The “Gran Madre” of Zinc Deposits – Chesapeake Gold

We have long held that Zinc was going to be one of the top metals of the decade and in just a year of recovery it has gone from being lodged perpetually in the doghouse to being the go-go metal of the day, certainly leaving the precious metals floundering in the dust. Zinc’s move has been one, at least for me, of thresholds. The first one, as it rose from its nadir around 66 cents per lb was when its price surpassed that of Lead. This was always regarded as a prime bullish signal by myself. The 90 cent mark was the next key trigger, then with some trepidation it breached the $1 mark and dallied around that area threatening a pullback. Then it moved on to the key $1.10 level which it has bounced off so many times in the past. The Zinc “glass ceiling”, so to speak.

Passing $1.10 did not seem to be so troublesome after all, which in itself is a very bullish signal, and in recent days the price looked poised to make a run at $1.20. In the past I have spoken of this at the price above which Zinc must remain for many months before serious investment decisions will be made on advancing projects that have been stuck on the drawing board for so long. It would also be the trigger for de novo listings of primarily Zinc oriented plays. Stablised above $1.20 most mothballed mines would return to production.

Moving Target

The rapidly shifting Zinc price is making havoc (in a good way) with what some developers think is the real gem in their deposits. The severe underinvestment in Zinc exploration and even less on development since the highs of 2006-7 have left the pipeline dry. This means that large scale Zinc projects are somewhat serendipitous, or maybe I should say coincidental, as they are the offspring of other types of projects.

In trawling around in search of the “next big thing” in Zinc, I keep circling back to Chesapeake Gold Corp.’s (TSXV: CKG | OTCQX: CHPGF) Metates project in Mexico. Its sheer size in Zinc reserves makes even primary Zinc-Lead projects pale into insignificance. And yet as Zinc has gone from strength to strength, the price of CKG has slipped back substantially from its mid-year highs. Certainly gold has gone off the boil and silver has retreated somewhat, but Zinc has continued to surge.

However a glance at Reserve statement for Metates shows a truly massive Zinc component of nearly four billion pounds. At a Zinc price of $1.20 then that is an in situ Zinc value of nearly $4.8bn.

Then if one looks at the Zinc metal flows a projected in the revised PFS from earlier this year one sees an impressive flow by any measure that will make a meaningful contribution to world production of Zinc. Moreover the deposit kicks out a very strong Zinc performance right from its early years after a steep escalation.

Conclusion

In a market that is crying out for major new Zinc projects to fill the pipeline into the 2020s, the Metates deposit is the 800lb gorilla that might just be the solution to the problem. Having such an abundance of the sexy base metal of the moment is not enough if the development also needs the gold price to come to the party but as we can see from the price scenarios outlined below the company wasn’t factoring in the current Zinc surge when setting its “high case” (below) when it shot for $1.12 being the Zinc high. It is far more likely we feel that we will see Zinc at $1.50 before we see gold at $1,400 so there is a case here for an announcement on how they might impact revenues with base metals (there is copper here too) being a larger part of the revenue mix.

The model above has been confounded by circumstances because we have Silver trading at lower than the low case, Gold slightly below the base case and Zinc now above the high case.

Potential acquirers of Chesapeake are probably of the school of thought that gold is going higher anyway. Having the added extra of Zinc having stabilised its price after such a long period of weakness should be a major consideration. It also adds some extra underpinning if the Zinc production can be forward sold (to a trader) rather than the gold or silver (to a streamer).

Those out there in the investment community hunting for the next major primary Zinc mine might be in a fruitless search for a unicorn of their own imagining. The next best thing… and a truly massive thing ..is the Metates project. Its potential to be one of the largest Zinc contributors coming down the pike cannot be ignored.

Alix Resources – Outdoing

Bacanora?

My view that Bacanora (TSXV:BCN) was a Short has been borne out by the long slide in its stock price. As the Lithium space has become hotter, the enthusiasm for BCN has become cooler. As we have said before “he who lives by the Tesla, dies by the Tesla”. We never liked the ramping associated with the deal “done” with Tesla as it essentially meant nothing. If Tesla were not putting up any money the onus still fell back on the marketplace and investors to fund this project and it is indeed a worthy project.

The Sonora Lithium project is in a good location to service US needs for Lithium and indeed extrapolating past experience with NAFTA it may be the basis for North American processing of Lithium to be established south of the border in a big way.

Ironically with our hedge fund manager thinking cap on we would have said that Bacanora was a potential for a classic Pairs trade, going Short Bacanora and Long its close and undervalued neighbor in same zone, Alix Resources (TSXV:AIX). Alix Resources main asset is the Electra Project, which borders Bacanora’s territory to both the north and the south. This first came to our attention via our work on Lithium Australia (ASX:LIT) that has bought in just at the cusp of Alix beginning work here.

