AGAINST ALL ODDS RESEARCH

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The Unsophisticated investor series: January-precious metals update

against all odds

Newmont (NEM)

Newmont is the largest gold miner, with [expected production of 6.2 million gold ounces in 2022](), increasing to 7.5 million gold equivalent ounces, the equivalents being silver, copper, zinc and lead. The company is well diversified and run by competent management. This is the "go-to" gold stock for fresh capital seeking to enter the gold space.

Barrick Gold (GOLD)

Barrick is the second largest gold miner, with expected production of 4.4 to 4.7 million gold ounces and 410 to 460 million pounds of copper in 2021. Barrick derives 22% of its revenue from copper, which is a plus in the current environment. CEO Mark Bristow is a deal maker, but not one to pay too much for sub-par assets, unlike some of his peers. This is not just conjecture on my part. The company has distributed $750 million in 2021 as part of its capital distribution program, on top of the regular 9 cent quarterly dividend. That's a total return of 78.15 cents per share (4.3% of current share price).

Barrick's CEO is quite vocal about the need for consolidation in the industry, so another acquisition may be in the works. But unlike peer Kinross (see below), I don't think Barrick will engage in a value destructive deal. That's important because acquisitions are typically paid for with shares and the share price of the acquiring entity tends to take a hit when a deal is announced.

Lundin Gold (FTMNF, LUG.TO)

Lundin Gold owns and operates the Fruta Del Norte mine in Ecuador. The mine has a storied history. Back in 2008, Kinross Gold acquired FDN, then a development stage asset, for a hefty price tag of $1.2 billion. Kinross bought the asset, even though the Ecuadorian government had imposed a six-month moratorium on mineral exploration and proposed to change its mining rules. While sane investors were ridding their portfolios of any junior miner with assets in Ecuador, Kinross decided to buy FDN because it was 'cheap'. A genuine value investment at the peak of the commodity bubble, surely nothing could top that.

Ecuador came up with new rules all right, in the form of a 70% windfall gains tax. The story ended for Kinross with an asset write-down of $720 million in Q2 2013 after failing to come to terms with the greedy Ecuador government. FDN was sold to Lundin Gold in October 2014 for $240 million. Lundin acquired the asset after receiving approval from the Ecuador government and proceeded to take the project through feasibility stage. Construction began in May 2017, with first pour announced in November 2019. Meanwhile, in early 2019, the new administration scrapped the 70% windfall gains tax. Lundin Gold was sitting pretty.

The difference between Lundin Gold and Kinross Gold

Kinross caught a falling knife, a time honored value investing tradition. As a consequence, Kinross fought an uphill battle to try to recoup their investment, failed, turned completely sour on Ecuador (and fired the CEO). Perhaps the Kinross Board wanted to part with FDN just so they could close the chapter on their costly mistake. In any case, LUG bought 'cheap' too, *but after securing approval from the government of Ecuador.* After it was apparent that the government had been chastised by the commodity bear market and a regime change was happening. And by paying $240 million rather than $1.2 billion, plus being able to advance the project rapidly, LUG was able to improve the economics of the project. Interestingly, I have followed the LUG story since 2016 and I cannot recall ever thinking the stock as 'cheap'. Kinross was always relatively cheap, PE wise, as compared to its peers in the space. I'm sure there's a lesson in there.

While lightning supposedly doesn't strike twice at the same place, some mistakes are apparently worth repeating. Earlier this month, Kinross bid $1.4 billion for Great Bear Resources. Great Bear's Dixie project doesn't even have a mineral resource estimate, just lots and lots of drill results. At least FDN had 13.7 million in Inferred gold resources at the time of Kinross' acquisition. Some things just never change.

FDN is now on track to produce 405-445k gold ounces at an all-in sustaining cost of $860-$930/oz. While politics in Chile and Peru have deteriorated, Ecuador appears to be relatively friendly to mining. This makes Lundin Gold an attractive acquisition candidate for any major miner, and especially the Chinese, who know how to do business in Latin America.

