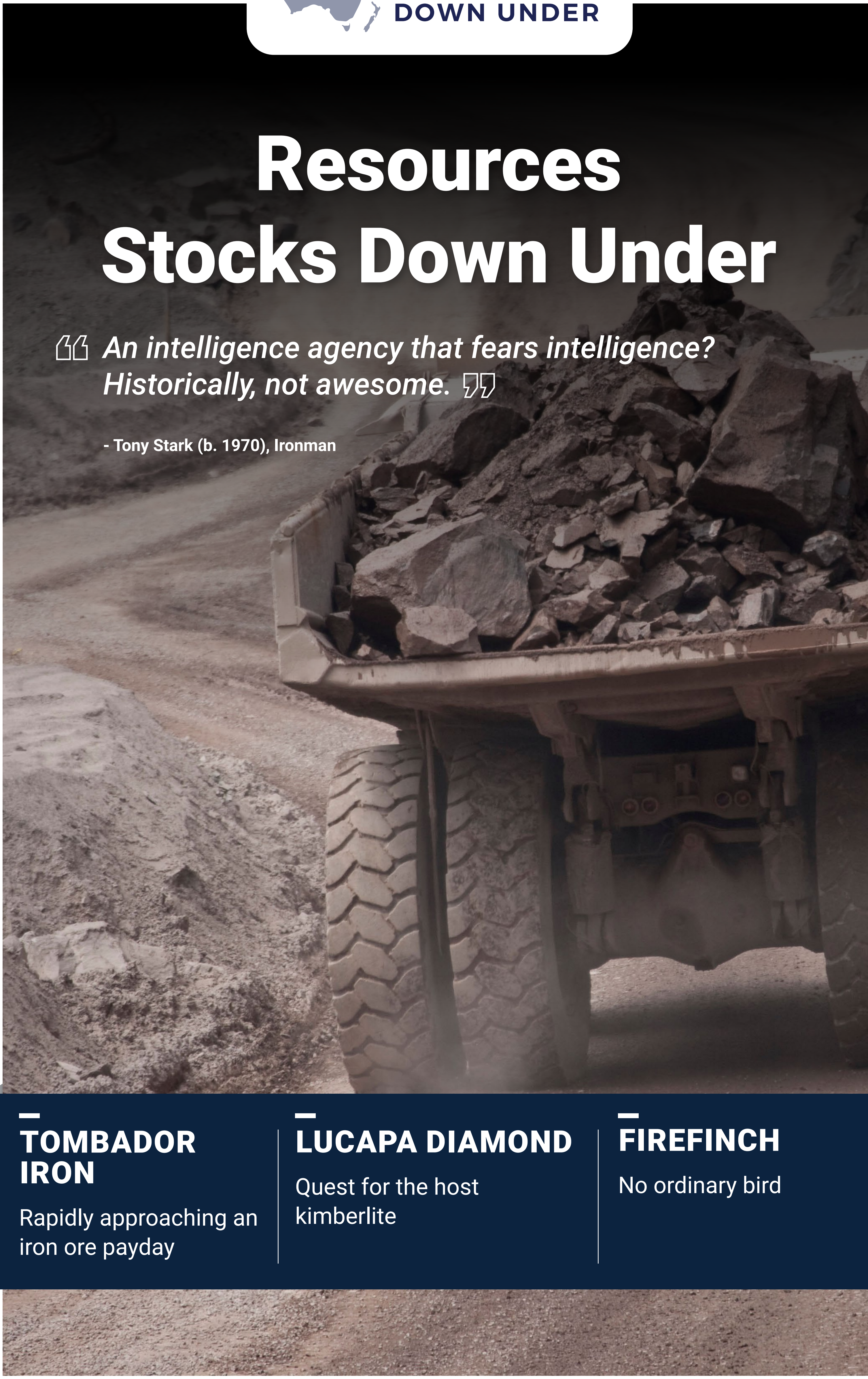
STOCKS DOWN UNDER

17 DECEMBER 2020



Resources Stocks Down Under

> *An intelligence agency that fears intelligence? Historically, not awesome.*
>
> **- Tony Stark (b. 1970), Ironman**

TOMBADOR IRON

Rapidly approaching an iron ore payday

LUCAPA DIAMOND

Quest for the host kimberlite

FIREFINCH

No ordinary bird

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Stocks Down Under rating: ★★★★

ASX: TI1
Market cap: A$ 43.7M

52-week range: A$0.023 / A$0.071
Share price: A$ 0.057

Tombador Iron has performed well since its Reverse Take Over was completed on 5 October. This company, which is developing its 100%-owned Tombador Iron Project Brazil, raised $15m at 2.5 cents per share in order to get the project to the commissioning stage. Since mid-November investors in that round have been well ahead on their money. We like the near-term nature of this opportunity.

