13 MAY 2021

Resources Stocks Down Under

> *I am drunk today madam, and tomorrow I shall be sober but you will still be ugly.*

- Winston Churchill (1874 - 1965), Former Prime Minister of the United Kingdom

MEDUSA MINING

A miner Rodrigo still likes

IRON ROAD

Take me home…just not yet

BOWEN COKING COAL

Broad Horizons at Broadmeadow East

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Stocks Down Under rating: ★★★★

ASX: MML
Market cap: A$ 168M

52-week range: A$0.615 / A$1.065
Share price: A$ 0.815

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Share price: A$ 0.187

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52-week range: A$0.042 / A$0.071
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With the price of metallurgical coal set to make a comeback in 2021, Brisbane-based Bowen Coking Coal is coming back with it. Its stock has rebounded from a 4.2 cents low recorded on 15 December 2020. As its name suggests, Bowen Coking Coal is the next would-be metcoal producer in the prolific Bowen Basin of central Queensland. It expects to make a development decision on its flagship Broadmeadow East Project later this year. Director Matt Lattimore likes what he sees – in April, he was an on-market buyer of the stock.

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Share price chart

Source: Tradingview

Believe it or not, there are still operating mines in the Philippines. The government of President Rodrigo Duterte has been widely reported as being ‘anti-mining’ since gaining office in 2016. However, the key issue of the Duterte Administration has been the industry’s impact on the environment. Under Duterte all of the country’s mines have been audited for their compliance with environmental regulations and those with a clean bill of health have continued to operate. That’s been good news for Medusa Mining, owner of the Co-O Gold Mine on the Philippines’s southern island of Mindanao.

The mine Kerry once owned

Co-O is an underground mine located in Agusan del Sur province, in the northeastern part of Mindanao. It’s around 170 km north of the major city of Davao in what is going to prove a very bumpy road trip if you ever get to visit this mine, road infrastructure not being Mindanao’s strong point.

Co-O was originally commissioned in 1989 by an Australian company called Muswellbrook Energy, which at the time was associated with the legendary Kerry Packer. The original mine plan proved to be uneconomic and Co-O was shut down in 1991. In 2000 a local, privately-held company called Philsaga picked the mine up and started work recommissioning it. Medusa Mining merged with Philsaga in 2004 and subsequently expanded the Co-O operation. By 2009 Co-O was producing 60,000 ounces a year. These days Co-O usually does 90,000 ounces a year and is likely to do so for the next decade.

A good FY20

The year to June 2020 was a good one for Co-O. The gold price moved in the right direction and Medusa had wisely chosen to remain unhedged, so the 95,000 ounces of production translated into revenue of US$148m. Medusa's EBITDA was US$62m, with Co-O's All-In Sustaining Costs (AISC) for the year coming in at US$1,132 an ounce. The company provided guidance of between 90,000 and 95,000 ounces in FY21, as usual, but indicated that AISC was likely to be higher at US$1,200-1,250 an ounce. And that's fair enough - COVID-19 has made life difficult for miners in the Philippines, as everywhere else in the world, and that means extra costs in terms of moving people and equipment around to keep everyone safe. Production at Co-O was briefly suspended in late October and early November 2020 due to a small number of COVID infections being detected on-site. However, Medusa decided that this stoppage wouldn't change the FY20 guidance.

So, Medusa and Co-O entered FY21 in reasonably good shape and the mine has apparently performed well all year, even dodging a bullet on 16 November when there was no damage from an earthquake in Agusan del Sur, not far from the mine site. The only trouble since mid-2021 for Medusa was that the company decided to stay unhedged and, as we all know, gold peaked in early August at around US$2,070 an ounce and has since trended back to around US$1,700 an ounce before rebounding. That was the main reason why Medusa stock has also eased back since the August 2020 peak. We think the stock's recovery from early November was due to increasing confidence that FY21 guidance would be met on the cost front, combined with market recognition that President Rodrigo Duterte has not created the no-go zone many mining investors had been led to believe.

Plenty of gold still to come

Co-O's Reserve as per the April 2020 annual update is 331,000 ounces while the Resource is 1.24 million ounces. We believe Co-O has a lot of life ahead of it. The mine hasn't been explored much below the 12 Level and that's where the current Reserve stops. There's at least four more levels where a lot more gold could show up in budgeted exploration work over the next two or three years.

Medusa is still making new discoveries, most notably the Royal Crowne Vein in 2019. The mill at Co-O only runs at about 60% of capacity, so the more gold that can be discovered and processed, the better the AISC at the other end.

