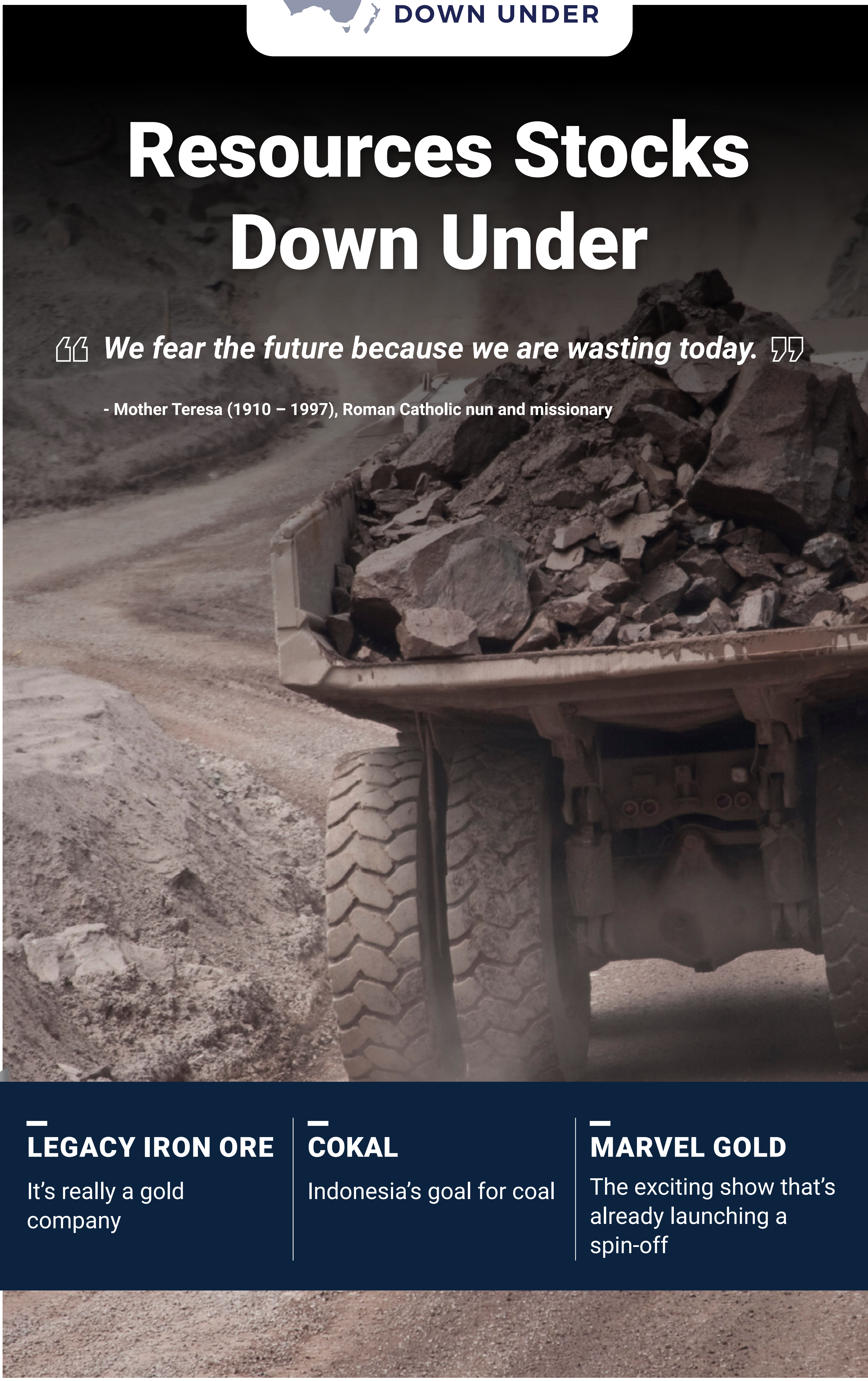
STOCKS DOWN UNDER

23 DECEMBER 2021

Resources Stocks Down Under



“We fear the future because we are wasting today.”

- Mother Teresa (1910 – 1997), Roman Catholic nun and missionary

LEGACY IRON ORE

It’s really a gold company

COKAL

Indonesia’s goal for coal

MARVEL GOLD

The exciting show that’s already launching a spin-off

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Stocks Down Under rating: ★★★

ASX: LCY
Market cap: A$141M

52-week range: A$0.012 / A$0.065
Share price: A$0.022

Legacy Iron Ore is another diversified miner with a portfolio of gold, base metal and iron ore projects, but its Mt Bevan Magnetite Project has been stuck in production limbo for a number of years now. Instead, the company is speeding up the development of another gold project while it considers the viability of Mt Bevan, which may or may not be influenced by iron prices or the increase in junior WA iron ore explorers looking for a good deal.