READ MORE

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The Perth-based Lucapa Diamond, which is involved in producing diamond mines in the southern African nations of Angola and Lesotho, has not had a great 2020. The stock re-rated briefly in July and August before losing ground again. Recent good diamond sales and large diamond recoveries at both of its operations, however, together with the fully funded 45% capacity expansion at Mothae, bode well for Lucapa, in our view.

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Share price chart

Source: Tradingview

The recent strong increases in the price of iron ore have a lot to do with Brazil. That would-be Latin American economic superpower is the world's second largest exporter of iron ore. Australia's iron ore industry has hardly been touched by COVID-19. Brazil, by contrast, has struggled to maintain output due to high infection rates at the mines. On 2 December 2019 the iron ore major Vale (pronounced vah-lay), whose stock is traded on the NYSE, told the market that it expected to produce 340-355 million tonnes of iron ore in calendar 2020 and 375-395 million tonnes in 2021. Current guidance, issued exactly a year later, is for only 300-305 million tonnes in 2020 and 315-335 million tonnes in 2021.

COVID-19 won't be with us forever

How bad is COVID-19 in Brazil? In this nation of 212 million people there's been 6.7 million infections to date. That's 3.1% of the population, which is not as bad as the US's 4.4%, but not great either. And new infections are running at something like 40,000 a day. Clearly COVID-19 will be an issue in Brazil for a while yet.

Which begs the question as to why investors should look at a new iron ore project in Brazil right now? Well, six or so months from now, when Tombador Iron expects to be getting ready to ship its first iron ore, the world and Brazil will be some way down the road towards widespread COVID-19 vaccination. We expect iron ore demand will stay strong for the foreseeable future as the global economy recovers. And then there's the inherent advantages of the Tombador project itself, including its very high grade.

Small resource, big potential

The people behind Tombador Iron include Bill Clough and his father Dr. Harold Clough. Their Colomi Iron Mineração Ltda has been working since 2003 on two hitherto undeveloped magnetite deposits in the northern Brazilian state of Bahia covering a 5 billion tonne resource. Tombador Iron represents the ASX-listing of a much smaller deposit, which sits next door to the Colomi deposits.

There's only 10.1 million tonnes of ore in the newly listed company's resource count and if you ignore the 2 million tonnes of low grade talus (i.e. heaps of rock) it's really 8 million tonnes, but at a very juicy grade of 67.3% Fe. That's high enough to be 'direct shipping' ore that can go straight into blast furnaces at the other end of the iron ore supply chain. The hematite lumps should command a decent price premium.

It's also worth noting that this is not just a Clough family story. There's a lot of other talented people involved as well, in Brazil and Australia, including Chairperson Anna Neuling, currently an Executive Director of S2 Resources (ASX:S2R).

Location, location

We think the biggest advantage for Tombador Iron will be location. Okay, the project may not be in the usual places where you find iron ore mines in Brazil. Most of the big operations are in the southeastern state of Minas Gerais and in the northern state of Pará. Bahia sits in the northeast of Brazil. What works in Tombador's favour, though, is that Bahia is a long way from major population centres, sitting as it does in sparsely populated sugar cane country, about 200 km west of a regional city called Petrolina-Juazeiro. The nearest big city is the Bahia capital of Salvador, down on the coast another 500 km south of Juazeiro. The location means that Tombador Iron can prepare its iron ore project for first shipments without COVID-19 breathing down its neck.

The flow sheet for this project is really simple: Drill, then blast, then truck to port, with a bit of conventional crush and screen in between. There's no tailings so no need to worry about the tailings dams Brazilians hate with a passion. Tombador does need to do some more infill drilling to convert the indicated and inferred resource into a measured resource. And permitting still needs to be completed, but Brazil elected a strongly pro-mining government in 2018 so this shouldn't really be a problem. The crush and screen plant is going up now and a mining contractor has been engaged. Tombador Iron believes that its small mine can be up and running in mid-2021.

The big risk with this one is that the iron ore market returns to more like 'normal' in 2021. We noted above that Vale thinks it can still grow iron ore output in 2021. An easing of Coronavirus in Brazil could allow Vale 2021's guidance to be exceeded, and if it turns out that China's current seemingly outsized demand is 'catch up demand', then iron ore producers and investors could be in for a rude shock.