We're not buying 'cheap', nor are we buying 'value'. The gold industry is consolidating, and LUG is an obvious candidate to be taken over as the consolidation progresses. I expect LUG to be acquired in H1 2022.

Victoria Gold (VITFF, VGCX.TO)

Sometimes a stock is priced so cheap that it becomes attractive for a bottom-fish. I highlighted Discovery Silver for the same reason in the AAO October 1 issue. That trade worked out well - entry at C$1.26, last close at C$2.05 for a gain of 63% in under 3 months.

Victoria is another bottom fish recommendation. These kind of trades seldom work out, but when they do, the gains make it worth your while.

Victoria operates the Eagle gold mine in the Yukon. The mine achieved first pour in September 2019 and declared commercial production on July 1, 2020. Yes, right in the middle of the plandemic when most miners were struggling. What makes this feat even more amazing is that the Yukon is not an easy region to operate in, and Victoria managed a successful fly-in/fly-out operation while fellow Yukon miner Alexco (see below) used the covid restrictions as an excuse to further delay its development plans.

Victoria is run by competent people. The mine itself is expected to produce 162,000 gold ounces in 2021, 10% below the low end of its original guidance of 180-200,000 ounces. All-in sustaining cost

(AISC) is also expected to increase by 5%, to US$1175/oz. The good news is that the gold is still there, just that the recovery will be pushed to Q1 next year. Assuming 2022 production of $180,000 ounces at an AISC of $1250, to account for cost inflation, the company should generate earnings before interest and taxes (EBIT) of over US$90 million at $1800 gold, rising to over US$110 million at $1900 gold. Current market cap: US$670 million (C$13.89 share price). The company has over US$175 million in long-term debt, and interest expense for the last nine months amounted to ~$5.7 million. I consider the stock fairly valued, given the debt burden and potential cash flows at $1800 gold. If valuation were my only guide, this stock wouldn't be a buy.

However, now that the tax-loss selling is over, and the disappointing production numbers are priced in, I'm interested. The stock is poised to benefit from any positive surprise - drill results, higher gold prices, debt rationalization, increased production, multiple expansion, etc.

Look for the breakdown to reverse later this week or by next week.

Alexco Resource Corp (AXU, AXU.TO)

Alexco is a primary silver company with a terrible historical track record.

In 2006, Alexco acquired a 233 square km land package in the Keno Hill Silver District in the Yukon. The area had seen historic production of over 214 million silver ounces from 35 mines until 1989. Alexco, which was then primarily in the business of environmental reclamation, committed $10 million to cleaning up the old mine sites and simultaneously began exploration activities.

By late 2010, the company had built the Bellekeno silver-lead-zinc mine, slated to produce 2 million silver ounces annually at grades averaging 779 g/t Ag. But the rapid collapse in silver prices following the $50/oz peak in silver in April 2011 rendered the mine uneconomic. By September 2013, the mine was shut down. It wasn't just the silver price. In 2008, management made a costly mistake that would continue to haunt them for the next decade. In its haste to raise capital, at the very depths of the 2008 financial crisis, Alexco entered into a streaming agreement with Silver Wheaton (now Wheaton Precious Metals).

The agreement called for the delivery of 25% of their silver production at a fixed price of $3.90/oz, which absolutely killed the economics of the project, particularly as the period from 2008-11 saw huge cost escalation for the mining sector.

Since then, the payment terms on the streaming agreement have been amended to improve project economics and the company discovered more high-grade deposits on its Keno Hill property. Investors have been expecting the company to re-start mining operations ever since the silver price started to pick up in 2016. After a lot of ~~procrastinating and multiple excuses~~ delay, Alexco finally obliged, restarting operations in November 2020.

