Riding the Bucking Bronco of Latin American Mining

Rodeo riders are often shown getting tossed off the horse and then dusting themselves off and jumping back onto their mount and repeating all over again. That is those riders who are not killed or maimed in the process… This activity reminds us somewhat of investing in Latin America. We rode the broader Latin American equities boom that began in 1990 and hung on like grim death until finally surrendering in 2001. Then we saddled up again after the crash of 2008 and rode the Latin American mining markets.

At one point we were told that there were over two hundred listed Canadian miners operating in Mexico. However this statistic comes with the same type of hyperbole as the “200 listed Rare Earths companies” number that was flying about in that boom. What was undisputed was that LatAm was hot. The enthusiasm was reinforced as the Monopoly game heated up and there was fast and furious M&A that then fed more activity.

Downfall

The shine started to go off LatAm earlier than the rest of the mining market’s decline into torpor. The reasons for this were various. Firstly regimes in the region did not match up with the glowing reports outside consultants had projected and while, in theory, Fraser Institute surveys might have rhapsodized about official receptiveness to mining, the practice on the ground was less welcoming. Bolivia was first into the penalty box, followed by Venezuela’s seizure of Crystallex and the Ecuador indulging in a long and confusing process of changing its mining rules and then its royalties. Argentina was particularly confusing as regulations are devolved to provinces in the 1990s meaning that it had over 20 different mining regimes. That was further compounded by some that were positive, flipped to negative upon the results of a provincial election and then switched back again. La Rioja is a good example of this. Mendoza and Chubut, two particularly mineral rich provinces allowed pressure groups to sabotage and hold up massive mining projects which had some of the world’s largest miners retreating from the country. Ironically the other country most like Argentina in having a proliferation of mining regimes is actually Canada!

The picture was then complicated further by base metals (excepting copper) never really being, post-2008, as sexy as they had been before the crash. Nickel (Brazil), and Lead/Zinc (Peru and Mexico) were way off their highs and never rebounded, except for short rallies that petered out. Copper was at good prices levels (until very recently) but the projects being envisioned burgeoned in size and thus outran the cash available to finance them. This era of gigantism in copper meant that small and even larger projects (like Yamana’s Agua Rica) were left to the side while Great White Whales like Oyu Tolgoi and Tenke Fungurume in other continents became the sexiest objects to pursue.

The Chinese purchase (and then putting in cold storage) of companies such as Peru Copper and Northern Peru Copper meant that some pre-2008 discoveries just disappeared from sight. Not all copper projects died out though as Norsemont’s Constancia is being brought slowly (and expensively) to fruition by HudBay, Las Bambas was picked up by Chinese-owned MMG from Xstrata and Candelaria passed from Freeport into the hands of Lundin. Hoped for projects like that of Baja Mining and Pascua Lama came to grief.

Chile deserves a special mention as the country that has had the steepest fall in my estimation in recent years. While the country has its perennial fans the combination of a persistent energy crisis, a very tight availability of water and the judicial system’s roadblocks to the Pascua Lama project mean it is not the happy hunting ground that many investors thought. This will not be remedied soon. That is why we favour small projects in accessible sites over grandiose schemes in the high Andes.

Time to Saddle Up Again?

Just as we are feeling more bullish about mining in general for 2015, the sentiment has spilled over geographically into my perceptions of Latin America. A microcosm of this is Lundin’s purchase of the long-becalmed Fruta del Norte project in Ecuador (from the hapless Kinross) where the company claims that the government is finally seeing the light (this illumination also coincides with the oil price plunging, surprise, surprise). Elsewhere I would expect Venezuela’s unsustainable regime to finally come to grief as lower oil prices finally give the death knock to Chavismo. Cuba is opening up and its nickel/cobalt riches might soon become accessible again. In Argentina the Kirchner regime stumbles towards its eventual demise. Bolivia is not even as bad as people paint it with mainly private operators getting their heads around how to operate with local cooperatives to come to mutually workable solutions. The country remains as always one of the great treasure houses of silver, lead/zinc, antimony and tin.

With things is such a state of flux, we thought it a good time to dust off an old concept of a Model Latin American Mining Portfolio to monitor the progress of stocks in the region over the coming years and hopefully identify some likely candidates for corporate actions, or recovery from bargain basement pricing, recovering currencies or changed country risk.