Since Tombador Iron is only a new company, and some of its current shareholders are only there because they were in iBuyNew, the company's predecessor, it will not be in a good place if iron ore returns to more like US$100 a tonne. However, with the commodity decidedly moving the other way right now and with the project having been in development for some time now, we're giving this one four stars for now.

LUCAPA DIAMOND

Quest for the host kimberlite

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Share price chart

Source: Tradingview

We noted on 3 December that now is a good time to be finding new diamond sources, ahead of the looming supply shortfall. One ASX-listed company that we believe will be an early beneficiary, as the diamond market turns around, is Lucapa Diamond. That's because Lucapa has interests in two currently producing mines – 40% of an alluvial mine called Lulo in Angola and 70% of a new kimberlite mine called Mothae in Lesotho.

Want to buy a 100-plus carat diamond?

Lulo, commissioned in 2015 was Lucapa's company-maker. In 2019 it produced about 19,000 carats worth US$38.5m, selling as they did in excess of US$1,900 a carat on average, which is about 19 times more than the global industry average. Lulo's EBITDA on a 100%-basis was US$12.9m. Every now and then a really valuable stone comes out of the river terraces and floodplains, leading to announcements such as the one about a 100+ carat diamond on 7 December. COVID-19 impacted Lulo in the March and June quarters, but production had returned to normal by September.

Four years after Lulo, Lucapa commissioned its second mine, Mothae in Lesotho, which produced a creditable 30,000 carats in its first year. COVID-19, however, shut the mine down from March until October. That hasn't stopped Lucapa from working on driving additional value through an expansion plan and the company recently raised $10m at 5.5 cents in order to raise the processing capacity from 1.1 million tonnes of ore per annum to 1.6 million. We think that raising contributed to the recent weakness in Lucapa's stock, but we believe it will ultimately pay off given the quality of the stones coming out of the mine. Case in point: on 10 December Lucapa reported the discovery of a 101 carat diamond from Mothae.

A kimberlite as big as the Ritz

Lulo is where the really big money could be made. Angola is the world's sixth largest diamond producer by volume, with 2019 output of 9.2 million carats. It recently liberalised its industry with the commencement of diamond auctions and other new marketing channels last year to improve transparency. The core of the Angolan industry lies in the northeastern provinces of Lunda Norte and Lunda Sul. In August 2007 Lucapa was granted a 3,000 sq km diamond concession in Lunda Norte. The company has called itself Lucapa since 2012 because that's a name of a town and geological belt near the concession area. From the get-go Lucapa's concession was a joint venture with Angola's state diamond company, Endiama, of which Lucapa got 40% of the alluvial venture and 39% of the kimberlitic venture. There is a mechanism for the kimberlite venture to reduce in the kimberlite venture, but this is well into the future and only after Lucapa's kimberlite project investment has been recouped.

Also, Lucapa is in discussion with the Angolan government to improve its stake in the kimberlite venture. Lucapa developed the alluvial operation first, along a 50 km stretch of a river called Cacuilo. However, somewhere in its concession area, Lucapa's geologists reason, is a valuable kimberlite or two, which are the sources of all those Cacuilo Valley alluvials.

Kimberlite is a coarse-grained intrusive igneous rock so-called because of the massive pipes of the stuff that created the amazing Kimberley Diamond Field in northwestern South Africa. Not all kimberlite pipes come with diamonds, but when they do they can be a virtual license to print money. There are three big diamondiferous kimberlites in the Lunda provinces belonging to other parties, and those have been huge diamond discoveries. Take the Catoca kimberlite in Lunda Sul, discovered in 1965, as a good example. Catoca today, under the aegis of Endiama and Russia's Alrosa, produces 5 to 6 million carats annually, something it will do for the next four decades or so.

Is this another Dia Met in the making?

Lucapa is now devoting substantial resources to finding its diamondiferous kimberlite at Lulo. A lot of the alluvial diamonds coming out of the Cacuilo are irregularly shaped and sharp-edged, indicating they haven't washed very far from the primary source. The usual magnetic surveying followed by drilling and bulk sampling have been ongoing for some years now and the company is zeroing in on an area near a tributary of the Cacuilo called the Canguige.

Once the company has its kimberlite the results could be spectacular. After the legendary Canadian geologist Chuck Fipke discovered a kimberlite near Lac de Gras in Canada's Northwest Territories in 1991, the ultimate result, seven years later, was the massive Ekati mine that was in BHP's stable for a long time. Fipke's company, Dia Met Minerals, saw its stock appreciate in Vancouver from a mere 21 Canadian cents all the way up to 55 Canadian dollars.

