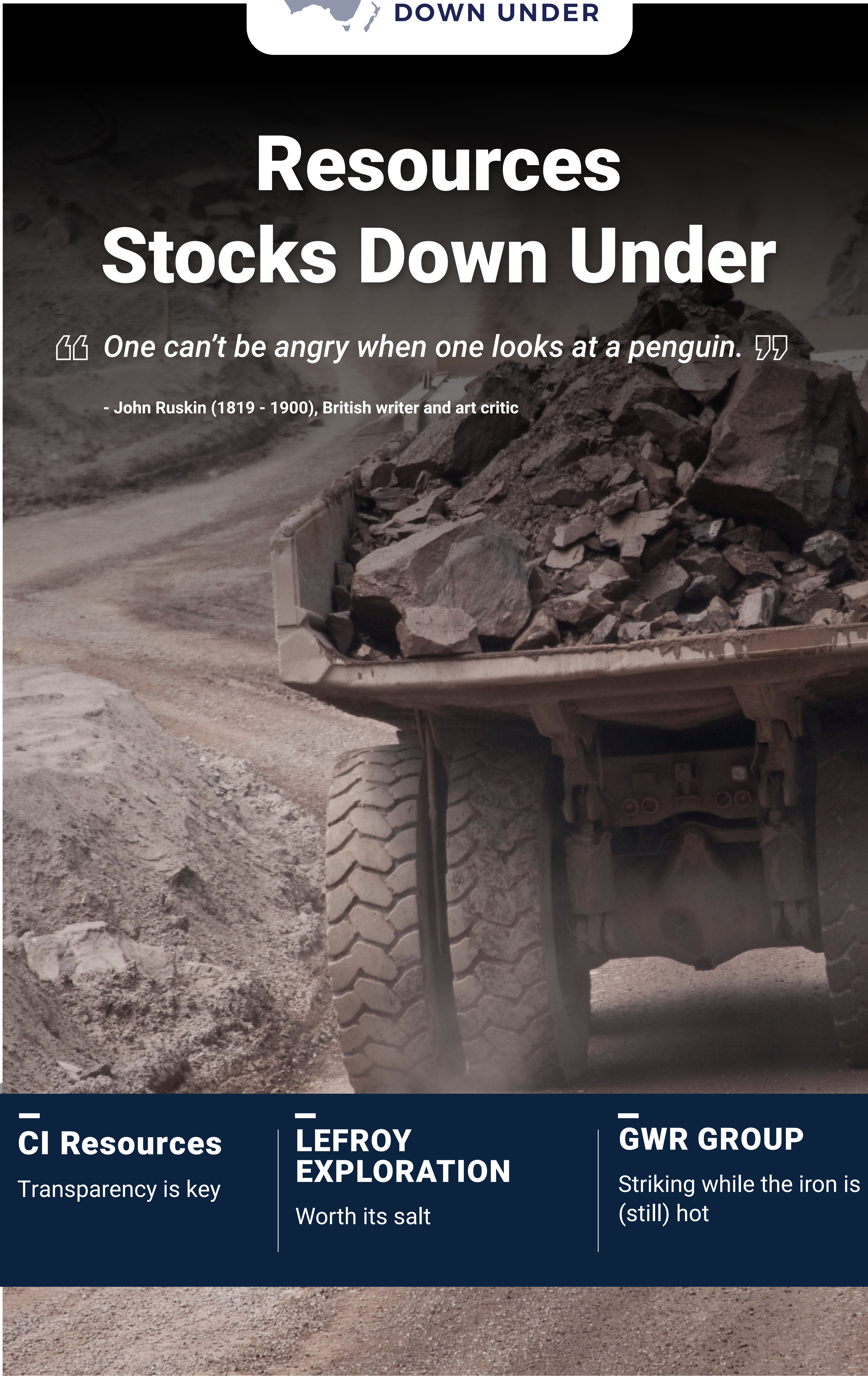
STOCKS DOWN UNDER

24 JUNE 2021



Resources Stocks Down Under

> *One can't be angry when one looks at a penguin.*
>
> - John Ruskin (1819 - 1900), British writer and art critic

CI Resources

Transparency is key

LEFROY EXPLORATION

Worth its salt

GWR GROUP

Striking while the iron is (still) hot

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Stocks Down Under rating: ★★

ASX: CII
Market cap: A$ 133M

52-week range: A$0.80 / A$1.20
Share price: A$ 1.16

CI Resources has had a rough few years on its home ground of Christmas Island. Fighting both government red tape against its phosphate mine extension plans as well as a volatile fertiliser market, the company has taken steps to expand its investment horizon through its subsidiaries. CI is confident in phosphate's long-term profitability, but the future remains uncertain.