The portfolio has twelve names, for starters, with a mix of countries and a mix of names familiar to Investorintel followers, plus some additions that I have long followed. We used a notional amount of US$1.5mn as starting funding. Most of the positions start out at $100,000, though some of the less liquid names are only $50,000 for starters. This leaves us also with a stash of cash to add some extra names in coming months (which shall also happen if cash is freed up by selling a position that reaches its target). We have no Shorts at the moment as everything is so cheap, but showing no fear or favour we shall add some if we find something egregiously overvalued in our wanderings.

Here is the current state of play:

Conclusion

This is just the opening shot. I shall be giving updates on the portfolio from time to time and continue highlighting as always our most favoured stocks, Chesapeake, Largo and Levon. Now all we need is for markets to see the light that things are stirring “South of the Border”.

Silver – Leave Your Tin Foil Hat at the Door

It used to be said that one could judge someone by the company they kept. The problem for those moderately or opportunistically attracted to silver a look around most of the information sources for the metal will find the airwaves jammed with a flock of tin-foil hatted enthusiasts that are obsessed that the Powers That Be are manipulating down its price to get back at them. This is enough to put anyone serious off any metal. Between the gold bugs and the tin-foil hatters, the two metals that should be explicable in the most simple of monetary or store-of-value terms, are periodically turned into sideshow acts with resident freaks.

The length of the current malaise in the two metals has put the conspiracy theorists into a form of shock which has lessened their presence as opinion-formers. Paradoxically one hears more of them on the way up than when silver, for instance, is down in the dumps. On the way up they claim that the Fed/Big Banks/Bilderberg are holding back the rise. When the prices are down they are far more tranquil (usually because they are licking their wounds and wallowing in "I told you so" retrospective justification.

Post Meltdown

We have not been silver bulls for so long it's difficult to remember when it last happened. Definitely we were of that persuasion when it was under $10 per oz. And we were decidedly of the "throw baby out with bathwater" when it soared to $50 in what we thought was a bout of collective insanity. Thus when I started turning bullish last year and predicted an $18 high for this year I thought I was being rather daring. However it was less than two weeks into the year that our target was fleetingly reached. This rapid move was not on any impetus we had foreseen but rather on the back of the surprise surge prompted by the Swiss franc revaluation. Not unsurprisingly the price has slid back in sympathy with gold.

I do however feel silver has the potential to outperform gold. The main rationale behind this is that I don't expect gold to do much better than a high of $1,300 for 2015.. or at least not a sustained period over that level. Meanwhile silver with its industrial applications has the potential to ride economic recovery in the West (yes, I am still a bull on Western economies).

Another thought that has struck me is that while the dip in gold to nearly $1,100 highlighted just how many gold producers were skating on thin ice with really high cash costs that were near the gold price or even higher. The vast bulk of silver producers had cash costs of $9 or lower when silver was a a “lowly” $14 per oz. This in an indisputably good position to be in and even better when one considers the kicker of Zinc, Lead, Copper or Gold that many silver miners have in their mix.

Demand – Three Words

The chief fact we would focus on here is industrial, industrial, industrial. This is almost all you need to know. The whiplash from the declining demand for silver for photographic purposes is now history. The vast bulk of industrial applications for silver carry on and stronger Western economies should underpin and enhance this. The chart below shows the lay of the land. The metal is only reliant for 20% of its demand from investors.

Some Supply Considerations – Investment Drought to Bite

The Silver Institute is the main industry body (read lobby group) and despite what one might expect to be an innate bias, I have always found their silver surveys (which are prepared by the respected consultants GFMS) to be a fairly accurate reflection of what the supply/demand situation is and what it might become. In one of their recent surveys their arguments for a tighter supply situation were primarily:

- Mine supply expected to peak in next 2-3 years
- Current price levels maintaining production but constraining investment in new capacity
- Supply from secondary sources will remain under pressure. Falling from 25% of total supply in 2012 to 16% forecast for 2014

- Hedge book remains at low levels and hedging is not forecast to return to the market in strength
- Government sales are not expected to be a feature of the market in the years ahead

Of these I might note on the first point that a significant chunk of production comes not from primary mines but from secondary production at Lead/Zinc mines which has proven to be rather price insensitive. With a swathe of these mines in decline due to underinvestment in these two metals during their dark phase, silver output should be the collateral damage of their imminent closure. Meanwhile it is hard to think of too many new silver mines that have come out of the gate in recent times. Mexico and Peru have some large known deposits but they remain in limbo more due to the sick state of mining finance markets rather than 415-16 per oz being unattractive levels at which to produce. It's worth noting here that Chesapeake's Metates deposit in Mexico has M&I resources of 518mn ozs of silver amongst its other goodies.

