EUREKA report

New kids on the gold block

By Troy Schwensen

PORTFOLIO POINT: Five companies aspiring the join the big league deserve investors' consideration – and close monitoring.

Investors have few choices if they are seeking a locally owned gold miner producing more than 100,000 ounces of gold a year in Australia. In fact, they could count the number of companies on one hand. The recent success of Canadian company Northgate in its bid for ASX-listed Perseverance leaves just five remaining companies that meet the criteria.

Top five Australian-owned domestic producers

Company	Annual production (oz) *	Share price (Feb 19, 2007)	Share price (Feb 19, 2008)	Gain (%)
Newcrest Mining	1,385,000	21.92	34.28	56%
St Barbara	164,500	0.52	0.90	73%
Resolute Mining ^	133,000	1.64	2.20	35%
Equigold	117,500	1.52	3.81	151%
Dominion Mining	114,000	1.94	4.13	113%
Average	**382,800**			**86%**
All Ordinaries		**5,969.30**	**5,688.60**	**-5%**

* Domestic gold production for calendar 2007

^ Just Ravenswood production (excluding Golden Pride in Tanzania)

The share prices of these five companies have performed extremely well over the past 12 months, in light of the uncertain investment climate and rising gold prices. Since February 2007 these companies have averaged gains of 86%, while the All Ordinaries index lost 5%. All these companies produce respectable quantities of gold in a politically stable part of the world, which begs the obvious question: "Which companies could join this exclusive club over the coming 12–18 months?

Finding new gold projects is tough, with many companies preferring to head offshore and develop projects in politically riskier environments such as the Philippines, Thailand, Ghana, Mali, China or Egypt. The risks are high, but so are the rewards for the management teams that have the experience and smarts to get it right.

Back in the Australia, as gold prices have risen 38% over the past year, the following five companies will potentially be producing 100,000 ounces or more per year in Australia over the next 12–18 months:

Australia's emerging domestic gold producers

Company	Current annualised production *	Forecast annual production	Share price (Feb 19, 2007)	Share price (Feb 19, 2008)	Gain (%)
Norton Gold Fields	179,000	150,000	0.10	0.39	290%
Avoca	16,000	170,000	1.25	1.92	54%
Dioro Mining	68,000	141,000	1.32	1.47	11%
Monarch Gold	30,000	125,000	0.80	0.52	-35%
Citigold	18,000	100,000	0.38	0.37	-4%
Average	**61,600**	**137,200**			**63%**

* December Quarter 2007 production multiplied by four to provide an indicative annualised rate

These five companies provide a very interesting mix, with many challenges ahead in the quest to join the established five over the coming months and years. Norton, Monarch and Dioro have chosen to purchase some of their production ounces and have recently acquired projects with established infrastructure from major international gold mining companies.

Recently acquired projects

Company	Project name	Vendor	Date	Cost ($Am)	Cost per oz ($) ^	Reserves (million oz)	Resource (million oz)
Norton Gold Fields *	Paddington Mine	Barrick Gold	26/04/2007	39	28	0.625	1.4
Monarch Gold	Mt Magnet Mine	Harmony Gold	8/11/2007	65	24	0	2.7
Dioro Mining	South Kal Mine	Harmony Gold	3/12/2007	45	24	0.26	1.9

^ This represents the cost per resource ounce paid by the company.
* Norton has since announced an upgrade on the January 15, 2008, after a significant drilling program and the conversion of the resource from Canadian 43-101 standards to JORC.

The three mining projects acquired by Norton, Monarch and Dioro were sold primarily due to deteriorating economics which no longer adhered to the strict performance criteria of the vendor companies. They had little in the way of remaining reserves, generally just one to three years' worth. The primary challenge for Norton, Monarch and Dioro is to expand on existing reserves via extensive exploration programs, whilst keeping the mines operational and profitable. These projects each come with extensive resource bases of one to three million ounces, providing ample opportunity for reserve upgrades. Norton Goldfields recently announced an upgrade of its Paddington resource from 1.4 million ounces to more than three million ounces after significant drilling and a resource conversion to JORC. (Joint Ore Reserves Committee, the ASX industry standard for resource verification).

Monarch has chosen to place Mt Magnet on care and maintenance and concentrate its efforts on exploration programs and the successful commissioning of its existing Davyhurst operation near Kalgoorlie. The advantage of these types of projects is of course the established infrastructure and the readily available mining personnel (both scarce and expensive in the present environment).

Citigold and Avoca have been developing projects the traditional way by establishing a resource via extensive exploration and then developing mines in their own right. One of the advantages of following this process is that the company management tends to gain a much better understanding of what they are working with. The disadvantage can be the time and significant cost it takes to get these projects up and running which tends to test investor patience. Dioro Exploration is developing its 49%-owned WA-based Frog's Leg project in the WA Goldfields, and intends to process the ore at their recently acquired South Kal mine, which is within trucking distance. This recent acquisition has given Dioro a strategic advantage that has effectively fast tracked it towards becoming a significant producer in 2008-09.

Development projects					
Company	Project name	Total development costs ($A m) ^	Cost per oz ($) #	Reserves (million oz)	Resource (million oz)
Avoca Mining	Higginsville GF	130	93	0.63	1.4
Citigold	Charters Towers GF	60	6	0.33	10.4
Dioro Mining*	Frogs Leg	40	80	0.3	0.5

^ This represents exploration and development costs for the respective projects plus any remaining anticipated capital expenditure to bring these projects into commercial production at the planned rates.
# This represents the total development cost divided by the resource base.
* Represents Dioro's 49% stake in the project

All these emerging producers are in similar positions, with extensive resource bases, relatively small reserves, and mines that are in or near commercial production. The rewards for the companies that get this process right will be immense. Some companies will fail. View Resources, which had been listed on the ASX, recently went into voluntary administration after failing in its attempts to bring the Bronzewing project back into commercial production. Although a rising gold price provides a safety margin for these companies, poor management or fluctuations in mining fortunes can quickly negate these benefits.

Investors should consider three important factors if they are considering putting money into developing gold mining companies:

Healthy balance sheets. The uncertain nature of gold mining, even for the more established players, lends itself to unexpected events which can leave companies at the mercy of their creditors. Ensure companies have healthy balance sheets and access to contingency funds in the event of unexpected delays. Debt and any gold price hedging can potentially pose very significant risks.

Good management. Difficult to quantify, but a proven track record usually speaks for itself. For example, Monarch has raised tens of millions of dollars to make acquisitions (its global resource is now more than five million ounces). Michael Kiernan, the former chief executive of Consolidated Minerals, fronts the company and has a stellar reputation of building successful mining houses against the odds.

Significant insider ownership. This generally aligns management's interests with that of its shareholders. For example the directors of Citigold own more than 13.5% of the company, with Mark Lynch the chief executive owning most of this stake. The Lynch family has been heavily involved in the development of the Charters Tower's Gold Field project for two decades. This sort of commitment inspires investor confidence, which is clearly demonstrated by the loyalty and patience of Citigold's shareholders. Regular capital raisings and prudent purchasing of equipment and infrastructure by management has ensured that Citigold remains largely debt-free and unhedged going into this important production phase.

Prudent, ongoing analysis needs to be done to monitor adverse developments – breaches of debt covenants, negative operating cash flow, chief executive resignations, directors selling shares, etc. In other words, these are not the sort of investments that can be made and simply forgotten. For those proactive investors who make the effort and have access to timely information, substantial returns can certainly be made with significantly less risk than one might think.

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