Medusa got to March 2021 with US$72m in cash and no debt. That's A$92m compared to its current market capitalisation of $168m. That means that those 1.24 million ounces in the Co-O resource are trading at only around A$62, which translates to US$49. By comparison, the resource-base of Barrick (NYSE: GOLD), one of the world's biggest gold mining companies, is valued at over US$200 an ounce.

Call Medusa's low rating the 'Duterte discount' – one that it can overcome once investors realise the Philippines is still open for business if you're a miner. With Medusa so inexpensive and gold likely to see a resurgence in the neer future, we rate this stock four stars.

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Share price chart

Source: Tradingview

If you've ever driven the Eyre Highway from Port Augusta in South Australia to Norseman in Western Australia, you'll have come close to Iron Road's Central Eyre Iron Project. You'll pass by the virtual ghost town of Kyancutta, roughly in the middle of the Eyre Peninsula, about two and a half hours west of Port Augusta. Just south of here, Iron Road has spent the years since 2007 building an initial project called Warramboo into an iron ore reserve of 3.7 billion tonnes grading 15.1% iron and 54% silica.

Easy-to-work iron ore

Notice we didn't call the Central Eyre Iron Project a 'company-maker' because the real company-maker is the infrastructure that can make it happen. Iron Road has long dreamed of a deepwater port at a place called Cape Hardy, down on Spencer Gulf on the Eyre Peninsula's eastern side. It also longs for a 145 km transport corridor to the port from the Centre Eye deposit. Bring those assets to life and you've got, potentially, billions in shareholder value because the easy part of the project is beneficiating iron ore into a 67% Fe premium concentrate.

The billions of tonnes at Kyancutta are not bad when it comes to the preferred flowsheet. The iron is contained in gneiss formations, gneiss being a type of metamorphic rock with banded texture alternating darker and lighter bands. Gneisses tend to be coarse and brittle, making them easy to crush. Consequently, turning the low grade iron ore into a high grade product with low impurities suitable for steel mills can all be done with conventional processing modalities.

Anyone got a spare US$4bn to invest?

A Definitive Feasibility Study on the Central Eyre was published in February 2014 and gave it a post-tax NPV of US$2.7bn using a 12.5% discount rate. The downside was the US$4bn in capital costs. The South Australian government granted the relevant mining lease and development approval in May 2017. However, that year was a bad one to be raising billions for anything to do with iron ore given the commodity was only recently off its US$40 a tonne lows.

Iron Road's first step back from that nadir was to cut the size of the project from 24 million tonnes per annum to just 12 million tonnes in February 2019. That took capital costs down to a more reasonable US$1.7bn. Then Iron Road started to get really innovative. Like, it started talking about hydrogen and grain. Say what?

Let us explain. In July 2019, Iron Road teamed up with a start-up called the Hydrogen Utility, a developer of hydrogen infrastructure, to explore the possibility of building a 'green hydrogen production and export hub' on the land Iron Road had at Cape Hardy. Then in late 2019, it got the South Australian and Federal governments interested in the idea of an initial port development at Cape Hardy to support grain exports. By early 2020 the grain growers who would benefit from the port were interested as well, with Eyre Peninsula Cooperative Bulk Handling talking about investing. By September 2020, the kings of infrastructure investment, Macquarie Bank, were serious players in Cape Hardy. Under a Joint Development Agreement, the bank is now working to raise the $250m in project finance. Iron Road retains the right to hold up to 25% of the project at financial close, expected later this year.

One grain port an iron ore project doth not make

A hydrogen plant at Cape Hardy sounds sexy, but is not really relevant to Central Eyre at the moment. The Cape Hardy Stage 1 port development, now being taken forward as the 'Portalis Joint Venture', is more relevant but still doesn't get Iron Road up and running as an iron ore producer. However, Hardy Stage 1 does create a grain port that can subsequently become an iron ore port as well. Iron Road is hoping this infrastructure babystep will attract other partners that can look favourably on Central Eyre and the associated transport options. At US$120 a tonne of iron ore and an AUD/USD exchange rate of 0.8, Central Eyre is still worth US$2.7bn on Iron Road's number's, which we think is very attractive. However, Central Eyre isn't the only large iron ore deposit in Australia competing for funds.

There's an additional problem for Iron Road right now. After a period in which iron ore has gone, to put it mildly, 'nuts' on strong Chinese demand and weak Brazilian supply, there are concerns the commodity may cool from the level north of US$200 a tonne it recently went to. If that happens, Iron Road stock will be in trouble.