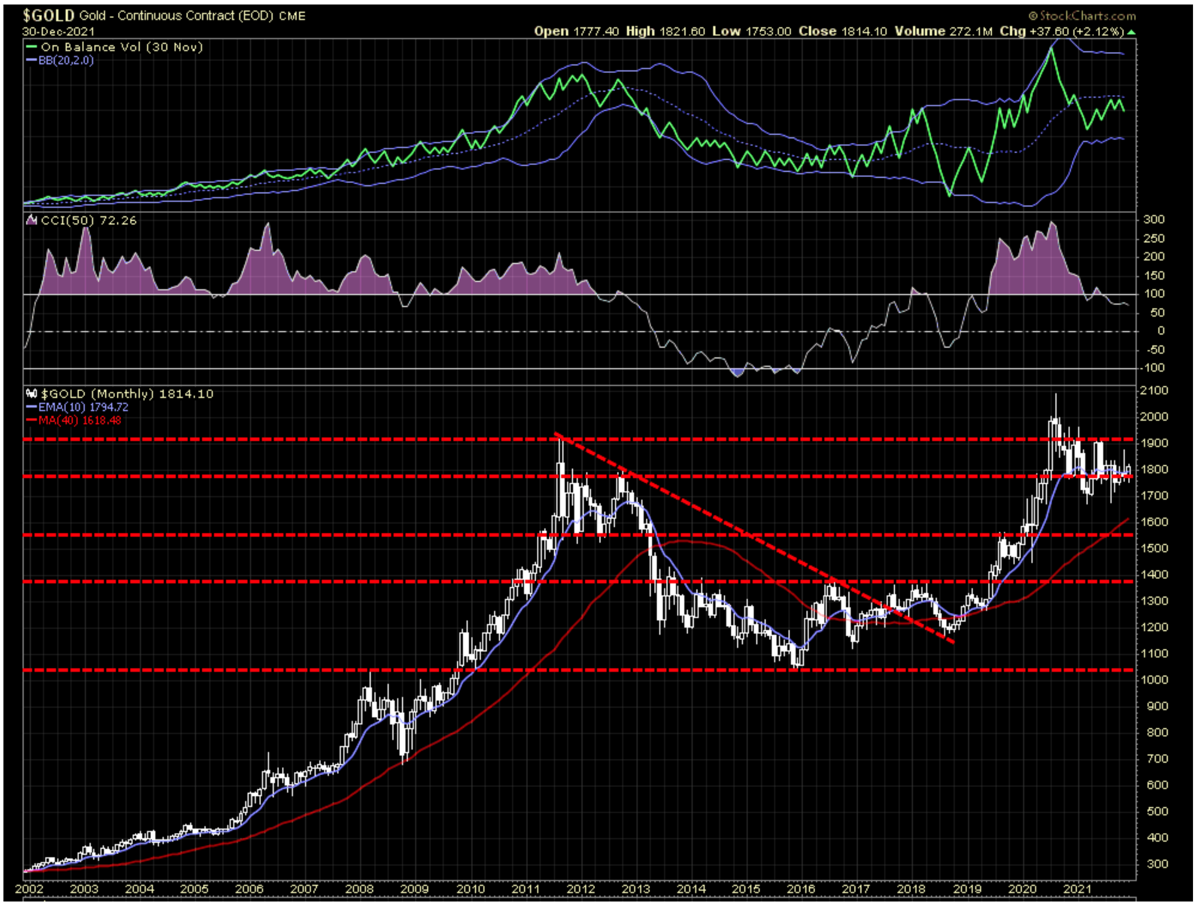
Alexco can 'potentially' produce 4 million silver ounces per annum at an all-in sustaining cost of $15/oz. I say potentially 'cos the company hasn't managed to declare commercial production yet. That's highly unusual after 13 months of operation, on a past producing mine owned by the same company to boot. They *may* declare commercial production in Q1 next year, but given the company's history of dragging its feet and poor operational decision making, I'm not holding my breath.

Still, this will be a hot story when silver runs higher, and the company's spectacular drill results from the Bermingham Deep zone, plus actual silver production, should cause investors to chase the stock higher. This is an easy double once interest in silver (and the silver price) pick up.

Some Comments

Going strictly by *fundamentals*, Alexco is a terrible stock. And yet, there's a reason to buy it now. Looking strictly at the *technicals*, buying stocks while they are breaking down is a sure way to lose money quickly. I am well aware I'm breaking the supposed rules of both camps in my trading, but that's my style. I trade this way because I have risk controls in place to mitigate the flaws in my style. Something to think about before putting on these high-risk trades.