There's three things we like about Lucapa right now. The first is the fact that diamonds appear to be at the bottom of their price cycle, at a time when Lucapa's mines are coming back to full strength, and with Mothae expanding. Secondly, both Lulo and Mothae have a habit of yielding very valuable and newsworthy stones. And, thirdly, there's the potential for a Lulo kimberlitic bonanza. All of that makes this stock four stars in our book right now.

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Share price chart

Source: Tradingview

If you blinked while watching the evening news back in August 2020 you may have missed the coup in the West African nation of Mali, population 19.6 million, capital Bamako. President Ibrahim Boubacar Keïta was, in effect, rolled from office by an Army mutiny after nearly seven years in the job and the country is now being run by the 'National Committee for the Salvation of the People', chaired by Colonel Assimi Goïta.

Coup? What coup?

That may sound ominous, but the 2020 Mali coup was swift and bloodless, and really hasn't changed Mali's accepted status as a mining-friendly country rapidly emerging as the third largest gold producer in Africa. Besides, we've seen this movie before - there was a military coup in 2012 and nothing much changed for the miners and explorers.

Coups, however, usually have bad optics as far as international investors go and for Mali Lithium the timing of this one wasn't great because the company was in the process of buying the Morila Gold Mine. The coup happened on 18 August and the Morila deal was announced on 31 August.

Firefinch just bagged the gorilla

Morila, first commissioned in 2000, was nicknamed 'Morila the Gorilla' at that time. It was the original flywheel that powered Randgold's emergence as a major gold player in central and western Africa before the 2018 Barrick merger. When Mali Lithium's acquisition was completed, on 11 November, the Perth company inherited, for just US$27.7m, 80% of a 1.3 million ounce resource around the old Morila open pit, plus the 4.5 million tonnes per annum processing plant and all the other infrastructure of what was once Mali's largest gold mine. The Malian state holds the other 20%.

Now, get this: That 1.3 million ounces sat within a 'conceptual US$1,250 per ounce gold pit shell'. What that meant in plain English was that the geologists were reasonably certain those 1.3 million ounces were economic at a gold price way below the current one and that there was ikely more where that came from, because the grade of the resource was 1.26 g/t and the cut-off grade was 0.5 g/t. Sure enough, on 24 November the Morila resource was upgraded to 1.49 million ounces.

Morila was down to tailings retreatment when Mali Lithium got it, after producing a creditable 6.9 million ounces, but the path to restarting open pit mining for the new owner was pretty straightforward. The only downside was that the names 'Mali' and 'Lithium' were temporarily out of favour in mid-2020, which was why the company was renamed Firefinch, after Lagonosticta virata, a red-coloured genus of finch native to the country and better known as the Mali firefinch.

Not as much risk as you'd think

Mali is a country of two halves. The sparsely populated and mostly desert northern half above the 15th parallel (which includes the legendary Timbuktu) is something of a badlands associated with terrorism and extremism these days. The more fertile southern half, where the capital of Bamako lies, is also where you find the gold mines and where the security risks are much lower. Morila is 270 km southeast of Bamako in Mali's southernmost region, Sikasso.

We expect Morila to drive a significant amount of news flow in the near term. The first gold pour under the new owners was registered on 26 November and the preparations for a return to open pit mining are ongoing, which will involve some satellite drilling. In the current climate of gold's high price, that's all for the good.

Don't write off Goulamina just yet

In addition to all this, Firefinch still owns a potentially very valuable hard rock lithium project in Goulamina. The company has been working on that potential monster, also in the Sikasso region roughly 150 km south of Bamako, since 2016. The company now has a large resource there of 108 million tonnes at 1.45% lithium oxide. Firefinch published its Definitive Feasibility Study for Goulamina in October 2020. Modelling a 6% spodumene concentrate product over 23 years, Firefinch got a US$1.2bn pre-tax NPV using an 8% discount rate for only US$194m in capital costs. Investors never really gave Mali Lithium the respect Goulamina deserves, since, for hard rock plays, they have tended to prefer first world jurisdictions close to where the gigafactories are going up. That said, so long as Mali manages its political transition back to democracy and stays mining friendly in the meantime, Goulamina could be looking good by 2022 when the lithium supply and demand curves start to swing back to would-be producers.

Obviously, it's early days for Firefinch with Morila, but we expect this project can be a solid value driver for investors, particularly with the drill rigs now active in the project area. Throw in Goulamina and there's a contrarian angle to this play as well.

Chairman Alistair Cowden has been in the market as a recent buyer of stock. Added together, all this makes for Firefinch to be a four star opportunity, in our view.

Pitt Street Research Pty Ltd

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