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Share price chart

Source: Tradingview

Secret island

CI Resources operates the historic Christmas Island phosphate mine. That's right, the Australian external territory in the Indian Ocean with the infamous Immigration Reception and Processing Centre that was in the news a lot a few years ago also has a phosphate mine. As an unlisted company, Phosphate Resources had owned the Christmas Island mine since 1990. That was taken public in 2015 through a Reverse Takeover into CI Resources. Through Phosphate Resources, CI has a role in the exports of phosphate rock to the south-east Asian region as well as other revenue opportunities in palm oil production in Malaysia and stevedores, fuel and maintenance services on the island.

A large part of those 'maintenance services' include the $20m facilities contract at the detention centre, which was bestowed to CI by the Department of Home Affairs in 2019 for three years. This contract award followed some tough years post-acquisition with environmental opposition to expanded mining activities on the island, with the company rejected for extra mining licenses. CI has been looking to extend the operational life of the mine, which currently has a LOM of five years. Under the existing mining lease, the company performs secondary recovery and salvage of phosphate stockpiles. Due to reduced tonnage and high prices, CI's share price has steadily declined from its May 2016 high of $2, now at $1.02 per share.

Between a rock and a hard place

The history of Christmas Island, which became an Australian territory in 1958 and was a British colony before then, has always been closely tied to phosphate mining. Indeed, that industry continues to be the island's main economic driver as it accounts for 35% of GDP. Mining began in 1896 under the Christmas Island Phosphate Company all the way to 1987 when the Australian government decided to close the mine. As all good unions do, the Christmas Island's Workers Union funded a feasibility study to lobby a reopening. A new mining lease was given to newly-formed Phosphate Resources in 1990.

Phosphate is an important ingredient in the production of agricultural fertilisers, which is a product expected to grow in demand to address the world's growing food insecurity, but you wouldn't know that from CI's current sales. Last year's perfect storm brought delays to operations as well as weaker market demand for premium rock phosphate across the region, meaning that the company only just broke even with a net profit result of $32,000 this financial year. Conversely, the profit for the FY before was $8.7m. Given these factors, it's hardly surprisingly that CI would look to diversify itself through other avenues – such as maintenance services – as it looks at other possible investments in the phosphate value chain.

The company maintains that a stronger high-value fertiliser market would enable it to continue mining at its previous production average (around 600-700,000 tonnes), but the company has been dealing with a pattern of lower-than-expected profitability and interrupted production due to softness in its key fertiliser markets, even without a major pandemic. When the company took the DC contract in 2019, phosphate sales already dropped from 643,000 tonnes to 486,000 tonnes in FY18-19, which slashed its $21m profit to $8m. It's fortunate that CI won that contract when it did, as both its maintenance services and oil divisions account for a large portion of overall profits, although it's still unclear what exactly those maintenance services involve. At the time of the tender, the centre held four people.

Get your house in order

While the fertiliser market is expected to pick up to meet the demand for higher crop yields, CI may struggle to compete in a highly consolidated market focussed on premium product if it's unable to expand production or gain access beyond south-east Asia. There's a definite problem for the company going forward in terms of phosphate's long-term viability on Christmas Island. With only a short mine life without the possibility of expansion, CI might have to look to Australia and elsewhere for mining opportunities, leaving Christmas Island's largest industry in the dust. Worse, the company's investment choices smack of nepotism: the company's board once included a former WA government minister while some directors hold ties to Malaysia's palm oil industry.

While CI is focussed on bringing around a brighter mining future, the restructure of operations, including a redundancy program, restructured working shifts and a previous 12-week shutdown, still leaves a great deal of uncertainly for those on the ground as well as the company's shareholders. It's been a few disappointing years for shareholders, and while they at least had the benefit of dividends over the past six years, this has also been cut until signs of a recovery. Perhaps it's best to wait for the market to recover – or perhaps CI could continue its side-hustle. Two stars from us.

