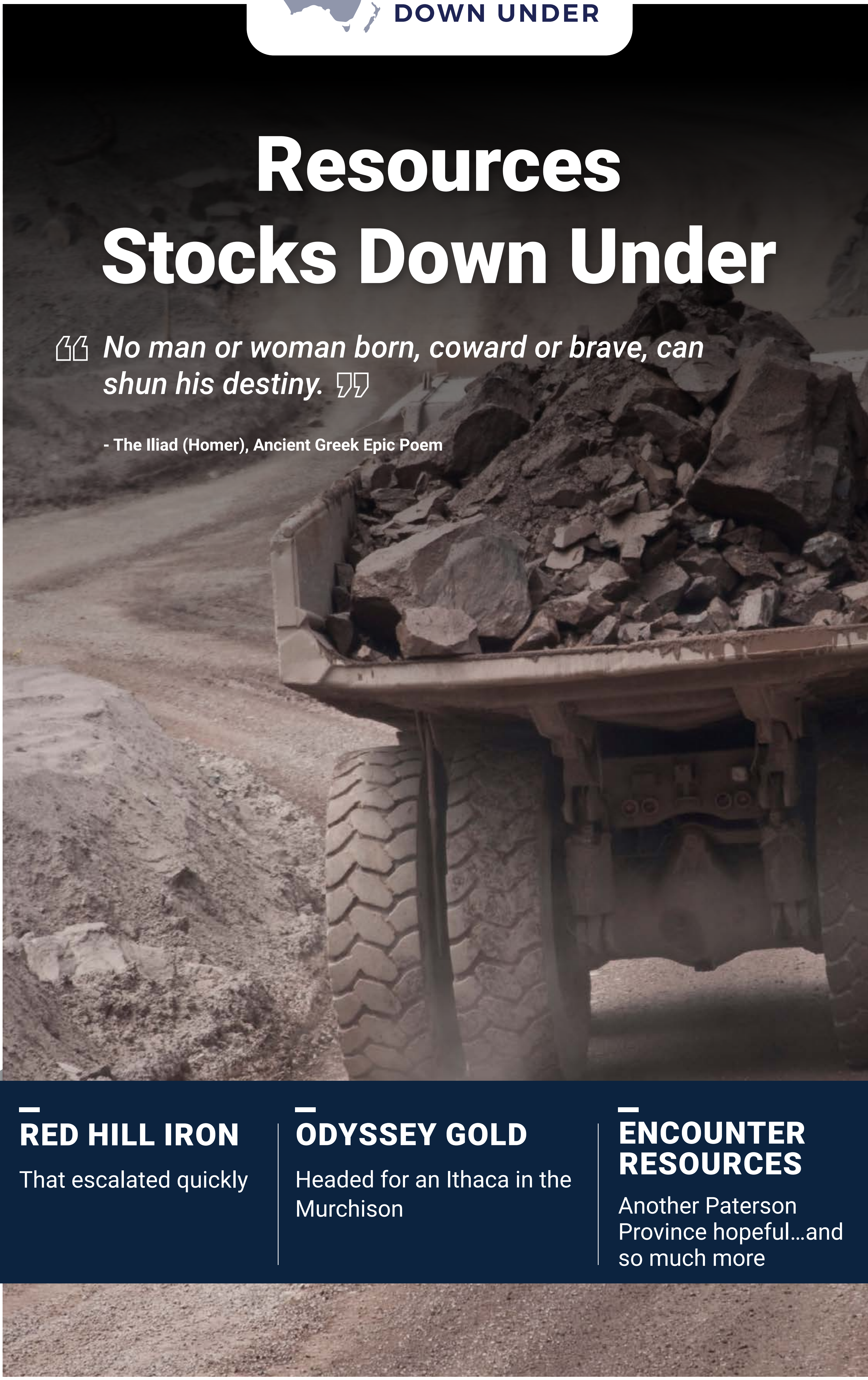
STOCKS DOWN UNDER

26 AUGUST 2021



Resources Stocks Down Under

> *"No man or woman born, coward or brave, can shun his destiny."*
>
> **- The Iliad (Homer), Ancient Greek Epic Poem**

RED HILL IRON

That escalated quickly

ODYSSEY GOLD

Headed for an Ithaca in the Murchison

ENCOUNTER RESOURCES

Another Paterson Province hopeful…and so much more

RED HILL IRON

That escalated quickly

Stocks Down Under rating: ★★

ASX: RHI
Market cap: A$ 233M

52-week range: A$0.20 / A$4.40
Share price: A$ 3.82

It was the transaction no one saw coming: On Friday 30 July Mineral Resources (ASX: MIN) announced that it was buying 40% of an iron ore joint venture that covered 820 million tonnes of the stuff. The price was a massive $400m…in cash. The vendor, the little-known Red Hill Iron, had been capitalised on ASX just prior to the deal at a mere $66m. Now you know why Red Hill Iron stock leaped on Monday 2 August from $1.10 to $4.06. However, even at the 11 August peak of $4.39 the Red Hill Iron market cap was only $263m. We think it will be a while before the market values the other $137m.