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We know that coal isn't very woke these days, but we haven't been able to take our eyes off the coal prices recently. Coal futures hit a record US$269.5 in early October and coal is currently three times more what it was worth a year ago due to global energy shortage concerns. Coal player Cokal has set up shop in Indonesia, with interests in four projects, and we're keeping an eye on its flagship Bumi Barto Mineral coal project in Central Kalimantan. Cokal has the kind of coal we're still going to need for a long time, coking coal.

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Marvel Gold is one of the newer gold players on the block, only changing to its current name in June 2020. Previously a graphite company, Graphex Mining (ASX: GPX), it couldn't resist the alluring gold deposits in the West African nation of Mali. The company has a portfolio that covers five gold projects in Mali and has lodged a prospectus to launch a spin-off company, Evolution Energy Minerals, to manage its Chilalo Graphite Project in Tanzania.

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Share price chart

Source: Tradingview

Time for a spring clean

Legacy has multiple iron ore, gold and base metal assets throughout Australia, but for the past six months most of its efforts have gone into exploration at the Mt Celia Gold Project, located 180 km northeast of Kalgoorlie in the Eastern Goldfields. In the recent RC drilling program, 20 out of 33 holes showed mineralisation peaking at grades up to 7.3 g/t gold. As of July 2021, the project had a mineral resource of 6.96 million tonnes at 1.38 g/t Au (309,200 ounces of gold) with further work scheduled to delineate new gold targets. An additional Mining Study has confirmed its economic viability through a toll treatment operation. Mt Celia is included in the company's South Laverton Gold hub, which incorporates the Yerilla, Yilgangi, Sunrise Bore and Patricia North prospects.

Over the last three months the company has formulated an exploration program for all of its projects, but there is a question mark over its mothballed Mt Bevan magnetite ore and nickel project 250 km north of Kalgoorlie and immediately north of the Mt Mason iron ore project of Juno Minerals (ASX: JNO). As a joint venture with Hawthorne Resources (ASX: HAW) at a 40-60% split to Legacy, Mt Bevan is said to have excellent potential as a DSO hematite and magnetite development with an indicated resource of 2.26 billion tonnes at a grading of 27% Fe. In June, the company completed a 13-hole AC drilling program to test DSO and nickel sulphide mineralisation with assays pending, but pre-feasibility work is otherwise on the backburner. And no wonder…have you seen what the price of iron ore has been doing lately?

Gold's headed up, iron ore not so much

Legacy has been involved in Mt Bevan since 2011, when iron ore prices were around $170 per tonne and in the same year cooked up a deal to develop it with NMDC, India's largest iron ore producer. As the company's biggest investor (at 78%), NMDC had a plan to invest $18m for 50% of Legacy and underwrite $1.3bn in the project's development, but a decline in prices led the company to pause its strategy. If prices manage to stay afloat in the interim, Legacy and Hawthorne Resources or NMDC could have another opportunity to make something of Mt Bevan, but the company appears keen to weigh-up its options a bit longer.

It's carefully watching the actions of its neighbours and other players, including Juno Minerals, which plans the near-term development of Mt Mason. Juno has previously pointed to Mt Mason's tier 1 potential, which could 'benefit' from other magnetite ventures – a point Legacy has previously considered as the Mt Mason tenement boundary extends into the company's territory.

Until a decision is made for that project, Legacy remains contented with the updated resource at Mt Celia through its pre-feasibility work, with extra attention given to the Yilgangi and Sunrise Bore prospects. Although the company has uncovered four promising induced polarisation (IP) anomalies through its geophysical work at Mt Celia's Kangaroo Bore and Blue Peter deposits, Yilgangi currently has a 18,000-ounce resource and remains highly prospective, which will add much-needed ounces to the entire Laverton hub.

Legacy held $9.7m in cash at the end of June and Mt Celia is the main beneficiary of that since the strong gold price bodes well. But Legacy has also reserved some of that cash for preliminary exploration at its East Kimberly Manganese Project at Halls Creek. The company's efforts at Mt Celia have seen its share price stabilise since about May 2021.

What's in a name?

For the September quarter, the company planned a second phase geophysical IP survey between the Kangaroo Bore and Blue Peter deposits and further exploratory drilling to increase the resource (with particular attention to Kangaroo Bore's strike extensions and IP anomaly). Similar exploratory work will be done at Yilgangi's Rainbow and Golden Rainbow deposits for another resource estimation. A pre-feasibility study is expected to be completed soon aided by Legacy's February capital raise of $3.15m at $0.02 a share, although we expect another capital soon as the company is running low on cash.