The technical view



1. Gold monthly

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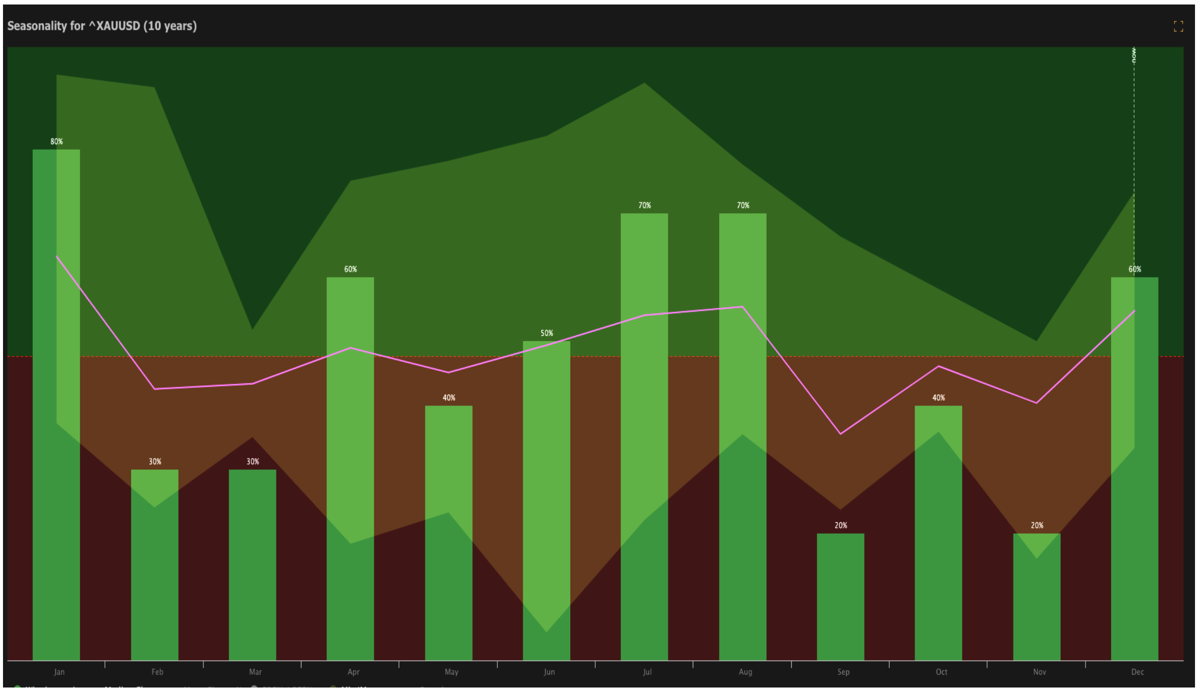
2. Silver quarterly