The Deal with LIT

In recent weeks, Alix Resources has announced the signing with Lithium Australia of an option agreement to jointly to develop lithium extraction technologies applicable to advancing Alix’s lithium concessions in Mexico. The deal is multi-stage with the terms being a first phase in which LIT may earn a 25% interest in the project by:

- Issue of 500,000 ordinary LIT shares to Alix
- Issue of 500,000 partly paid LIT contributing shares paid to A$0.0001 each (A$0.2499 unpaid) to Alix
- Expenditure of AUD$150,000, spent entirely on phase one work
- LIT to subscribe for CAD$100,000 private placement in Alix Resources at CAD$0.05 per share with a full CAD$0.075 one-year warrant

During this phase Alix will be the operator. Then in a subsequent phase LIT can earn a 49% interest in the project by:

- Issue of 500,000 ordinary LIT shares to Alix
- Issue of 500,000 partly paid LIT contributing shares paid to A$0.0001 each (A$0.2499 unpaid) to Alix
- Expenditure of a further AUD$250,000 within 12 months of signing. Alix – LIT combined board to agree on scope of work, LIT to have deciding vote.

Following upon that, LIT might up the ante to a 65% interest in the project by:

- Issue of 1,500,000 fully paid ordinary LIT shares to Alix
- Expenditure of a further AUD$1.1mn within 24 months of signing. Alix – LIT to manage all work program facets.
- Cash Payment of AUD$250,000

LIT will have to gain shareholder approval for the stock issuances in the first phase due to no placement capacity, EGM to be held within 60 days of this term sheet.

Clearly if there is something to be found here then for a relatively modest price LIT will get its hands on control and Alix will be along for the ride.

Lithium Australia is clearly trying to leverage its rather unique work with Lithium silicates (particularly micas) in

Australia onto a broader stage. The opportunity to partner on a deposit with a similar mineralogy in Mexico was too good to let pass, and clearly Alix, as very much a junior in the exploration space needed a big brother to supply the skill sets and technology to augment its credibility.

Work Plans & Geology

The first phase of the work program will commence on the Tule Concession this month and will focus on two initial, high priority targets determined by Alix geologists.

Alix reported the discovery of sedimentary beds on its Tule Concession similar to, on trend and correlating with, geological units which host Bacanora’s La Ventana deposit. The exploration program completed by Alix on the property in December included sampling which returned moderately anomalous lithium values from the portion of the concession area that Alix has prospected to date.

The Electra Project consists of two large exploration concession applications covering 22,625 hectares, with one adjoining Bacanora Minerals’ Sonora Lithium Project to the north and one to the southern end, as shown in the map below:

Alix’s Tule Concession, comprises 18,125 hectares (approximately 15 kms east-west by 12 kms north-south), covers the extension of three lithium-bearing horizons, as outlined in recent Bacanora presentations.

The mineralised trend on the Bacanora property has been interpreted as extending approximately 15 kms SSE from the La Ventana Lithium deposit to the location of another lithium prospect, and at least an additional 12 kms from this point, towards Alix’s Tule Concession.

Alix’s Tecolote concession is located north of the Buenavista

Concession at Bacanora’s Sonora Project and north of the village of Huasabas. The property covers approximately 4,500 hectares. Intercepts from 11 of the 24 reverse-circulation holes drilled at the Buenavista Concession returned values in excess of 1,018 ppm Li and as high as 2,210 ppm Li (equivalent to 0.54% and 1.18% LCE respectively) in a lithium-rich stratigraphic trend interpreted by Bacanora to extend north, through Alix’s Tecolote concession. This concession covers approximately 7 kms of this interpreted stratigraphic trend.

The host rocks on the Buenavista concession are calcareous, fine-grained sandstone to mudstone intercalated with tuffaceous bands that are locally gypsiferous. The stratigraphic controls and strong bedding of the volcano-sedimentary sequences are projected to be traceable for long distances north of the Buenavista concession.

Mexican Lithium Geology

In 1992, US Borax commenced an exploration program in the area, which led to the discovery of some weakly anomalous boron showings which also were high in lithium. US Borax abandoned exploration in the area shortly thereafter.

The project area is underlain by Oligocene to Miocene age rhyolitic tuffs, ignimbrites and breccias of the upper volcanic complex of the Sierra Madre Occidental. This succession was subjected to Basin and Range extensional normal faulting during Miocene times that resulted in the development of a series of half-grabens. The half-grabens are locally filled with fluvial-lacustrine sediments and intercalated tuffs that contain lithium-bearing clay units. Quaternary basalt flows cover the basinal sediment-volcaniclastic succession.