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Drive about 60 km south of Kalgoorlie and you come to a large ephemeral salt lake called Lake Lefroy. Because the lake is usually dry and smooth, it's a perfect place to enjoy the sport of 'land sailing'. If you're not into land sailing but looking to find the next big multi-million-ounce gold deposit, Lake Lefroy is also a good place to go because they've been making discoveries in and around the lake since the 1890s. Lefroy Exploration is so-called because it wants to be next and since February of this year the market has been confident that this company is on to something.

Is this the next Hemi?

The Lefroy Gold Project covers 598 sq. km in the neighbourhood of the lake and is split into two zones: Eastern Lefroy, which contains the aforementioned Burns prospects among others, and Western Lefroy, which is directly adjacent to the St Ives Gold Mine owned by the South African major Gold Fields (JSE: GFI). That mine, you may recall, was an old WMC operation, which the folks from Johannesburg bought in 2001. The mine still does 350,000 ounce a year.

Lefroy Exploration has the aid of the $25m farm-in agreement from Gold Fields for the western side of the project. While most of the exploration success to date has come from the east, progress is being made slowly but surely. On 21 June 2021, management provided an update that stated, as part of its agreement with Gold Fields, that the delays in exploration caused a shortfall in the agreed upon $10m in expenses. This $2.76m shortfall was supposed to be 100% paid to Lefroy in cash, but an agreement has been reached where Gold Fields pays 50% in cash and the excise of Coogee South from the Farm In. This will allow Lefroy to retain 100% ownership.

The fateful February 23 announcement disclosed a 60m copper-gold intersection in hole LEFR260 at Burns, located at the eastern margin of a large intrusion zone. The whole 60 metres graded 5.22 g/t gold and 0.38% copper, but within that was a juicy 20m at 12.2g/t gold and 0.87% copper. It wasn't just the length and that grade of LEFR260 that excited. Nor was it the fact that the mineralisation was still there at the end of the hole. It was the fact that in the various RC holes, of which LEFR260 was a part, there were interesting intersections in both in porphyry and in basalt. What that meant was that Lefroy Exploration might just have a larger intrusive gold system on par with big-time resources, like the recent Hemi discovery of De Grey Mining (ASX: DEG) up in the Pilbara, or Newmont's monster gold mine down at Boddington.

Good ground if you can get (under) it

A century ago you never could have discovered Burns because all that salt would have obscured the deposit. Although modern techniques have made finding prospects like Lucky Strike and Burns a lot easier, Burns was not originally part of Lefroy's tenement package – the company was lucky enough to secure it in ballot in November 2019. Burns has been a highly sought-after piece of ground, with numerous previous owners including BHP in 1985, Newmont in 2007 and a smaller company called Octagonal Resources in 2011. Although Octagonal came closest to finding something interesting before it was taken over, none of these companies tested as far as the intrusion Lefroy has now punched into.

By 20 April Lefroy was putting down 2,000 metres of diamond tail on 14 previous RC holes at Burns as a first effort to see how big this elephant really could be. Unsurprisingly, it was LEFR260 that was first in line to get tested. Lefroy Exploration stock had moved into cool-off mode by mid-April, having peaked at $1.52 on 9 April. By 12 May the stock had trended back to 78 cents. In retrospect those sellers should have been careful knowing that another drill intersection from LEFR260 was likely to come soon. And indeed, a reckoning was awaiting the Lefroy naysayers on Thursday 13 May.

Burns is getting hotter

The headline on the ASX announcement of that morning said it all: 'Burns success continues – 55m vertical depth extension and more strong mineralisation now established'. The diamond twin of LEFR260, called LEFD004, had come back with 38m at 7.63g/t gold and 0.56% copper from 134 metres. That finding alone bumped Lefroy stock back to 91.5 cents. Then on 25 May Lefroy jumped from $1.00 to $1.17, not because of any intersections, but just because the third diamond drill hole in this current programme, called LEFRD267, is cutting through similar kind of porphyry and basalt rocks to LEFD004.

Has Lefroy Exploration bagged the elephant in the Eastern Lefroy that it was looking for? This story does have a Hemi-type feel about it and it's worth remembering that De Grey, now a billion dollar company, has barely stopped for breath since the early days of the Hemi discovery in 2020. We think there's more exciting news flow from the next dozen or so diamond holes to keep everyone interested for a while yet.