3. Gold seasonality-80% win rate in January

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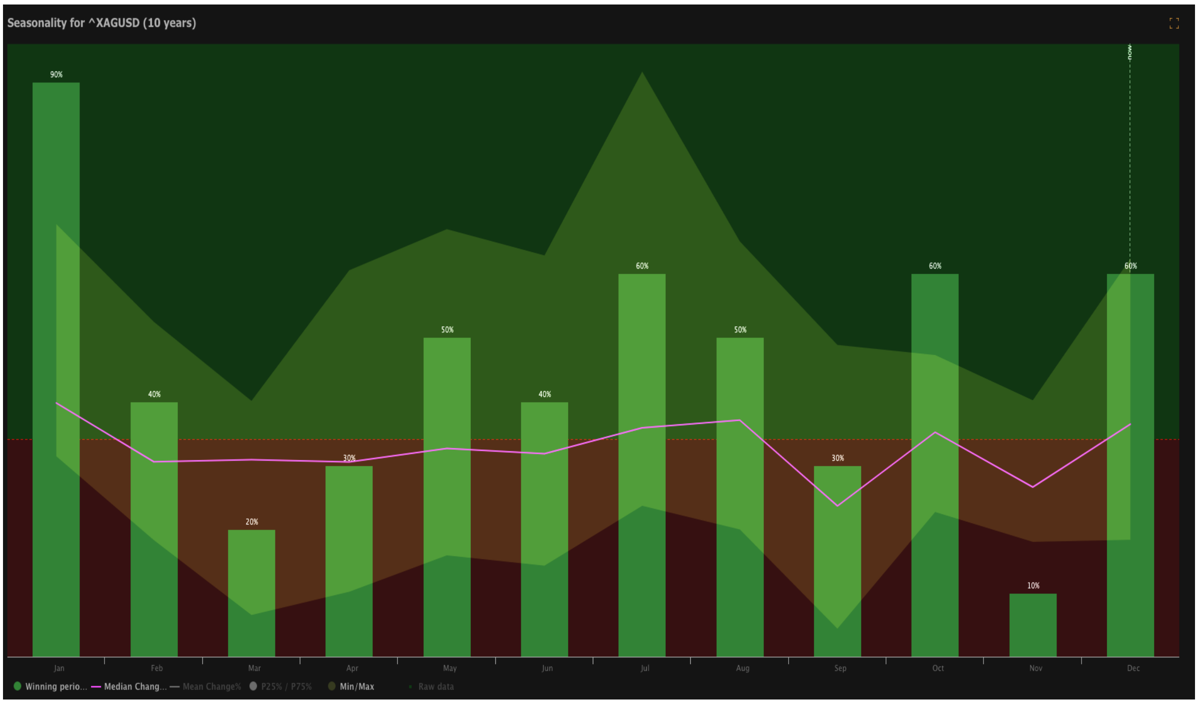
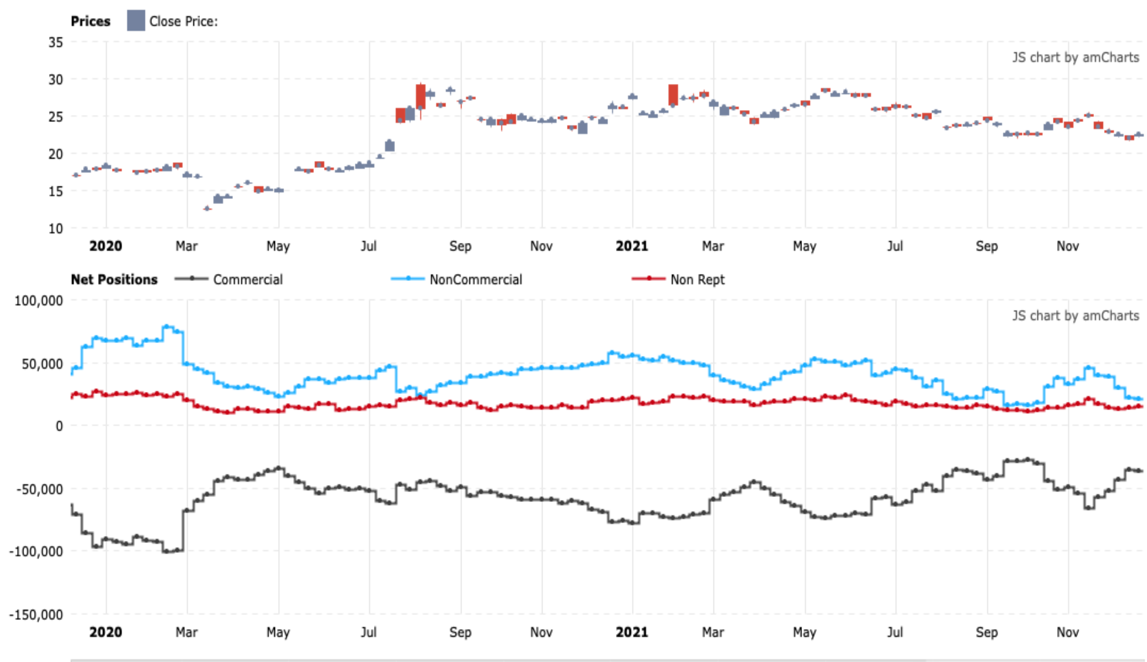


4. Silver seasonality- 90% January

Prices & Net Positions



5. Silver commercials (Black line) accumulating. Bullish.

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6. Silver to gold ratio. Not pretty… I would like to see this turn up to get very bullish on the PM space. Patience.