In Mexico, Lithium-bearing hectorite and polylithionite clays crop out of a volcano-sedimentary sequence located near the towns of Bacadehuachi and Huasabas.

The Sonora Lithium Project

It is useful to look across the boundary line at the Sonora project to get an idea of what might await the AIX/LIT JV. The Bacanora package consists of ten mining concession areas covering approximately 100,000 hectares in the northeast of Sonora State. It is managed by a Joint Venture between Bacanora Minerals and the AIM-listed Rare Earth Minerals.

The JV partners, through drilling and exploration work to date, published in November of 2015 an NI43-101 Indicated Mineral Resource estimated at 364 Mt, averaging 2,600 ppm Li for 5.0 Mt of LCE, in addition to an Inferred Mineral Resource estimated at 355 Mt averaging 2,000 ppm Li for 3.9 Mt of LCE.

The attractions of the Sonora project are various but its main advantage is the clay nature of the mineralisation and the fact that this is relatively near surface (though with a basalt cap over much, but not all, of the deposit).

Below is a cross-section of Bacanora's deposit, which shows that the clay zones were created as per the previously mentioned weathering and breakdown of the mica, and then overlain by volcanic activity with a basalt cap.

Clearly, Alix and LIT are targeting the same type of occurrence on their adjoining concessions.

Girding the Loins with a Financing

In recent weeks the company announced a non-brokered private placement of up to four million units at a price of $0.05 per Unit for aggregate gross proceeds of $200,000. Each Unit will be comprised of one common share and a full warrant. Each warrant is exercisable at $0.075 per Share for a period of 12 months. Proceeds will be used for general working capital and to advance the Mexican assets.

At the same time Alix announced it had licked its balance sheet into shape as it settled a total of $80,000 of debt with a non-arm’s length creditor in the amount of $50,000 and an arm’s length creditor in the amount of $30,000. These matters were settled by issuing an aggregate of 1,600,000 Shares at a deemed price of $0.05 per share to the creditors.

Conclusion

Much to our surprise running a one year comparative chart of Alix against Bacanora shows Alix coming out on top. This looks rather like a Hare & the Tortoise-type story. Tesla is obviously something of a two-edged sword for Bacanora’s promotional efforts.

At this point we are looking forward to Bacanora getting back to basics and moving its project forward. There is clearly potential to move Mexico into the column of Lithium producing nations and now the race is on to see if Alix can overhaul Bacanora or whether Bacanora will move on Alix to consolidate its territory further. Either way, Alix shareholders win…not to mention LIT coming out a winner also. Then again we might speculate on Alix being folded into LIT as some juncture.

Lithium boom moves to Mexico

In the first flush of the Lithium boom, Latin America featured prominently but Mexico was not one of the countries mentioned in dispatches. Mexico has only bubbled to the surface in recent times with Bacanora Minerals (with its Sonora project) getting airtime due to its “offtake” with Tesla, which we wrote about at the time. As is well known I am a sceptic on Tesla as an auto maker and only slightly less so on Tesla as a battery maker. However, all is fair in love and war and if Bacanora can get a leg up by doing some sort of mutually promotorial deal with Tesla then more strength to them.

If Bacanora achieved nothing else they have shone a spotlight on a hitherto unnoticed area and in the process brought attention to another scarce-noticed TSX Venture listed entity, Alix Resources (TSXV:AIX). That in turn has brought one of the most adventurous Lithium explorers to Alix’s door in the form of Lithium Australia NL (ASX:LIT), a company that I have also written of under its former nomenclature as Cobre Montana. LIT has the Lepidolite Hill Lithium mica deposit in Western Australia and the Lithium/Tin deposit at Cinovec in the Czech Republic.

In the latest development, LIT has announced the signing with Alix Resources Corp of a memorandum of understanding to jointly to develop lithium extraction technologies applicable to advancing Alix’s lithium concessions in Mexico. Here we shall look at the specific properties and at Lithium clays, the predominant mineralisation at the Mexican deposits of Alix and Bacanora.

Lithium Clays

Most of us are accustomed to saline lakes (*salares*) and spodumene (hard rock) as Lithium host mineralisations however, Lithium, in small amounts, is widespread in clay minerals. The USGS is one of the few bodies to have highlighted this due to the US once having had a producing Lithium mine based on clay. Lithium may be present in clays as impurities, as inclusions, in lattice cavities, adsorbed on the surface, or by isomorphous substitution. Isomorphous substitution is the most common occurrence. The clay containing the largest amount of lithium is swinefordite, but this mineral is found in only one location. Hectorite, a trioctahedral smectite, can contain a large amount of lithium and is not uncommon in arid regions. There is one TSX-listed Lithium hunter that has long championed a hectorite deposit in the US Southwest.

