion published a Bankable Feasibility Study on the Prieska restart in June 2019 and updated this in May 2020. The updated BFS looks good. Using Prieska's 'foundation phase' resource of 30.5 million tonnes at 1.2% copper and 3.7% zinc, Orion proposes a 12 year operation that would process 2.4 million tonnes of ore a year and produce 22,000 tonnes of copper and 70,000 tonnes of zinc a year. The All-In Sustaining Cost allows a margin of close to 50%. The initial price tag for the Prieska reboot comes in at A$373m, but the post-tax NPV at an 8% discount rate is a cool A$552m. With Prieska fully permitted as of August 2020, all that is needed is project finance. We think that won't be too hard to raise.

Okay, this is a project in South Africa, which the Fraser Institute in its 2019 Survey of Mining Companies only gave 65 points when measuring its 'Investment Attractiveness'. However, balanced against this is the fact that, with zinc credits, Prieska could end up one of the lowest cost copper mines in the world. And since this is South Africa, all the infrastructure to support the mine, such as sealed roads, grid power and rail links to the ports, are already in place. The really hard part, which is Black Economic Empowerment (BEE), has also been taken care of.

Black people empowered, shareholders empowered

In post-Apartheid South Africa black-owned entities get to take meaningful stakes in the economy. Under the new 'Mining Charter 3' that came into force in March 2019, Prieska needs to be 20% owned by black entrepreneurs, 5% owned by employees and 5% owned by the local community. Not long after the new Charter came into effect, Prieska's ownership was restructured to comply. Orion's take going forward is 70%. Significantly, Charter 3 acknowledges that there is no such thing as a free lunch, with employee and community stakes to be paid for from mine cash flow. Orion has also gone one better than the current Charter and it has a BEE partner which actually owns listed stock.

Beyond Prieska, Orion believes there are probably other copper and zinc mines in the Northern Cape in the 'Areachap Belt', which is considered prospective for the type of base metal mineralisation called Volcanogenic Massive Sulphides. There's been no decent exploration in the region for a long time, but Orion hopes to make up for lost time with an 1,800 sq km land holding.

Good times for copper

The times are right for potential project financiers to come take a look at Prieska, with copper and zinc both having a great 2020 after the havoc of the year's opening. Both metals turned around in March and have since enjoyed a better demand profile and gradually reducing stockpiles. Copper was close to US$4,500 a tonne on LME back then and now it's close to US$7,700. Meanwhile, zinc went from near US$1,800 a tonne to more like US$2,700. A lot of copper producers are talking about increased future demand for copper in Electric Vehicles and recently there's been political instability in Peru, which is a major copper producer.

Orion stock re-rated in August 2020 when the last of the permitting matters were dealt with, reaching 3.8 cents on 24 August as against 1.8 cents on the 12th of that month. The stock has since eased back in spite of good times for copper and zinc.

The company currently holds only A$5m in cash and may need to raise some more. And, of course, mining company stocks tend to trade way below the NPV of their projects while there is still funding risk. However, with other risks now out of the way for Orion, we think this is four stars for investors with a bit of patience.

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Share price chart

Source: Tradingview

Time was when Americans lived in fear that they were at the mercy of sometimes hostile foreign oil producers. Then in the late 1990s the Shale Oil Revolution started. American operators figured out that 'fraccing' and horizontal drilling could allow oil and gas to be profitably unlocked from shale, a type of rock previously considered too 'tight' to get to. The first shale formation to be tackled was the Barnett, in north Texas, but that was followed by many others, such as the Marcellus Shale in Pennsylvania, the Bakken Shale in North Dakota and a particularly lucrative shale in south Texas called the Eagle Ford. Such was the surge in shale oil and gas production that by 2019 America had, in effect, achieved energy independence for the first time since the late 1950s.

How to hustle up A$1.9bn in shale oil in just nine years

One ASX-listed company that did well out of the Shale Oil Revolution was Aurora Oil and Gas. It listed on ASX in 2005 as a small cap active in the Eagle Ford. By 2011 investors were paying attention in part because the US oil major Marathon was operator of some of Aurora's acreage. By 2014 Aurora was able to be sold to the

Calgary-based Baytex Energy for a cool A$1.9bn. Aurora stock had gone from 32 cents to $4.20. Not bad for nine year's work. And great timing given that the gut-wrenching oil price crash of 2014 happened just months later.

Australis Oil and Gas, which did its ASX IPO in 2016, is 'Aurora 2.0'. They picked the name because of the Aurora Australis, that beautiful natural light display in the Antarctic sky. The founders – Chairman Jon Stewart, CEO Ian Lusted and CFO Graham Dowland – were all former Aurora executives, and now they wanted to be not just early in a relatively new shale play, but gain the dominant land position. The play was the Tuscaloosa Marine Shale, or TMS for short. It's named after the home of the University of Alabama although the target depositional area is southern Louisiana and Mississippi.

Welcome to Tangipahoa Parish. Enjoy your type curve

From 2015 to 2017 Australis could buy up big in the TMS. Not only had the 2014 oil price rout made things cheaper for shale players everywhere, the experience of other players in the TMS had been variable, so prices were very low. Australis had identified a sweet spot in the TMS, which it called the TMS Core, where wells would flow as readily as they did in other shale basins. Lusted et al. swooped down on Wilkinson, Amite and Pike counties in Mississippi and Tangipahoa and St Helena parishes in Louisiana like an Australian wedge-tailed eagle that hadn't eaten in a while.