READ MORE

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52-week range: A$0.065 / A$0.225
Share price: A$ 0.09

When a drill sample assays for gold at greater than 30 g/t, you can see it with the naked eye. So, on 14 May 2021, when Odyssey Gold reported that there was 'significant visible gold' at the oddly named 'Bottle Dump', the market was all over it, kicking the stock up from 7.1 cents to 14 cents. Most of those gains have since been given up. However, the Odyssey of Odyssey Gold, with its Tuckanarra and Stakewell projects in the Meekatharra-Cue belt, is still worth paying attention to.

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Share price chart

Source: Tradingview

At Stocks Down Under we called 'time' on the iron ore bull market of 2020-21 back on Friday 28 May. If you look at our regular 'Friday Beers with Marc & Stuart' show, on the 'Insights' page of our website stocksdownunder.com, we argued that expensive iron ore was a temporary phenomenon and the coming 'normal' was well south of the US$230 or so that iron ore was trading at around that time. Like, maybe, under US$100 a tonne. So far, events seem to be unfolding as we predicted. That red dust is now at US$160 per tonne and headed lower.

With iron ore, you have to take the long view

The thing about iron ore is that good deposits can be worth a lot even at times when the spot price is depressed. That's because iron ore mines can have extremely long lives and low costs of production once they're up and running. Take Mount Tom Price, Rio Tinto's maiden Pilbara iron ore operation, as an example of longevity. It's still going strong 55 years on. To get that value, however, you have to think in terms of decades, something not many resources investors are in the habit of doing.

One company that takes the long view, and whose modus operandi when it comes to investing in long-life mines is described in Stocks Down Under on 10 September 2020, is Mineral Resources (ASX: MIN). That company recently decided that 1,900 square km in the neighbourhood of Robe River in the Pilbara is something it thinks will be valuable in the long run and it was prepared to pay up for 40% of it.

Same project, different day

The 1,900 square km covers the so-called Red Hill Iron Ore Joint Venture, or RHIOJV for short. If you have a map of the Pilbara, cast your eye over to the left-hand side of the page and find the town of Pannawonica, postcode 6716. That's near where Robe River Iron Associates, the Rio Tinto-led joint venture that dates from the 1960s, has its Mesa A and Mesa J mines, which rail ore to Cape Lambert for export. The RHIOJV area is due south of there.

Red Hill Iron did its ASX IPO in early 2006 in order to develop RHIOJV, with the listed company owning 40% and the other 60% held by a private company, called API Management. That company in turn was owned by the ASX-listed iron ore developer Aquila Resources and by ACMI, a resources investment company associated with businessman Hans Mende. The Korean steel maker Posco bought half of AMCI's stake around 2010, Aquila got bought by China's Baosteel and Aurizon in 2014, and recently Mineral Resources bought Aurizon's Aquila stake. Other than that, the RHIOJV is almost the same as it was 15 years ago – an undeveloped iron ore resource. The deal between Red Hill Iron and the RHIOJV was that, the day the first ore ships, it could either reduce to 19% and have its share of capital costs paid out of project cash flow, or take a 2% FOB royalty.

In one sense the Red Hill story improved over the years. Between 2010 and 2020 it doubled in size, from 422 million tonnes at 56.6% Fe to 820 million tonnes at 56.4%. However, an ongoing issue was that this resource, however large it got, was 'stranded' because there was no rail infrastructure to get the iron ore to the port. That's an old story when it comes to Pilbara iron ore deposits. We wrote about another such stranded project when looking at Flinders Mines (ASX: FMS) back on 21 January 2021. In July 2021 the market was basically assuming that RHIOJV would be stranded indefinitely. Mineral Resources, however, is working on becoming the next big iron ore player in the Pilbara with an export port at Onslow and believes it has the balance sheet, in-house expertise and commercial relationships to unlock the RHIOJV riches. It decided that $400m for 40% of 820 million tonnes was a more-than-fair price to pay.