The USGS states that two potential origins have been postulated for hectorite: hydrothermal alteration of a montmorillonite, which was suggested first and is valid in some cases, and direct precipitation in saline lakes, which has gained support in recent years.

The Lithium is liberated, according to the USGS, through the degradation of micas, by weathering, through illite to mixed-layer clays and then to smectites. The lithium is not carried to the montmorillonites during this transformation; because it is highly mobile, it is soon weathered out of the mica and either is carried away in solution or remains to be incorporated into the structure of newly formed clay minerals. The ubiquity of micas suggests that they should be considered as the carriers of lithium in clay mixtures. The micas may be so fine grained that they cannot be separated from other clay minerals and may not be recognized, unless the clays are given a very close examination by X-ray powder diffractometry and other methods.

In Mexico, Lithium-bearing hectorite and polylithionite clays crop out of a volcano-sedimentary sequence located near the towns of Bacadehuachi and Huasabas. A glance below at a cross-section of Bacaonora’s deposit shows that it would appear that the clay zones were created as per the previously mentioning weathering and breakdown of the mica and then overlain by volcanic activity with a basalt cap.

Clearly Alix and LIT are targeting the same type of occurrence on their adjoining concessions.

Surfacing Down Mexico Way

This brings us to why Lithium Australia has taken a shine to Alix Resources's so-called Electra Project in Mexico. This consists of two large exploration concession applications covering 22,625 hectares with one adjoining Bacanora's Sonora Lithium Project to the north and one to the southern end.

LIT has bought in just at the cusp of Alix beginning work here. The first phase of the work program will commence on the Tule Concession this month and will focus on two initial, high priority targets determined by Alix geologists.

The Tule Concession, comprised of 18,125 hectares (approximately 15 kilometers east-west by 12 kilometers north-south), covers the extension of three lithium-bearing horizons as outlined in recent Bacanora presentations.

The mineralized trend on the Bacanora property has been interpreted to extend approximately 15 kilometres SSE from the La Ventana Lithium Deposit to the location of another lithium prospect, and at least an additional 12 kilometers from this point, towards the Alix Tule Concession.

The Tecolote Concession is located north of the Buenavista Concession at Bacanora's Sonora Project and north of the village of Huasabas. The property covers approximately 4,500 hectares. Intercepts from 11 of the 24 reverse-circulation holes drilled at the Buenavista Concession returned values in excess of 1,018 ppm Li and as high as 2,210 ppm Li (equivalent to 0.54% and 1.18% LCE, respectively) in a lithium-rich stratigraphic trend interpreted by Bacanora to extend north, through Alix's Tecolote concession. Alix's concession covers approximately 7 kilometers of this interpreted stratigraphic trend.

The host rocks on the Buenavista concession are calcareous, fine-grained sandstone to mudstone intercalated with tuffaceous bands that are locally gypsiferous. The stratigraphic controls and strong bedding of the volcano-sedimentary sequences are projected to be traceable for long distances north of Buenavista concession.

The Sonora Lithium Project

It is useful to look further at the Sonora project to get an idea of what might await the LIT/AIX JV. The Bacanora package consists of ten mining concession areas covering approximately 100,000 hectares in the northeast of Sonora State. It is managed by a Joint Venture between Bacanora Minerals and the AIM-listed Rare Earth Minerals.

The JV partners, through drilling and exploration work to date, established an NI43-101 Indicated Mineral Resource of 1.12mn tonnes LCE contained in 95mn tonnes of clay at a Li grade of 2,200 ppm and an Inferred Mineral Resource of 6.3mn tonnes LCE contained in 500mn tonnes of clay at a Li grade of 2,300 ppm.

The Sonora PEA

Its also useful to look at the PEA for Sonora to get a look at the potential economics should LIT/Alix find something similiar (or better). The Sonora Lithium Project Partners have been working to develop a l mine and processing facility that will have an initial production capacity of approximately 35,000 tonnes of lithium compounds, with the scaling potential of up to 50,000 tonnes per annum.

It is currently anticipated that lithium hydroxide and lithium carbonate would be among the materials produced by the mine. Lithium hydroxide is a key feedstock material in the manufacture of certain kinds of lithium-ion battery cells.

