


Globe Investor



How prospect generators work

Mineral exploration is a risky business, with low odds of success. But prospect generators bolster their chances by teaming up with deep-pocketed partners.

 <p>1 Acquire exploration rights to an area with good potential for discovery</p>	 <p>2 Identify grassroots exploration prospects that warrant further testing</p>	 <p>3 Find a joint venture partner to bear the financial brunt of drilling and further testing</p>	 <p>4 As the discovery becomes better defined, look for an opportune time to sell</p>	 <p>5 Re-invest in finding new prospects</p>
<p>■ Good prospect generators combine geological skills with business acumen. They typically develop expertise in particular regions.</p>	<p>■ They use their own money to identify prospects based on geological assessments backed up by relatively low-cost geophysical and geochemical tests.</p>	<p>■ The partner pays for the huge cost of drilling in return for a controlling interest – typically 51 per cent to 75 per cent of a successful project.</p>	<p>■ Prospect generators aren't miners. So they look for a good time to sell – typically to their partner – before the project is developed as a mine.</p>	<p>■ The payoff from successes can be used to help fund the cost of generating new prospects, to purchase royalty streams or returned to shareholders.</p>

THE GLOBE AND MAIL » SOURCE: DAVID ASTON

MINING

A better way to prospect for profits

Tired of losing money on junior mining stocks? Firms known as prospect generators may give you a better chance of hitting paydirt

DAVID ASTON

Anyone who has invested in junior miners knows what a tease Mother Nature can be. A hot drill result will excite investors and seduce the market into thinking that a company has discovered the next bonanza. Then – far more often than not – further work shows the discovery to suffer from what geologist Brent Cook calls a fatal flaw: insufficient size, low ore grades or any number of other problems that ultimately render the find uneconomic to mine.

“The basic fact of mineral exploration is the odds of success are really, really low,” says Mr. Cook, co-author of the newsletter *Exploration Insights*.

Investors who are eager to tilt the odds in their favour may want to look at a different way of getting involved in the early stages of finding a mine. Firms known as prospect generators specialize in sniffing out promising grassroots prospects. Their goal is to partner with larger mining companies that can bear the financial brunt of testing these potential finds to identify the tiny percentage that turn out to be economic to mine. Both partners then share the bounty.

Invest in a handful of reputable prospect generators and you get a diversified portfolio of projects. “With six to 10 prospect generators, you can have exposure to 50 to 100 projects over several years which can dramatically increase your odds of success,” says Adrian Day, CEO of Adrian Day Asset Management and author of *Investing in Resources*.

Why don't mining firms do the grassroots exploration work themselves? Many miners focus their exploration on expanding around existing mines. Working with a prospect generator offers them a chance to preview a large range of possible targets in regions they may not know well and then invest in the best opportunities.

Ideally, “it's a symbiotic relationship between a company whose core expertise is exploration feeding a company whose core expertise is mining,” says Paul van Eeden, president of privately held Cranberry Capital Inc. and a director of prospect generating firms Miranda Gold Corp. and Evrim Resources Corp.

FIVE EXPLORERS WITH POTENTIAL

COMPANY	MARKET CAPITALIZATION <i>(in millions of dollars)</i>	KEY AREAS OF FOCUS
ALMADEN MINERALS (AMM-T)	\$121.8	Gold, silver, copper prospects in Eastern Mexico. Currently drilling out its 100 per cent-owned Ixtaca discovery.
ALTIUS MINERALS (ALS-T)	\$326.5	Iron ore and base metals in Labrador. Royalties from Kami iron ore project could generate more than \$50-million a year if it is developed as a mine, according to Altius estimates.
EURASIAN MINERALS (EMX-X)	\$137.4	Gold and copper in Turkey, Haiti, Western U.S., Sweden and Australia. Partners include Newmont, Vale, Inmet, Freeport McMoRan, Antofagasta.
RESERVOIR MINERALS (RMC-X)	\$124.2	Gold and copper in Serbia and West Africa. Partner with Freeport McMoRan on the Timok copper-gold discovery in Serbia.
VIRGINIA MINES (VGQ-T)	\$318.5	Gold and base metals in the James Bay region of Quebec. Partners include Goldcorp, Anglo American, Iamgold, Xtrata.

Source of market capitalization figures: Bloomberg. Figures are as of April 4. These prospect generators were the ones with the highest market capitalizations that were common to lists of recommended prospect generators supplied separately by Brent Cook and Adrian Day. Mr. Cook holds each personally and Adrian Day Asset Management holds each in client accounts. Article author David Aston owns shares in Almaden Minerals, Altius Minerals, Eurasian Minerals and Virginia Mines.

THE GLOBE AND MAIL » SOURCES: BLOOMBERG AND AUTHOR

long odds of success. After prospect generator Virginia Mines Inc. discovered the rich Éléonore deposit in Quebec, it was able to sell the deposit to giant Goldcorp Inc. in 2006 for \$420-million (U.S.) worth of Goldcorp shares and a rich royalty.

Investing in prospect generators requires a different approach than putting money into a conventional junior explorer, says Mr. Cook, who invests in both types of companies. With conventional explorers, you need to assess the geology of a specific site, step on top of every drill

problems.

“I spend all my time looking for the fatal flaw,” he says. “If you know 95 per cent of the time the stock is going to go down, you want to find that fatal flaw as soon as you can and get out before the crowd.”

When it comes to prospect generators, you aren't betting on a particular find, but rather on the ability of the firm's team of geologists to turn up a stream of interesting projects. Most prospect generators concentrate on “greenfields” opportunities away from existing mines. This is a

prospect generator has to finance only the relatively inexpensive work of exploring and testing a site for drilling potential, it doesn't chew up money at anywhere near the rate as the miner that does the drilling. If several projects fizzle, that need not be a disaster.

This allows average investors to adopt more of a buy-and-hold approach, Mr. Day says. Another attraction: Non-geologists can see how a prospect generator is doing simply by checking on how successful it has been in enlisting joint venture partners

many of the world's leading mining companies and their scrutiny of potential projects is rigorous, Mr. van Eeden says. “You have to persuade their geologists that they have to go get financing within their company for your project instead of taking their budget and spending it on their own projects.”

Project generator stocks offer less downside than conventional junior miners, Mr. Cook says. “Their bad isn't that bad,” he explains. “If their partner drills a project and it turns out to be not that great, it didn't cost these guys a dime.” Conversely, if a project does well, the payoff can be sizable. “You're not going to get a ten-bagger [a stock that goes up 10 times],” he says. “But I'll take four three-baggers any day.”

Prospect generators typically have small teams of geologists who perform relatively low-cost geochemical, geophysical and geological tests to identify promising targets. The prospect generator may drill a few holes to test a concept, but generally looks for a well-funded partner to shoulder the big bucks of drilling.

If the project continues to yield encouraging drill results, the joint venture partner accumulates a hefty bill, but typically ends up with a 51- to 75-per-cent stake of the project, leaving the prospect generator with a minority stake. As the resource becomes better defined, the prospect generator looks for an opportune time to sell, typically to the mining company partner.

But doing this well is not easy. Few prospect generators are able to combine geological expertise with the business savvy needed to manage partner relationships, Mr. van Eeden says.

The accompanying table lists prospect generators recommended by Mr. Cook and Mr. Day. Do your own research before investing in any of them. (Disclosure: I own shares in several, as identified in the footnotes.) And don't go overboard. A portfolio of prospects generates more shots at success, but prospect generators can explore for years without finding anything economic.

Mr. van Eeden says to only invest money you can afford to lose. “Just because you're dealing with prospect generators doesn't take the risk away. It's still a risky business.”