As for government sales, the long serve leakage of silver into the market has come from the Russians. While they have been in financial strees in recent times, they have also been reported as strong gold buyers. With oil not being the "black gold" it was, we would see the Russians selling less silver and instead keeping it for a rainy day. It is not as if the Russian Central Bank feels such a warm inner glow towards holding dollars or Euros these days.

The "Eternal" Ratio

Back in the dim dark past when I was President of the supply-side thinktank, Polyconomics, the resident guru Jude Wanniski commented to me that historically, over the centuries, an ounce of gold had an approximation to the value of a good man's suit (not the suit of a good man). Silver fans would also point out that a historical ratio to gold of 15 to one reigned for many centuries and that even accepting a "new normal” of 50 to one then the silver price is out of whack.

At the moment the Holy Grail for silver “bugs” is to see silver back at the ratio that was “established” when gold crossed $1000 in early 2008 and silver briefly hit $22. It was like all their Christmases had come at once. When gold retreated to $650 in October 2008 silver was back under $10 which was like being blasted back to the Dark Ages for a silver “bug”. In the crash of 2008 the ratio blew out to 83:1.

When the rally in gold began in late 2008 the silver crowd have been rubbing their lucky rabbits’ foot, lighting candles to Macumba deities and dancing naked by the full moon to try and get their ratio down to its true destiny (i.e. 50 to one). Their hopes were more than fulfilled when the spike to $50 in early 2011 took the ratio down to 31:1. Since then disappointment has been their daily meal.

Therefore the ratio at its peak was a tad above 30 to one while at the darkest hour it was back at over 80 to one.

Historically though the ratio was closer to 15 to one over the years when bimetallic currencies ruled (essentially until the end of the 19th century). The hot button issue of US elections in the 1880s and 1890s was the gradual eclipse of silver. Curiously one might even speculate that silver’s relative decline coincidentally (or maybe not) dates back to when it became an industrial metal in the photographic applications. Silver bugs rather ironically are constantly touting new applications for silver (the latest being biocides) while gold’s advocates feel no need to underpin demand with industrial applications, beyond jewelry.

Conclusion

So this is like a golden moment (pardon the pun) when one does not have to be a tin-foil hatter to like (or, indeed, prefer) silver. The supply dynamics are good.. the demand dynamics are also favorable and the price of the metal is not at some crazy unsustainable level. As long as financing remains mired in misery there is NO chance of a flood of new production for 2-3 years AFTER financing avenues reopen. Therefore the secret here is to filter through projects that have special things going for them.

Advanced towards production is a good indicator. Having meaningful Zinc components in the deposit will also open more financing avenues. Good jurisdiction is always a perennial positive. And finally we might mention management committed to producing rather than just promoting. Such unicorns do exist and in coming weeks we shall be hunting them…..

Levon acquires 10% of one of Nevada’s most promising precious metals assets

Last week, the precious metals explorer Levon Resources (‘Levon’, TSX: LVN | OTCQX: LVNVF) announced that the company has entered into an agreement with the emerging gold producer Pershing Gold Corporation to purchase a total of USD$ 9.85 million worth of its shares (35,178,572 ordinary shares). This corresponds to 9.9% of the total. In a separate release, Levon has announced that the company will conduct a private placement of $ 5.4 million to finance this investment, which will include the participation of a number of U.S. investors. Levon is a Canadian gold, silver, zinc and lead and precious metals exploration company that is engaged in the acquisition, exploration and development of natural resource properties in Canada, Nevada and Mexico. Its flagship is the silver, gold, lead and zinc Cordero project, which is located 220 km south of Chihuahua, Mexico.

Levon recently reported that it has completed the fourth phase of drilling at the Cordero property involving 24 core holes testing the Aida claim, located in the middle of the property. Levon has received 14 Assays so far, revealing considerable potential tonnage for silver (Ag), gold (Au), zinc (Zn), and lead (Pb) mineralization, which is present from the surface in and around the Aida claim. Levon also noted that three of the new holes "intersected wide, higher grade mineralization across mineralized volcanic feeder zones at depth within the volcanic Cordero Felsic Dome Complex". Levon will benefit from Nevada's prolific resources. Nevada gold mines represent excellent opportunities because of the quality of the assets and the potential for expansion, which translates to excellent productivity. Pershing is located along the highway, just two hours away from Reno in one of the most active mining jurisdictions of North America. Moreover, Pershing has a fast-track to the production phase because its project is based on reviving the Relief Canyon mine (three open-pit mines and a modern and ready to operate – permits included – heap-leach processing facility). Pershing's assets include a total of 25,000 acres of land covering the Relief Canyon mine and all of the surrounding territory; its former owners abandoned the project.