Obviously, there's a lot of risk here because we are nowhere near a JORC resource of any kind, but at the moment one does have the advantage of a gold price that has returned to bull market territory since late March. For investors cognisant of that drill risk and not averse to taking a profit should the stock continue to move, this is four stars.

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Share price chart

Source: Tradingview

Spoilt for choice

GWR Group began 2021 with its first iron ore shipment from Wiluna West and did 107,498 wet metric tonnes before the March 2021 quarter was done. Situated 40 km southwest of Wiluna and 700 km east of the Port of Geraldton, the Wiluna West project is expected to produce 10 million tonnes of iron ore over 15 years. Although Wiluna West can be broken up into eight distinct deposits, the initial focus will be on the C4 deposit, which holds 21.6 million tonnes at 60.7% and will yield the first 1 million tonnes during Stage 1. As GWR is already working at 90% nameplate capacity, the company is taking steps to increase Stage 1 tonnage capacity before moving onto Stage 2 operations, which should see a production increase to 20 million tonnes.

On the same tenement ground, the company is eyeing the gold exploration potential of the Joyners Find Greenstone Belt. The Wiluna West gold project only covers a 22-metre strike across the belt, but the limited exploration to date and the proliferation of neighbouring gold mines, including Northern Star's Jundee and Blackham Resources' Matilda/Wiluna, implies a straightforward resource with exploration potential.

Wiluna West Gold has a new mineral resource estimate (MRE) of 4.57 million tonnes at 2.0g/t gold for 293,000 ounces. In April, GWR announced that it would demerge the Wiluna West Gold project under its subsidiary company Western Gold Resources.

Three commodities are better than one

Since GWR completed its first shipment in January, iron ore has exceeded just about everyone's expectations and leapt to US$230 per tonne. Maybe that's not such a surprise given the performance of the Chinese construction industry after the pandemic downturn, but what is surprising is the continued supply constraints from the likes of South America, where producers are still struggling to catch up. With prices remaining at record highs and revenue coming in, the company is ramping up Stage 2 development, including the expansion of the pit design and an increase in mining, crushing and haulage. This is as much about reducing costs as it is about production; by renegotiating certain terms of its offtake agreement with Hong Kong-based Pacific Minerals, GWR is drawing free on board (FOB) cash costs of A$120 per tonne as efficiency improves.

While the iron ore supply/demand scenario is not expected to even itself overnight, the company is still staying two steps ahead with its growing asset portfolio combined with its joint venture participation and equity investment. In the short term, GWR is making the most of iron ore's current cycle through the addition of a joint mining rights agreement with Fe Limited (ASX: FEL) to exploit another high-grade deposit within the Wiluna West tenements, called JWD.

JWD itself has a resource of a 10.7 million tonnes at a grade of 63.7% Fe. Fe Limited's 51% interest will net GWR additional cash, royalties and options for ore in the long term – with the trigger of $4.25m payable to the company at the 2.7 million tonne mark. The company's other strategic investments in Tungsten Mining (which includes a joint venture in SA's Hatches Creek Tungsten Project) and eMetals (ASX: EMT) means that GWR is increasingly gaining exposure to a range of commodities with the potential to increase its presence in those areas later in the game.

It's best to be strategic

GWR's share price was on an upward trend to 45 cents in early January, although it plummeted in March after a contractor fatality near Meekatharra. As of May, the share price has eased back towards 30 cents. As the company's development of Wiluna West spanned the course of the last decade, GWR is hoping for a much quicker jump to Stage 2 now that the money is coming in and the appropriate offtake partners are lined up.

At the end of the quarter the company held cash reserves of $10.4m and no debt. While the company holds a diversified portfolio, GWR's main priority is creating cash generation as it transforms itself from a mineral explorer to an iron ore producer. While that seems sound (at least in the short-term), we believe that the company will want to keep its diversified exposure to other commodities (especially tungsten) in the pipeline even as it demerges from its current gold opportunity.

We like what GWR has achieved at Wiluna West, but we think that with iron ore likely to retrace a lot of ground in the medium term, it's best to be cautious on this one. Three stars until iron ore stabilises.

Pitt Street Research Pty Ltd

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