Still some upside, but only if there's a mine

That may be good for Mineral Resources, but not good for Red Hill Iron shareholders coming in after the re-rating. You see, Mineral Resources will pay A$200m now, but the other A$200 doesn't come until first iron ore shipments, when Red Hill Iron also gets a 0.75% FOB royalty. Sure, the current market cap undervalues that upside. However, before that can accrue, Mineral Resources needs to make some progress in moving RHIOJV forward.

Red Hill Iron's Executive Chairman, Joshua Pitt, was an on-market buyer of stock, so he's optimistic. However, we'd be a little cautious. We actually think the stock will settle down a little from here given the current bearish dynamics of iron ore. Two stars for now.

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Share price chart

Source: Tradingview

If you follow the resources sector Down Under, you’ll often read about companies active in the ‘Murchison Region’. What they’re talking about is a ‘bioregion’ in Western Australia, not a distinct local government entity, where the geology and landform patterns are different from the neighbouring bioregions. If you drove from Port Hedland in the north to Esperance in the south you’d pass through six bioregions, starting in the famous Pilbara region, and continuing through the Gascoyne before you got to the Murchison. Keep going and you get to the Coolgardie region where Kalgoorlie lies, after which comes the Mallee and finally the fertile Esperance Plains.

Cue another interesting gold exploration play

But come back with us to the arid backblocks of the Murchison. Mineral explorers like this region largely because of Cue, where gold was discovered in a big way in 1892 and where there’s been substantial gold-related activity ever since. Today, there are major mines in the Cue neighbourhood belonging to Westgold (ASX: WGX) and Ramelius Resources (ASX: RMS). We talked about Cue, 640 km north of Perth on the Great Northern Highway, on 10 July 2020 when looking at Musgrave Minerals (ASX: MGV). Musgrave’s Cue Project, including the amazing Starlight discovery, is just south of town. Today we’re looking at a couple of projects about 50 km further north, halfway to Meekatharra, called Tuckanarra and Stakewell. If Odyssey Gold, their new 80% owner, were a poem by Homer, this would be the Ithaca they're making for.

The 176 square km of Tuckanarra and Stakewell are what allowed the old Odyssey Energy to be reborn as Odyssey Gold earlier this year. Stakewell actually hosted a small gold mining operation in the early 1990s called Kohinoor and the geologists who've looked at it reckon it could host another of those big gold deposits you often find in the Murchison in so-called BIFs, that is, banded iron formations. Tuckanarra next door covers a historic goldfield from the early 20th century that was also worked in a small way in the 1980s and 1990s. At Tuckanarra there were four open pits and in one of them, called Bottle Dump, the pre-Odyssey drill work looked promising, with intersections like 30 metres at 3.7 g/t gold from 87 metres and 13 metres at 8.5 g/t gold from just 15 metres.

All across Tuckanarra and Stakewell there had been a lot of drilling, but relatively little since about 2012 and the experience of Musgrave with Starlight, and other operators in the area, was that you just had to pick where the old-timers left off in order to find a lot of good mineralisation if you went further than 100 metres. That sentiment made it fairly easy for Odyssey Gold to raise $3m at 2.5 cents to fund 10,000 metres of RC and 3,000 metres of diamond drilling. The stock came back on the market at 6.9 cents on 14 January.

Naked yellow

Which brings us to the 14 May 2021 magic we noted above. An RC hole called TKRC0014 at Bottle Dump had come back with 13 metres at 3.9 g/t gold from 198 metres and, above that, 16 metres at 2.3 g/t from 100 metres. More importantly, the team had cut a diamond hole below the RC hole called TCKDD003. That hole had gone through a different BIF to the one where the gold had come from thirty years before and the yellow stuff was there in the core for the naked eye to see. Maybe, the market reasoned, this was the next Musgrave Minerals…

Now, the trouble with Odyssey Gold right now is that the stock has since retraced most of that sudden spike. The company quickly raised more capital to go harder at Cue and got $10m at 12.5 cents, but that took the wind out of the secondary market's sails so that it couldn't response to good drill results on 3 June and 2 July. To use one more Homeric analogy, it's like the stock is back on Calypso's Island again. However, since late July the stock has been stabilising between $0.09 and $0.10 per share.

Maybe Levi is on to something…

And no wonder. On 28 July Odyssey Gold reported some good hits at the Anchor and Maybelle prospects at Tuckanarra, such as 8 metres at 6.2 g/t from just 60 metres. From what we know about Cue, it's reasonable to expect more where that came from. Odyssey Gold director Levi Mochkin must agree with that sentiment. Between 30 July and 18 August, he bought 9m shares on-market at an average of $0.092 per share.