The metrics from the PEA are below and the capex is truly impressive for being as low as it is:

The attractions of this project are various but the main advantage it has is the clay nature of the mineralisation and the fact that it is relatively near surface (though with a basalt cap over much, but not all, of the deposit.

Conclusion

Lithium Australia is clearly trying to leverage its rather unique work with Lithium clays (particularly micaeous clays) in Australia to a broader stage. The opportunity to partner on a deposit with a similar mineralogy in Mexico was too good to let pass and clearly Alix, as very much a junior in the exploration space needed an elder brother to bring it the skillsets and technology to get some credibility or risk languishing as just another wannabe. The blessing of LIT bestowed upon the two Mexican properties certainly leapfrog's Alix's prospects up the credibility scale at this time and will definitely be something to watch "south of the border".

Mexican Silver Miners – a Piranha Pond in the Making

With the pace of takeovers hotting up in the stricken mining industry even the most cashed-up companies are coming under scrutiny as potential targets. While there are thousands of miners out there only a few hundred are likely targets as the rest do not have worthwhile projects, attractive metals or jurisdictions or enough cash on hand to overcome the aforementioned shortcomings. If we are looking at projects as the key asset of the prey then the project generally has to be hyper-economic and also very advanced. Applying all these criteria narrows down the field substantially. Being a producer is a trump card that makes any miner worth considering.

However, to review all the potential victims is a herculean task so in this commentary I shall look mainly at Mexican plays in the silver business and review what combinations could be imagined.

First Majestic/Silvercrest

The first shot in the battle for consolidation was fired by First Majestic and hapless Silvercrest shareholders have come out worse for the wear. FM extracted an outrageous $8mn termination fee out of Silvercrest when usually break-up fees are related to the cost of the acquirer in the event the transaction falls through. There is no way that First Majestic will be $8mn out of pocket in legal fees for a plain vanilla takeover…

Therefore, Silvercrest has locked itself in a room with First Majestic and then swallowed the key. This is an effective way to scare off other predators but considering that FM is getting the better of the deal in any case, management at Silvercrest have not done their own shareholders any favours by refusing to countenance other bidders. All in all, it is an odious deal. However just because Silvercrest does not know how to do a fair deal, does not mean that other management's in the space are as hapless.

Conjuring with Some Names

The fall of Silvercrest to the predatory blandishments of First Majestic leaves Great Panther and Fortuna Silver as the main "unattached" silver plays in Mexico. As we have made clear elsewhere we would have viewed a Silvercrest/GPR tie-up as infinitely preferable to what has played out. Interestingly both of the remaining prospective targets are both Mexico/Peru plays now. A tie-up between Fortuna and GPR is an interesting concept to conjure with. One might also muse upon the possibilities of Hochschild (HOC.L) combining with one or both of these entities. Farther out in left-field is Sierra Metals (the former Dia Bras), the ARC Capital entity, which is also ensconced in Mexico and Peru and very well-cashed up. However, it is also too much inclined to thinking it can seize control without a takeover premium being offered and various of its plays (e.g. Largo Resources) show it may not be mistaken.

Great Panther Silver – Tasty & Vulnerable

One of our "best in class" picks in the silver space is Great Panther Silver, which has recently diversified into Peru by buying Nyrstar's Coricancha silver/lead/zinc mine there. With a tidy $18mn in cash in the bank and several producing silver mines in Mexico (one with meaningful base metals) the company strikes us as a target in waiting. The only pity is that it did not move on Silvercrest (or vice versa) before First Majestic started snooping about.

With production hitting records in recent quarters and cash costs declining steeply the company has all the look of an accretive target for a predator.

The current valuation of GPR surprisingly does not contain one iota of takeover premium and this is frankly ridiculous because the Silvercrest deal shows that bottom-fishers are trawling the waters looking for lone surfers to pull under if the valuation is low and the prospects sound. GPR fits both those criteria.

Hochschild – Aristocrats of Peruvian Mining

This company is a strange animal. While London-listed it is actually a Peruvian company owned by a very long-established Peruvian family, famous in base metals circles. The company has mines in Peru, Argentina and Mexico. It seems that there is a quite a Peru-Mexico axis apparent in a number of these players. This might have to do with both countries having such a strong history of mining amongst local entrepreneurs.

With a market cap of GBP £312mn at the current time it is a company with the heft to be a predator rather than mere prey. Therefore Great Panther could be a tasty morsel for it to munch on and digest easily. It would provide a significant beefing up of its Mexican position and its Peruvian expertise could be put to work on moving Coricancha forward.

Another target could be Fortuna Silver. Ironically this company's best asset in Peru was a 'throw-away" of Hochschild's that became a company-maker for Fortuna.

