

Mineral exploration – A risky business
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A hard-nosed look at the chances of successfully putting a mine into production from a grassroots exploration play should be enough to discourage any right-minded investor. But the world is full of various personalities and there are some who like to take risks, and those who take high risks, if they are successful, can expect to get high returns. This may be called gambling by some but rarely by a financial analyst or investment advisor.

Tim Searcy, recently with Wellington West Capital Markets and now president of Auryx Gold Corp., pointed out to an audience of a couple hundred that the chances of putting a mine into production from the very beginning of the exploration cycle (selecting an area to explore) to actually producing a saleable mineral product (production) are very low.

At each stage of the exploration cycle, the cost increases to advance the target to the next stage. The cycle starts with selecting an area to explore. The target area is explored and a target is identified for further investigation. The target is then tested. If it is successful a resource evaluation takes place. If the evaluation is successful, the resource can be mined. This is a simplistic sequence without a time-line, but at each stage of the cycle a negative result can kill the project and the process starts anew in a new area. As each successive stage in the cycle is reached more money has to be spent.

To put it into perspective, he gave a real life example: to find a gold mine, a company had to drill test 125 targets in the Abitibi before one could be advanced to the production stage. Likewise, an example based on Rio Tinto's experience saw the company test 332 targets before getting a deposit into production. This is akin to having to look at 1,000 10-year old hockey players to perhaps find one who will eventually play in the NHL.

As discouraging as this may seem there is opportunity to make money on the share price as a company advances a project through the exploration cycle. Searcy put up several slides of the share price of companies that were successful in turning grassroots discoveries into producing mines. Within that cycle there are times when share prices generally rise and when prices decline even though the project has successfully passed a hurdle.

Share prices are generally low in the early stages of the cycle. Selecting an area and selecting targets to test are associated with low prices. If exploration drilling is successful share prices tend to rise as the potential of the new discovery has to be assessed. Once the target is outlined, share prices tend to sag because the next phase is to evaluate the resource. This is a long and costly process that does not produce any news until the results of the resource evaluation are announced. If the results are positive, the share price usually starts to increase in anticipation of building a mine. If the resource evaluation is negative the project comes to a halt and share prices decline drastically. As mine production approaches, share price increases in anticipation of a cash flow from the mining operation.

Searcy points out that money can be made by knowing at what stage of the exploration cycle a project is in. Knowledge is an important investment tool.