We like where Odyssey Gold is sitting right now. You've got sentiment returning to gold, the example of Musgrave Minerals to show what a well-managed exploration project in the Cue area can achieve and plenty of depth and strike extensions to known mineralisation being intensively evaluated. It's speculative, obviously, but if, like Levi Mochkin, you have the risk appetite, this one is four stars.

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Share price chart

Source: Tradingview

If you could describe the way Encounter Resources works to create shareholder value in a nutshell, it would be this: pick underexplored parts of Australia that the data suggests have potential to throw up the next Tier 1 discovery in way previous explorers didn't think much about; secure a large block of exploration ground; start work on the most promising targets; then joint venture it with a company that has deeper pockets.

Your taxpayer dollar at work

Take Encounter's projects up in the Northern Territory as a good example of that approach. Encounter believes that one of the world's next big sedimentary-hosted copper deposit is going to show here and it's secured an exploration portfolio covering 26,500 sq km over eight projects. That's right, there's a comma after 26 in that land holding number, not a decimal point. Encounter isn't just going after a mine. It's going after what the Canadians call a 'camp' – a whole suite of mines. But it's doing it in a systematic way, with its people spending a lot of time kicking around in new datasets from the Territory's Geological Survey and from its Federal counterpart, Geoscience Australia, to pick the ground that best fits its model.

Seven of those eight NT projects sit in the triangle formed by the town of Tennant Creek in the south, the McArthur River Zinc Mine in the north and the Century Zinc Mine over in Queensland to the east. Elliott was the first project, with the initial tenement grants happening in March 2020. The attraction here is a 'copper in groundwater' anomaly that showed up in the Geoscience Australia data. Groundwater? Yeah, metal in the groundwater isn't a geological clue that explorers usually look at, but Geoscience Australia had the resources to track it. That's your taxpayer dollar at work in a good way to build Australia's competitive advantage in the global mining industry.

Thank you IGO Ltd

That taxpayer dollar pretty quickly did some good for Encounter Resources. Barely six months after the Elliott tenements were granted, BHP optioned the project and, as we noted above, that option quickly got exercised. Encounter hadn't even mobilised a drill, but it already has a huge validation for the other NT projects. Encounter stock briefly re-rated on the news, from 13.5 cents to 20.5 cents. The market has since shrugged its shoulders, but we think this isn't the last investors will be hearing about Elliott.

We also think investors haven't heard the last of Encounter's projects in the Paterson Province. For the Rip Van Winkles out there, the Paterson has turned into a hotbed of copper exploration in recent years. You'll find that juicy Neoproterozoic metasedimentary basin on the map by finding the Hamersley Basin, where all the iron ore is and just shifting a little to the right. It's where Newcrest's legendary Telfer gold mine got discovered in 1972 and where Western Mining found the Nifty copper mine, now with Metal X (ASX: MLX | see 15 April 2021 report), a decade later. The Paterson's recent shot in the arm came from exploration success at Winu by Rio Tinto and at Haverion by Britain's Greatland Gold (LSE: GGP). Encounter reckons it has a shot at Paterson excitement with Lamil and Yeneena. The latter is a joint venture covering 1,600 square km to the south of Nifty where IGO Ltd (ASX: IGO) is spending $15m to earn 70%. It's relatively early days there, but what has Encounter really excited right now is Lamil, which it still controls 100%.

The next Winu?

Lamil is only 25 km northwest of Telfer. Structurally it looks a bit like Winu and the drill results have been consistently good. And on 21 April there was a particular good one. An RC hole called ETG0227 at a prospect called Dune went through 132 straight metres, averaging 0.31 g/t gold and 0.11% copper from 87 metres, and still had mineralisation at the hole's end. That was enough to suggest that Encounter was getting near an exploration payday at Lamil and diamond tails were ordered up to take a better look at that hole and others. The first assays from those tails are coming soon.

The great thing about Encounter right now is that any one of Elliott, Lamil or Yeneena could deliver the big money in the not-too-distant future. Or it could be Aileron, an IOCG target in the West Arunta part of WA, where the gravity surveys have thrown up some good targets. We might see some diamond drilling there before the year is out, funded by WA's Exploration Incentive Scheme. It might even be Hamelin Gold, which is being spun out to develop Encounter's gold project in the West Tanami region on the WA/NT border and where Encounter has been hoping for a repeat of Newmont's uber-rich Callie Gold Mine.

At least one Encounter director seems to like all this optionality. The Melbourne barrister Philip Crutchfield was a recent on-market buyer of stock. We like what he sees. Four stars from us.

Pitt Street Research Pty Ltd

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