Fortuna Silver – Needing More Projects

This TSX-listed company is also Peruvian owned and managed. It started out with some starter mines in Peru and then added an off-the-beaten-track mine in Oaxaca in the south of Mexico, where Canadian miners scarcely ever ventured. However with a market cap of over CAD$540mn, it would virtually be a merger of equals if it combined with Hochschild and then one wonders whether two powerful Peruvian families could get on together or would it be a case of "this town is not big enough for the both of us"?

Acquiring Great Panther would be a good move for Fortuna as it would diversify the company further as it currently only has two mines. The current market cap of Fortuna though makes it an unlikely takeover candidate unless it came into the sights of a group like Pan American Silver. However that company has been licking its wounds for a long time after a series of ill-fated purchases.

Sierra Metals – Stealthy Mover

This company has shown little inclination to doing its deals in public. Creeping acquisitions are its management group’s forte with unsuspecting shareholders never knowing they are about to get eaten until the fangs sink in. Once again this company is run by a scion of an old Peruvian mining family in the guise of a New York private equity fund manager by way of the investment banking world.

This company is most definitely not afraid of base metals as it has mines in both Peru and Mexico that are predominantly in lead, zinc and copper but all with precious components in the mix. The group was cobbled together out of Dia Bras (which had been a case of creeping takeover and then with a daring move on a company listed on the Lima stock exchange in 2011, the Yauricocha mine was brought on board. This in itself shows that ARC is not above making a bid when it really wants something.

With a market cap of over CAD$350mn Sierra also could indulge in a merger of equals with Hochschild or Fortuna but again the issues of “Latin Families” comes into play. No such problem picking off Great Panther though.

Nieves – Out of Sight but Not Out of Mind

It’s worth mentioning one unlisted asset which is the Nieves property that was owned until recently by Quaterra. This is now ensconced in a private US group called Blackberry. It has long been one of the most interesting assets we have encountered in Mexico, however under Quaterra’s benign neglect it was going nowhere and missed the opportunity to be sold when silver hit $50 back in 2011. When silver next gets going we suspect that this shall be on a number of companies’ shopping lists.

Silver Bull – a Play for Base Metal Hunters

Passing mention might be made of this unfortunately named small cap company which we met and liked when it was called Metalline. It owns the Sierra Mojada property in Mexico. New management (when we last met them) didn't leave us super-impressed. However, it might be worth any of the names conjured with here taking it over (particularly Sierra though) and most likely this will happen when the Zinc/Lead shortage starts to really bite and it is reflected in metal's prices.

Conclusion

All this talk of merger-mania makes us feel hungry. Nothing like a bit of blood in the water to attract the sharks or the piranha at least. The names to ponder are not as numerous as in the past but still there are some which are still so undervalued as to provide a bit of takeover premium, a scarce commodity these days.

The Silver Mergers – a Zero Sum Game

For centuries, indeed millennia, churches told their followers, particularly the poor and the meek, that they should not look for a reward for their sufferings in this life, but in a later life. Then in the middle of the 19th century the poor came to their senses and decided that Marx's description of religion as the opium of the masses might actually have some truth in it. The poor have not been so meek and accepting of their lot in life ever since, or at least not in the West.

I was reminded of this philosophy of accepting your lot and awaiting a very much delayed reward when I initially encountered First Majestic Silver in New York back last decade. Frankly its “gospel” stuck in my craw more than most. Basically it was a story of a never ending spiral of added ounces in resources and production rising on the back of this. However it struck me as thin gruel so I had the temerity to ask the question “what about a dividend?’.

Now I knew what Oliver Twist felt like when he asked “Please sir can I have some more?” I was told that the investors’ reward was going to be in higher valuation not in mere piddling dividends. To the crowd of New Yorkers this supercilious approach from management did not go down well. Believe it or not there are investors out there who think that a dividend is a good thing. Maybe there is also good reason why the company rarely (never?) showed its face in London where a dividend is *de rigueur* for a producer in any metals. In Australia one is run out of town when production starts if one thinks one does not need to share the largesse with shareholders through an annual (or more frequent distribution).

Time Rolls On

Fortunately for First Majestic there were enough Canadian investors who were prepared to put up with not even getting a “widow’s mite” and the company was able to wash and repeat with generations of punters happy to let management get paid while they did not.. If reward in some financial afterlife was so great then why didn’t management work for free as well, taking their reward only in shares?

The problem for those who did believe this story is that the stock is now wallowing near decade-lows down from over $25 when the NY crowd was told “heaven can wait”. *Seems more like hell to us..*

Spreading the Joy

So now we have First Majestic in its latest announcement saying that it has agreed a friendly merger with Silvercrest. The latter is a stock we have liked in the past.