The Relief Canyon was once known as the 'Batavia and Pacific Mine' and its production history goes back to 1869 when silver ore was extracted. Gold would be discovered there 110 years later in 1979 and Lancana Mining started gold extraction in 1984. After a series of owners, Firstgold Corp. (with Chinese financial backing) tried to take over the mine in 2008 but the US federal Committee on Foreign Investment denied the deal, claiming that the mine was too close to a sensitive national security asset (the Fallon Naval Air Station) to support a foreign entity. Creditors took over the asset from Firstgold, which had to declare bankruptcy, who then sold the asset to Pershing in 2011 after a thorough review of the mine's history. It happens that the mine has an excellent production record even as it is located in a territory that has been under-exploited leaving many new exploration targets. Pershing is counting on the mine's combination of fresh exploration potential and existing productive assets as the basis of its appeal to investors. Pershing can also count on an experienced geological and engineering team and a turnkey and current crushing and leaching facility. Through Pershing, Levon has buttressed its already high potential Mexican operations with one of the most promising resources in the United States.

Mexican authorities have been generous with Canadian (and others) firms , encouraging them to invest in Mexico's best precious metals mines, imposing relatively few controls on production and offering many concessions covering an area close to 100 million hectares, most of which available in the prolific States of Chihuahua, Zacatecas, Sonora and Durango. Chihuahua alone accounts for 17% of Mexico's gold production. As Mexico and Nevada prepare for increased gold production and exploration, China, which has recently become the world's largest gold producer, will be cutting back output significantly in the coming years. Chinese miners are concerned by their lower profitability as gold prices remain below expectations. However, the slowdown in China is welcome news to miners elsewhere, because while Chinese gold production may experience a setback, Chinese gold consumption remains high, which translates to an increasing dependence on imports in order to satisfy demand. Chinese gold miners may also be targeting overseas projects to address this demand, which can only increase the value of gold companies holding interesting assets with superior exploration potential and convenient infrastructure such as the ones held by Levon. The history of the Pershing asset certainly testifies to this. In 2007, China had become the largest gold producer in the world, surpassing South Africa and in 2013, China overtook India as the largest gold consumer.

Mexico's mining sector growth has also been encouraged by political and financial stability and from its proximity to the United States. Even when the US economy is lagging, Mexico also manages to secure strong export of its minerals to China. Indeed, demand from China will continue to stimulate the Mexican mining sector as the Asian giant is investing heavily in Latin America. Currently, China is the largest gold, zinc and lead producer but if it wants to continue its industrial development, it will be forced to consume more than 50 % of major mineral commodities in the world in the next decade. Moreover, China is also trying to contain environmental pollution deriving from several mining activities – most famously rare earths – so it will need to find alternative sources beyond its borders. Levon is certainly in a position to benefit from just such demand. Indeed, to meet Chinese demand, the global market is witnessing a phenomenon of mergers and purchases from Chinese mining companies, which has significantly affected the Mexican market. For example, the Jinchuan Group Ltd made an offer for Tyler Resources' proposed copper, zinc, molybdenum, silver and gold in the state of Chihuahua. It is very likely that Chinese investors will be looking to buy more companies.

The need for raw materials in the world is growing and in fact many projects are underway in Mexico. Canadian companies like Levon are well positioned to meet this demand. Mexico has an open market economy with a skilled workforce and has signed several free trade treaties such that it has a free trade agreement with 41 countries. Mexico is a signatory to the North American Free Trade Agreement (NAFTA) with Canada and the United States which entered into force in 1994 liberalizing trade between the three countries.

Levon Resources could benefit from growing Chinese demand for Mexican minerals

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Mexico has a centuries' long mining tradition; even before the arrival of the Spaniards, and until today. It stands out for its production of silver, gold zinc and lead among a host of other high demand metals. Mexico is the largest silver producer in the world, accounting for some 17% of global production. Mexico, moreover, has enormous potential for mining growth. Only 20 % of the territory has been explored and geological studies indicate that two-thirds of Mexican territory contains ore deposits at least as important as the ones that account for most of current production. Levon happens to be located in one of Mexico’s most prolific mining areas, the state of Chihuahua. The mining sector also has a privileged position in government support because it is considered an important engine of economic development in the country. The growth of the Mexican mining sector is mainly due to the increase in prices of several metals and minerals in the 2008-2009 period but there is renewed interest in gold and silver investments prompted by a new ‘gold rush’ in North America – especially in the Canadian Province of Quebec and – very likely – in Ontario.

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