The feast didn't cost much, with Australis buying or leasing at less than 40 US cents per barrel of recoverable resource. But by the end of 2019 Australis had a massive 110,000 net acres in the TMS Core and the independent reservoir engineers reckoned there was 94 million barrels in 3P reserves (that is proved, probable and possible) and the remaining acreage had 235 million barrels in 3C resources (that is, all contingent resources up to the most speculative). And that, dear reader, was just those acres which Australis believed could be developed with a modest drilling schedule during a stipulated five year window. The first Australis wells, notably the Stewart 30H-1 and Taylor 27H-1 wells, have performed as good shale well should, establishing a valuable 'type curve' of flow rates, so Australis in early 2020 felt pretty good about its real estate.

An NPV of US$3.4m per well. And that's base case

How valuable is the portfolio? Australis has picked out about 425 well locations and if you NPV an Australis well at US$50 a barrel and the TMS type curve, they're each worth US$3.4m base case. That kind of notional shareholder value probably explains why Australis was able to get through oil's 'Less than Zero' remake this year in one piece – the company had to restructure some debt, but the bankers looked at Lusted's type curves and proved amenable. It helped that the company had a decent hedge book for the current portfolio of wells, which allowed it to sell at above US$50 a barrel. So while Australis stock got slaughtered, falling from 9.5 cents on 15 January 2020 to just 0.7 cents on 24 March, one could make the case that the stock would recover. With oil on the mend in recent days, Australis stock is mending with it.

The thing about shale that everyone kind of assumes, is that with low oil prices it's the shale players that go to ground first. We think that perception is changing, but it explains why Australis stock, at about A$60m in market cap, is markedly undervaluing even a modest appraisal of the assets it has accumulated in the TMS Core. Therefore, this quality outfit gets four stars from us.

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Share price chart

Source: Tradingview

Back in early May you could get Magnetite Mines for a mere 0.1 cents per share. Since May, iron ore has defied all expectations in terms of price. That's lifted Magnetite Mines back up over a cent a share. However 1 or 2 cents is still a far cry from the 20 to 30 cent range this stock traded at back when it first became the latest owner of the vast iron ore riches of the Braemar in South Australia. With a Preliminary Feasibility Study now underway, we think there might still be some life in this project.

What Sir Doug did when he wasn't freezing at the Pole

The world has known about the Braemar, and the iron ore covered by Magnetite Mines' 100%-owned Razorback Project, for a long time. You'll recall that between 1984 and 1996 the paper version of the Australian one-hundred-dollar note featured a portrait of Sir Douglas Mawson (1882-1958) on the front. Australians generally remember Mawson as a player in the heroic age of Antarctic exploration alongside Scott, Shackleton et. al. His real 'day job', however, was Professor of Geology at the University of Adelaide and it was in that role around 1930 that he identified the Braemar Iron Formation, a large iron ore region only about 250 km northeast of Adelaide.

In the 1960s, when Australians first discovered how truly rich in iron ore their country was, the South Australian government looked into the possibility of developing a deposit called Razorback Ridge, near the town of Yunta, because that was where Mawson and his colleagues had found the richest outcropping of the Braemar. Razorback Ridge missed the boat at the time and subsequent owners have never had their timing right either. What Magnetite Mines now owns is 3.9 billion tonnes in a JORC 2012 iron ore resource over three main ore bodies in the Braemar. Razorback is the primary deposit followed by two others, called Iron Peak and Ironback Hill. Magnetite Mines believes that a 2020 renewal in strong iron ore demand from China makes the present time another good window of opportunity to develop these deposits.

You want high grade? We've got high grade

It was Pasteur who famously said 'Chance favours the prepared mind'. In November 2019, before the current good times really rolled in iron ore, Magnetite Mines had published a Scoping Study on Razorback. What that study showed was that the big competitive advantage for Magnetite Mines wasn't location and the necessary infrastructure – although that's not bad with rail only 40 km away and grid power 100 km away. What you want this mine for is grade...so long as the mining is selective.

We now know, thanks to the smart cookies at Magnetite Mines, that there's enough continuous high-grade iron ore horizons within the Razorback Project deposits to allow a very high grade product to be mined and then sorted. How high? Magnetite Mines is current talking in the order of 68.5%, with silica at only 3.3%. Wow! All they needed was 62% Fe and under 4% silica to get a decent premium.

Magnetite Mines' new knowledge about where the high grade zone exists can be likened to the realisation by Andrew Forrest and his colleagues back in the early 2000s that their ostensibly lower-grade deposits in the Pilbara could be high-graded to give customers what they needed. Throw in the fact that the Razorback resource is at surface, so stripping ratios are low, and then what we already knew about the iron ore being softer in the Braemar, and you're starting to get the makings of a decent project that would be way down on the cost curve.

Preliminary Feasibility Study coming soon

The Scoping Study gave Magnetite Mines the confidence to move to a Preliminary Feasibility Study, which is now underway. The company is going to need some more capital soon because as at September 2020 it had $320,000 in the bank.

That said, a decent PFS in the current iron ore environment can easily carry this ambitious developer into a DFS if the capital costs look manageable enough. And it's worth keeping in mind that if this mine gets up and running by about the middle of the decade, it will likely enjoy a mine life well in excess of 25 years. So it will be worth the company's while to keep progressing.

The potential trouble for investors getting into Magnetite Mines right now is that this project is into its 12th year under the current ownership, so some observers of the story may have become a little fatigued. Also, iron ore has re-priced so quickly in 2020 that some investors may be a little nervous. However, the current approach to mine development is probably the best yet. For investors with the speculative appetite who know the iron ore space, this one is four stars. But watch it carefully.

Pitt Street Research Pty Ltd

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Pitt Street Research Pty Ltd is founded on more than 40 years of combined experience researching companies in a range of different sectors.