If approved, SilverCrest's Santa Elena Mine would be First Majestic's sixth producing silver mine, with the mine projected to produce in a range of 4.7 million to 5.1 million silver-equivalent ounces in 2015.

First Majestic had recently claimed that its five operating mines in Mexico produced 3.8 million silver-equivalent ounces in the second quarter and are on pace for production of between 15.3 million and 17.1 million in 2015.

Under the agreement, First Majestic would acquire all of common shares of SilverCrest for 0.2769 of a share of First Majestic plus C$0.0001 in cash per SilverCrest common share. First Majestic would issue approximately 32.8 million common shares, assuming no exercise of existing SilverCrest options, valuing SilverCrest's equity at approximately CAD$154 million (or a value of C$1.30 per SilverCrest share). After the transaction, the current shareholders of SilverCrest would hold 21% of the outstanding shares of First Majestic.

About the only consolation is that shareholders of SilverCrest will receive shares in a newly formed company, New SilverCrest, which will hold certain exploration assets currently held by SilverCrest and First Majestic.

What SVL Holders are Getting

Well may SVL shareholders ask who is rescuing whom here? First Majestic's statement of first quarter highlights stated:

- Generated revenues of $54.6 million
- Mine operating earnings amounted to $5 million
- Net earnings after taxes amounted to a loss of $1.1

million or earnings per share of ($0.01)
- Adjusted earnings per share (a non-GAAP measure) of $0.00, after excluding non-cash and non-recurring items
- Cash flow per share (a non-GAAP measure) of $0.15
- All-in sustaining cost was $13.88 per payable silver ounce
- Total cash cost, net of by-product credits, was $8.22 per payable silver ounce
- Average realized selling price for silver was $17.05 per ounce compared to the quarterly COMEX average price of $16.70
- Cash and cash equivalents of $22.4 million held at the end of the quarter this was down from $40mn at the start of the quarter.. yikes..

After the end of that quarter, First Majestic completed a CAD$30 million bought deal private placement, issuing 4,620,000 common shares at a price of CAD$6.50 per share (of which holders have lost a third of their money already). Wasn't the reason for NOT paying dividends that the company would be self-financing? Seems not…

The progression of results in recent years was a profit of $103mn in FY11, down to $88.9mn in FY12, then a fall into a loss of $38mn in FY13 and a loss of $61mn in FY14.

Conclusion

Going all biblical we may ask "What profiteth it a man to produce 20 million silver ounces per annum and have so little to show for it?". Our memory is fuzzy but we cannot remember the word for a type of scheme where the first investors in take their money out and then those attracted by the story of the first ones' profits throw their money in but alas find diminishing returns and ultimately can't get out when they find the exits blocked by debris. Any suggestions?

Meanwhile if First Majestic can provide us with a compelling reason to think that this company will ever bear fruit (for shareholders) in this lifetime then we might be tempted to overcome our long-held (and justified) wariness of the story. Silvercrest can probably do better.

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”.

Levon Resources – Ticking All

the Boxes in Resurgent Metals

The last time I wrote on Levon Resources (TSX: LVN | OTCQX: LVNVF) the silver price was looking insipid and the Zinc price was on a tear. That had caused investors to focus more on its Bralorne project in British Columbia and only glance in passing the massive (in all senses) Cordero Silver project in Mexico. Now that silver has broken out of its malaise, we thought it useful to go back and consider the ways in which Cordero could tussle with Bralorne to be first in the affections of those that find the Levon story fascinating. Clearly this would be by some sort of reconfiguration to match the current financing situation and capture the imagination of investors by placing the project firmly in the camp of "doable" mines.

Silver's Moment to Shine?

We started turning bullish last year and predicted an $18 high for this year we thought we were being rather daring. However it was less than two weeks into the year that our target was fleetingly reached. This surprise surge was prompted by the surprise Swiss franc revaluation and was thus not enduring as a game-changer. Not unsurprisingly the price has eased 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 number. 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).

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 “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.

Some Background on Cordero

Levon began its exploration of this deposit during February 2009 under a joint venture agreement with Valley High Ventures, Ltd (VHV). Large scale, early reconnaissance mapping by Levon lead to the re-staking of all available lands in August 2009, which doubled the land position to about 20,000 hectares (200 sq kms). The staking was guided by geologic mapping, which defined the existence of two large scale belts of porphyry mineralization showings the Porfido Norte Belt and the Cordero Porphyry Belt. Levon eventually merged with Valley High in early 2011.