As diversified as the company is becoming, with its slide into position as a hopeful gold producer, there seems to be a great deal of speculation from investors on whether it will dust off Mt Bevan and live up to its name. Perhaps Legacy is correct in waiting for the right deal at the right time, but as temperamental as commodity prices can be, investors may also be hoping that the window doesn't close before they have to wait another ten years. In the meantime, we think Mt Celia can gradually lift the fortunes of this well-endowed explorer.

However, it seems the company isn't sure which way to go, and when, so for us it's three stars until we get a sense of direction from the company.

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Share price chart

Source: Tradingview

A quick recap

Back in the 1960s we all knew that things go better with coke. What a lot of people have yet to figure out is that we can't do without it. No, not the carbonated soft drink, but the carbon-dense fuel. Without coke you can't make steel. And without steel…well, that kind of economy just isn't going to happen any time soon. Which means that deposits of coking coal, also called 'metallurgical coal', are going to be valuable long after the last lump of thermal coal gets shipped. What's a coking coal deposit look like? Various things, but above all, it has to have a lot less sulphur and phosphorus content than thermal coal, allowing it to go through the 'destructive distillation' process required to make coke.

For those who have been living under a rock, business in China has shaken things up in the past couple of months. Iron ore dropped because of Evergrande, yet metallurgical coal has risen to record levels even in these contentious times. An unofficial ban on coal imports from Australia took place late last year, causing Chinese companies to scramble for coking coal elsewhere. Mongolia would have been the next go-to, but COVID-related restrictions mean fewer truck drivers were able to go in and out of China. With China having to hunt for new suppliers, the premium they're paying is shooting coking coal prices through the roof. We think that Cokal is positioned well to make a buck off this trend.

Deep in Indonesia's rainforest

The flagship coal project for Cokal, called Bumi Barto Mineral (BBM), covers 14,980 hectares in Central Kalimantan, one of the five Indonesian provinces on the island of Borneo. Cokal owns 60% of the project and it will hit a payday early next year when the first coal is expected to ship. Cokal's logistics to get the coal out involve both previously established logging routes and a river called Barito, which flows through the province into the Java Sea and is wide enough to hold barges. Just recently, Cokal finalised a port site with over 300m of river frontage that has a 'coal reclaim' (i.e. a tunnel to move coal from a stockpile) connected to a 1,000t/h barge loader. The BBM project is Cokal's closest project to the production phase.

The numbers from Cokal's exploration phase are promising and when you consider the current coking coal prices it gets better. If you look at Cokal's 28 September 2021 announcement reporting on BBM's resources and reserves, Cokal currently puts an NPV on the project of $US255.3m based on 23.1Mt reserve (13.8Mt proven, 9.3Mt probable). With only a payback period of 1.1 years, the BBM project has a mine life of 10 years, with average annual EBITDA of A$61.1m. By the end of next year, Cokal thinks it can push out 2Mtpa of coking coal product. This is based on an estimated life of mine coking coal and pulverised coal injection (PCI) product of $US170/t and $US145/t respectively. We think this is quite conservative, with premium coking coal prices reported over $US400/t this year.

The operating costs are slightly higher for Cokal when compared to the best of the bunch listed on the ASX. Cokal's operating cost per tonne is US$107.5/t for coking coal, whereas Coronado Global Resources (ASX: CRN) are currently producing saleable coking coal at $US85.8/t. But we also have to consider that Coronado has a debt of US$236.5m as of 1HY21 with a market cap of A$2.5bn, whereas Cokal only has a debt of US$1.2m and US$20 million owing to a finance facility for the BBM project. With an 85% recovery rate for Cokal's coking coal and no processing required for its saleable PCI product, we still reckon they're decently competitive given its market cap. Oh, and hardly any of this matters if coking coal prices can hold the levels that were established in the past few months. Even if there is a correction, margins will remain handsomely profitable, regardless of operating cost as long as you can find Chinese buyers.

A lump of coal might be a good Christmas gift this year

Dive a bit deeper in the coal world and you find that coking coal is here to stay for a while. Anthony Albanese, Leader of the Opposition and a prominent backer of renewables, has gone on record arguing that there's no replacement for metallurgical coal in steel manufacturing, seeing the industry continuing after 2050.

Lumps of coal from Santa are never a good sign, but that won't stop us from watching Cokal in the next year. With strong coking coal prices, a very low capital cost for their BBM project and defined logistics, it's hard to find a reason not to like Cokal – even if it's not woke. Cokal is well-positioned to profit from the boom, as long as it can find some Chinese buyers. Four stars.