7. GDXJ:GDX ratio-not making new lows but it has some work to do. Patience.

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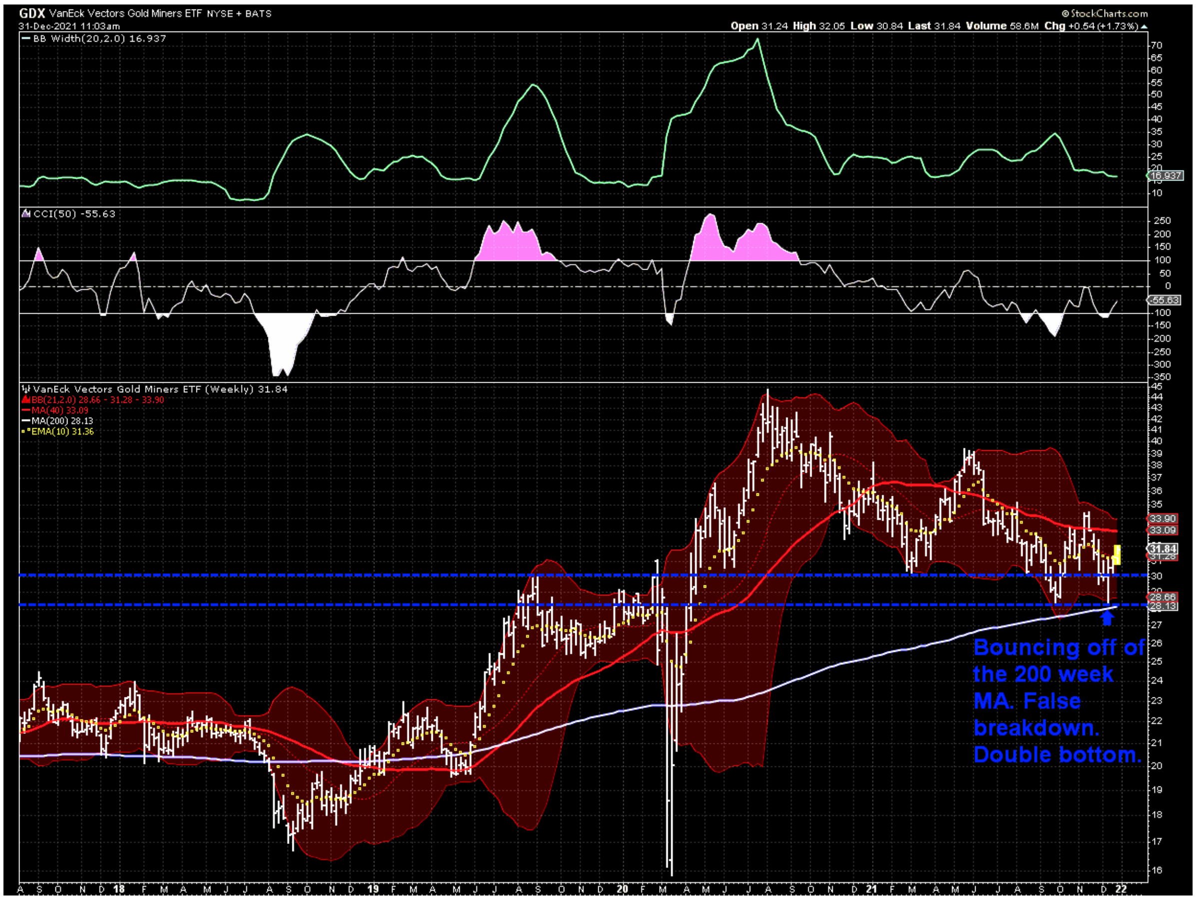
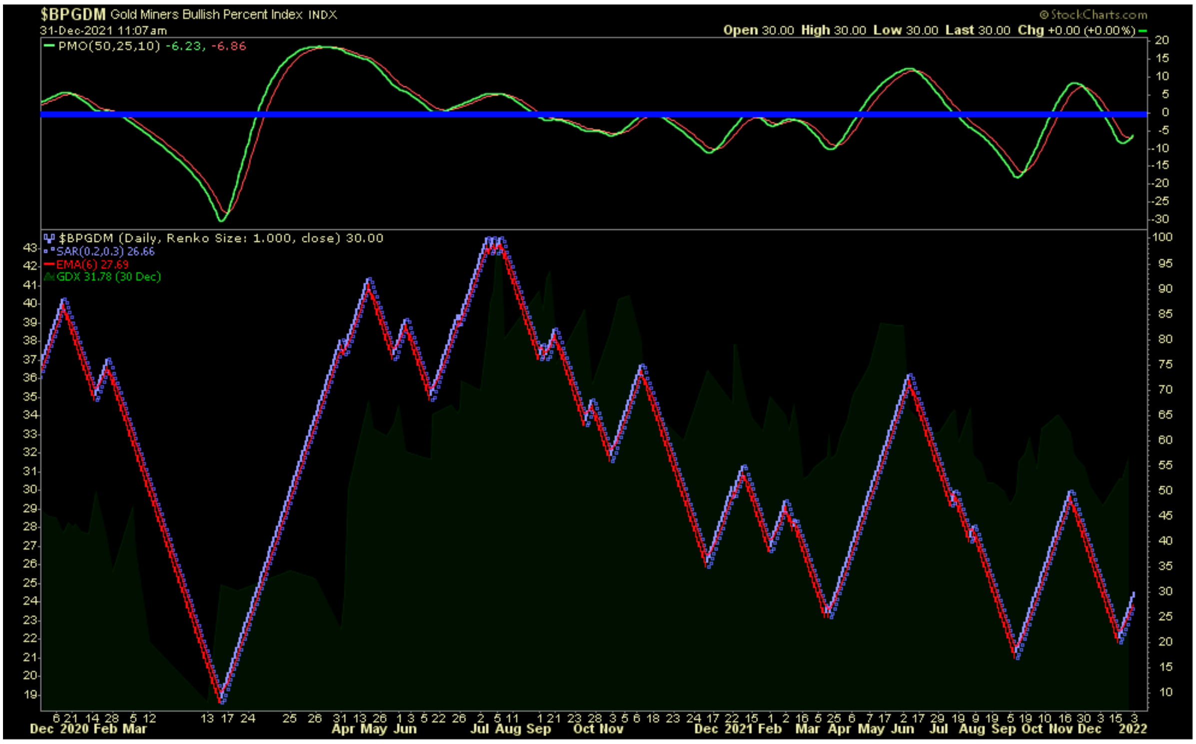


8. GDX-Tons of signals are pointing at a possible bottom. The uptrend would be confirmed if we can hit 33.90.



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9. Bullish percent gold miners-Not looking great but we do have a short term buy signal and a PMO cross.

10. NEM is where you want to be in the large cap PM space. This is in a full buy signal and is outperforming.


AXU Alexco Resource Corp. AMEX
30-Dec-2021
©StockCharts.com
Open 1.82 High 1.82 Low 1.63 Close 1.76 Volume 3.3M Chg -0.03 (-1.68%)
BB Width(20,2.0) 42.102
On Balance Vol
EMA(20)
AXU (Weekly) 1.76
PIVOTS 0.17, 0.96, 2.21, 3.00, 4.25
MA(21) 1.78
MA(200) 1.83
Short term
target 2.90
2 trigger
points. Buy
above 1.83
and 2.01
Stop: 1.4
Trailing stop:
25-30%
(extreme
volatility)

11. AXU trade

12. Barrick Gold-very weak still. The technical view is to stay patient.

Overall I like gold as a cornerstone in your long term portfolio. A small allocation can smooth out your returns. Trading wise there is still some work to do. We marked off the levels that we want the price to clear. In the short term (4 week time frame) there is potential for a bounce here.

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