So, while Hardy Stage 1 represents a real step forward for Central Eyre, there's plenty of other things Iron Road needs to do before it can get close to making Centre Eyre a reality. The $4.25m recently raised at 21.5 cents isn't enough to get those things done. So for now, this stock is two stars for us.

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Share price chart

Source: Tradingview

If you want to build a future billion dollar company in a pleasant country town, we suggest you move to Moranbah in central Queensland, postcode 4744, population 9,000. In Moranbah, a two-hour drive to the southwest from Mackay, you can be in the middle of the most productive part of the Bowen Basin. Some think that Bowen's glory days were back when Sir Joh Bjelke-Petersen was Premier of Queensland and BHP was buying Utah Coal. We predict a heck of a lot more metallurgical coal mines are going to be developed there in the future. The task is made relatively easy by ongoing strong metcoal demand from Asia and the availability of all the infrastructure you need.

Thank you, Peabody

Bowen Coking Coal believes at least four of its projects up here have a decent shot. The first, Broadmeadow East, 25 km northeast of Moranbah, is coming close to an investment decision. As its name suggests, Broadmeadow East is not far from the Goonyella-Riverside-Broadmeadow complex that ships metcoal from Hay Point, near Mackay.

Broadmeadow East, a mere 33 million tonne resource, is a midget by comparison with BHP and Mitsubishi's monster. Peabody owned the major American coal producer, but in mid-2020 that company decided that Broadmeadow East was too small to bother with given falling coal prices. They allowed Bowen Coking to buy it for a mere A$1m plus a royalty on future production of A$1 a tonne, capped at A$1.5m. Their loss, Bowen Coking's gain.

The mining lease was granted and, importantly, the project came with access rights to a coal handling and preparation plant called New Lenton and an associated train load-out facility for at least a million tonnes a year. That infrastructure is already built, but is currently idle because the Peabody mine it served, called Burton, shut down in 2016. So basically, all Bowen Coking has to do is move in some equipment and start open-cut mining. Not a bad deal at all.

In the crucible

The beautiful thing about Bowen Coking is that Broadmeadow East isn't the only near-term opportunity in the works. Isaac River covers another 8.7 million tonne resource some 30 km west of Moranbah. Bowen Coking is currently completing a Preliminary Feasibility Study on this project after a 'concept study' suggested that the key Leichhardt seam here was open-cuttable.

Hillalong is potentially bigger than Broadmeadow East at 43 million tonnes. It's about 100 km north of Moranbah, near the town of Glenden and in the neighbourhood of Glencore's Hail Creek mine. It is still early days for Hillalong because we don't yet know how big the deposit is or how good the coal is. Early testwork is, however, promising. Coal makes great coke if it has a high CSN, that is 'Crucible Swelling Number'. Yeah, we know, this industry has some weird lingo.

To find coal's Crucible Swelling Number, simply heat it to 820 degrees centigrade, then watch how it swells inside the crucible. The more swelling, the better. Less than 4, and you don't have coking coal. If it's 6 it's good. If it's 8.5, which is what some Hillalong coal has been getting, you've got great coking coal. Now you know why the Japanese major Sumitomo, having earned 10% under a farm-in arrangement, is continuing that programme to earn 20%.

Jorss II – the sequel

Then there's Cooroorah, down near the town of Blackwater and close to the huge Curragh mine of Coronado Global (ASX: CRN), which we wrote about on 23 July 2020, noting that the American company wanted to expand that mine. There are 177 million tonnes in an underground resource for Bowen Coking at Cooroorah and if it ever develops, it will get the company some of the lowest ash coal with the highest CSNs you can get from the Bowen. We don't expect to see Cooroorah develop any time soon, though, given the other projects Bowen Coking has in the works, but this is a nice bottle of Grange to mature in the cellar for a few more years.

So there's a lot to like about this, potentially, Next Big Thing for the Bowen Basin. One other thing to like is the most recent hire. Nick Jorss is famous in coal industry circles as the man who arranged for Stanmore Coal (ASX: SMR) to get hold of the Isaac Plains Coal Mine in 2015 for just one dollar (we wrote about that in Stocks Down Under on 22 January 2020). He had been a non-executive director of Bowen Coking since late 2018, but last February it was announced that Jorss would become Executive Chairman. Once you've gone from $1 to over $1bn in shareholder value for the first time, it gets easier to do it again, right? With Jorss likely to preside over a year of progress at Bowen Coking, we think this junior is a four-star opportunity.

Pitt Street Research Pty Ltd

95 Pitt Street, Sydney, NSW 2000, Australia

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