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Share price chart

Source: Tradingview

The Tabakorole Project – the one we're keeping our eye on

Tabakorole is Marvel Gold's new flagship project in southern Mali. The project is continually expanding in size, with a most recent update of 830km2. The nearest town, which you've probably never heard of, is Garalo, in the Sikasso Region. You might have heard of Bamako recently, about 220km away, since that's the capital of Mali. Bamako is currently the epicentre of civil unrest in Mali, with two coup d'états in only the past two years. We probably don't have to tell you that the northern regions of Mali have been facing low-level skirmishes for years as part of the ongoing Mali War, which started in early 2012, but that's a long, long way from Marvel's flagship.

Not only is Tabakorole a long way from trouble, the geology is promising too, being located between the Seikerole Shear Zone and the Bannafin Shear Zone. Shear zones are similar to faults, but they are more ductile and lack brittle fractures. Instead of having a brittle split, shear zones stretch out and deform to accommodate for movements. Geologists have long debated whether shear zones are prime gold deposit land, but the results don't lie for the Bannafin Shear Zone. It's the same shear that hosts 'Morila the Gorilla', the massive open pit mine currently owned by Firefinch Ltd (ASX: FFX), which we wrote about in this publication on 17 December 2020. Morila, you may recall, historically produced in excess of 7 million ounces of gold over 20 years, with one year (2003) seeing output of 794,000 ounces at a ridiculously low production cost of just US$108 per ounce.

Striking out in Mali

On 5 October 2021, Marvel Gold released an upgraded resource announcement for Tabakorole touting an indicated and inferred mineral resource of 26.5Mt at 1.2g/t for 1.025Moz @ 1.2g per ton over a 3.2km strike length. An attractive attribute revealed is that 70% of the mineral resource sits within 150m of the surface, showing that a low strip, open pit mine can be supported.

This upgrade is off the back of some recent drilling discoveries, all within 100m of the surface. During the 2020-21 field season, the company completed a total of 9,995m of drilling consisting of 4,320m of diamond drilling and 5,675m of reverse circulation. Metallurgical test work showed that 90% of the resource sits in fresh rock and bottle roll test work confirmed non-refractory metallurgical characteristics, meaning it can be processed cheaper through cyanide leaching. The test work also showed high gold recoveries range, from 92.7% at 150 microns to 96.6% for 75-micron grind sizes. What all this shows is that, although Marvel Gold is still in its exploration stages and trying to find the perfect spots, it has the know-how to produce cost-effective gold when it's found.

The spin-off episode

Marvel Gold also has 100% ownership of the Chilalo coarse flake graphite project in Tanzania, which it is currently in the process of transferring into a separate company, to be called Evolution Energy Minerals. It's a construction-ready, fully permitted project, with a Definitive Feasibility Study completed. The rationale behind the spin-off is that the graphite asset flew under the radar for investors and they haven't realised the value of it. We think Marvel Gold's Managing Director Hoskin is not wrong, as the 29 January 2020 DFS shows a post-tax NPV8 of US$331m and a post-tax IRR of 36% on a capital cost of US$87.5m. On 26 November 2021, Evolution Energy Minerals listed on the ASX at $0.20 per share.

Variability test work and pilot plant production has confirmed its premium product status, producing high-tier coarse flake distributions. A larger flake size results in better performance in lithium-ion batteries and, consequently, in a higher price. This is all underpinned by an 18-year mine life, producing approximately 50,000tpa of high-value graphite product with an average annual EBITDA of US$74m and a post-tax payback period of 3.5 years.

Money moves

The DFS also confirmed the Chilalo graphite project to be a high-margin operation with the capability to produce three distinct graphite products, i.e concentrate, expandable graphite and micronized graphite. The concentrate production segment shows an average sales price of US$1,534, with a C1 operating cost of US$778/t (margin of US$765/t).

Expandable graphite shows an average sales price of US$5,960/t with a C1 operating cost of US$512/t (margin of US$5,178/t) and micronised graphite is revealed to have a sales price of US$2,802/t with a C1 of US$512/t (margin of US$2,419/t). So, Evolution Energy Minerals definitely has the potential to be a strong graphite player.

What this spin-off means for Marvel Gold, however, is that it will be able to pay off a $9.5m debt, receive $2m in cash and $10m in shares (31% of the spinout) to continue focusing on gold exploration in Mali. This potentially makes Marvel Gold a strong play, both short term and long term.

The economics of the Chilalo project look extremely promising and we reckon it's a safe play considering the future demand for graphite materials. An investment in Marvel can yield sound value from the Chilalo project, whilst still being exposed to the riches that Mali gold (hopefully) can offer. Four stars.

Pitt Street Research Pty Ltd

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