Cordero – the Lay of the Land

The Cordero deposit is a very sizeable porphyry target for silver, gold, zinc and lead. Over the last couple of years the concession has nearly doubled again to around 37,000 hectares. The concession hosts at least eight large-scale targets on two distinct porphyry belts and a third mineralized volcanic center. It is situated within the same emerging Chihuahua-Zacatecas silver-gold belt in northern Mexico that also hosts bulk-tonnage silver deposits such as Penasquito (Goldcorp), Camino Rojo (Goldcorp) and Pitarilla (Silver Standard).

An Eye-popping Resource that needs a Recalc

The mineral resource at Cordero has had quite a few iterations and is thus a work in progress. The most recent resource dates from September 2014. Prior to this there was the June 2012 Mineral Resource Update Technical Report dated July 31, 2012 (as amended May 10, 2013) and the Preliminary Economic Assessment prepared by M3 Engineering & Technology, dated March 12, 2012 (as amended May 8, 2013). The PEA included the mineral resource developed by IMC in June 2011.

The latest (Sept 2014) mineral resource was declared because of additional drilling and geologic information and contained some truly mind-boggling numbers with nearly half a billion ounces of silver and Lead and Zinc resources denominated in billions of pounds.

This was a further hike upwards from the resource, dating from June 2012, which had estimated:

- Silver: 364M oz indicated, 91.2M oz inferred
- Gold: 945,000 oz indicated, 152,000 oz inferred
- Zinc: 6.1bn lbs indicated, 0.7bn lbs inferred
- Lead: 3.3bn lbs indicated, 1.2bn lbs inferred

One of the key reasons for the uplift was the inclusion of the Aida claim which had been bought subsequent to the 2012 resource estimate. Some other important points to note about the deposit (for calculation purposes are that the mineral resource crops out at the surface. The resource has not been fully delineated by drilling along most of its perimeter, nor at depth down plunge to the northeast. Within the geometry of the modeled open pit containing the resource, rock in largely undrilled areas *has been modeled as unmineralized waste rock*. The calculated stripping ratio is nevertheless a low 1.2 to 1.

The use of a silver equivalent (AgEq) to represent the value of the deposit is a change from the previous mineral resource estimates where a net smelter return was used. As we noted in our last commentary on Cordero investors are frequently boggled by the use of the unfamiliar NSR format. Levon made this change to provide the deposit value in a format consistent with the reporting by other polymetalic resource companies.

The current resource is open to expansion on strike and at depth beyond the gigantic 2.8km x 2km conceptual open pit.

How to Move this Forward

As mentioned back in 2013 the company came out with a PEA. Of course the situation back then was quite different to now though the financing drought hasd already begun in precious metals. However for those with good memories there was also a perception that this “wouldn’t last”. Well it did and as we know everyone has had to cute their coat to suit their cloth since.

Levon’s main concern, after financing, is that its Cordero project is widely perceived as a low grade, bulk tonnage deposit, which will need favorable metal recoveries, metal prices and low operating costs to be developed. Then again, our response to that is “doesn’t everyone need those three things to be viable?”.

The PEA’s main metrics (dating from May 2013) are:

- Silver Price of US$25.15
- Internal Rate of Return of 14.8%
- Mine Life of 15 years (to complete four stages of a planned eight-stage open pit)
- Mill Capacity: 40,000 tpd
- Strip Ratio: 1.2/1
- Payback period of 5.1 years

The key thing for us is the Zinc in the mix. It is almost as if the Zinc recovery now puts that metal in the driving seat (as chauffeur) with Silver being a rather classy passenger in the backseat. The silver price that is used in the PEA is now ancient history, as the price has been sub-$20 per oz for a long while now. However the zinc price (and the lead price in its wake) is now trending higher. As noted earlier the company has a very low strip ratio in its favour, and a low grade in the lead/zinc playing against it.. But in the matter of size the deposit is truly prodigious.

Conclusion

Despite Lead and Zinc slipping back in recent weeks, I and many other watchers, think this is just a temporary phase in a renewed bull cycle for them, in particular, for Zinc. Now silver has perked up Levon has something massive to offer both the precious metal investor (as they emerge from the bunkers) and the base metal follower.

Once again we come back to the truism of “right-sizing” a project. The PEA’s 40K tonnes per day throughput is rather ritzy. Talk of getting this up to 80K per day is now clearly historic. This is the next thing that needs a workover.

Levon are well-positioned to “make hay while the sun shines” if they can come up with a production plan that gets product out of the ground in very short order to capitalise upon higher prices for the precious and base metal components of this deposit.