THE (SOMETIMES ON) FRIDAY SHEET
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Still trying to figure out what to do with a dead camel
Altius Minerals
Exploration as a business, part II
Reader feedback
Baked Camel

Last Sheet (09-29-01) we left off wondering what to do with a dead camel and opened the subject to your input. Abdullah bin Ja'far shot right back with the following insight. "The Prophet once passed by a lean camel whose belly had shrunk to its back. "Fear God" he said to the owner of the camel, "in these dumb animals, and ride them only when they are fit to be ridden, and let them go free when it is meet that they should rest." Although the above comment demonstrates considerable insight into the care and maintenance of camels, the discussion (metaphorically) was directed towards cost effectively dealing with the inevitable camel under most tents. More succinctly, we looked into minerals exploration as a business and threw out the proposition that offsetting the heavy exploration costs through joint ventures with major mining companies offered the most cost efficient method of discovering and developing economic mineral deposits for junior exploration companies given the current market conditions.

These conditions, in a word, suck! In a few more words, metal prices are awful, money from equity markets is virtually non-existent, the major mining companies are pre-occupied with M&A activity and, economic deposit hurdles are rising due a number of environmental, economic and political factors. The global economic outlook is depressing and prospective terrains in politically reasonable locales are reaching an increasingly advanced stage of exploration maturity.

The topic of how to fund exploration and what is the best use of shareholder funds generated a fair bit of reader input, some of which appears below, as well as a credible camel recipe. The most compelling argument in favor of taking the joint venture path to exploration success vs. going it alone came in a short note from Altius Minerals: *17.1m @ 11.0g/t Au!

The significance of the gold intersection at the Moosehead property, Newfoundland, is not so much the grade (covered later in this sheet) but that it is the 27th hole drilled here. That's more than a few dead camels. All of which were slaughtered through funding of joint venture partners, most recently Teck. Sudbury Contact Mines (SUD.T, an affiliate of Agnico Eagle), Altius's current partner, is earning a 60% interest in the Moosehead property package by spending C$1.8mil in exploration. At roughly C$65/m all-in drill costs, that provides ALS with approximately 25,000m of drilling, more than enough to prove up (or kill) the property's potential at no risk to ALS's working capital, or shareholders' equity.

Altius (covered 09-25-00, 6-15-00 and we own a bunch) is unique in that they see the business of exploration as a very high risk venture that requires considerable capital, stamina and luck. They view their role in the exploration, discovery and mining process as supplying the early stage conceptual mineral targets in a geologic environment which they know better than nearly anyone, then leveraging their "intellectual" capital into the financial capital of a company capable of surviving a failure. Joint venture partners at 14 projects (four currently active) have funded about 70 drill holes on base and precious metal projects without discovering an economic deposit, yet. These "failures", some of which actually added value and impetus for further drilling, cost ALS and its shareholders virtually nothing. Since formation in 1997, ALS has continually increased drilling footage and anticipates that at least 7,500m will be drilled in 2001.

The company has ~13mil shares outstanding, a market capitalization of C$9mil @ C$.70/share, C$650,000 in cash (C$1.8mil fully diluted) and burning ~C$20,000/mo, a considerable portion of which could be offset by management fees and option payments collected from projects. Had ALS opted to go it alone on these 14 projects and 70 drill holes (and assuming they could have raised the $$), you would be looking at an ever decreasing share price and exponentially increasing equity dilution until it's roll-back time. The Moosehead property provides a good example of what these geologists do best. They recognized epithermal textures in quartz float within the Botwood Basin, central Newfoundland. Sampling returned anomalous to 100 plus gram gold values with elevated epithermal trace elements from boulders (outcrop is very poor). Fluid inclusion studies from high-grade vein material showed a 180* formation temperature; further substantiating the interpretation that low-sulfidation epithermal mineralization is present within the Silurian-Devonian sedimentary basin. The mineralizing event is considered to have occurred shortly thereafter and is hosted within a sandstone-shale-limestone sequence. Until now, no one would have believed Devonian aged epithermal gold mineralization existed in Newfoundland. Previous drilling on the property was mostly unsuccessful and failed to improve on or extend the 15cm interval at 259g/t Au drilled in 1996. This year ALS re-interpreted the data and postulated that the mineralization was controlled by NW trending structures. DH 01-13 seems to have confirmed this interpretation intersecting 17m @ 11g/t Au, including 1.5m @ 96g/t Au in quartz vein and breccia material at 27m vertical. The data so far suggests to me that the quartz veins follow anatomizing and possibly en-echelon structures, blowing out in both size and grade at cross structural intersections within ~200m X 1,000*m corridor. Picture something like Great Basin's Ivanhoe, Nevada vein system only it lies near surface under a bit of glacial till. Drilling in progress will either confirm or refute this interpretation. Either way, ALS treasury and game plan remain intact. Here's the good part. Altius has been prospecting the entirety of this developing epithermal gold belt for years and controls a number of, what they believe to be are, the best epithermal and (seriously) sediment hosted gold prospects. If Sudbury Contact Mines is successful in defining an economic discovery, the entire ALS Botwood property package could become quite valuable.

Back to the joint venture vs. go-it-alone discussion: In theory, the strategy of offsetting the high costs of proving up an exploration property through joint ventures is great (assuming you accept the thesis). The reality seems to be that all too often, the majors are difficult to deal with and not necessarily interested in "conceptual" targets. They need drill ready targets presented in a fashion they can sell to their bosses (try: EV=P(1-n) x TV-C, 5-25-01 Sheet).

A geologist toiling in obscurity puts it this way in the following 5 points.

1) There are very few dance partners (i.e. majors) available to do a JV with these days. Most have very narrow exploration focus, arbitrary criteria, politically motivated bureaucratic senior management and are staffed by a group of shell-shocked surviving geos who are terrified of losing their jobs.

2) Creative, entrepreneurial exploration ideas are a tough sell on these guys, who got to where they are by NOT taking risks.

3) Find a major who likes your project and they hand you off to their legal department. Legal then kicks the shit out of the cash strapped junior. If the junior is not extremely careful, the junior ends up with a very onerous JV, which will see the major dilute them into oblivion when the JV is consummated. The only deals being done by majors where the junior is carried to production are in the diamond sector.

4) The majors have us by the nuts and they know it. Makes going it alone more appealing, once the junior's management understands the reality of the situation.

5) The details of the JVs are often ignored by analysts. In many cases, the junior has little hope of ending up with anything of value. We need a stronger junior equity market to provide an alternative to the majors as a source of funding. Only then will they become easier to deal with. Until then, they are the only game in town".]

Even Tim Termuende, Eagle Plains Resources, who has had a considerable amount of success killing camels with other people's money, notes that it is becoming increasingly difficult to attract majors or juniors to the party.

"One thing I have concluded from recent events in the mining biz, is that the JV game ain't what it used to be. Coming from 2000 where we (EPL) had four JVs going with majors at once, to a year where we have no involvement with majors, I think I can speak from experience when I say that the market for JV partners has changed considerably. We have been trying as hard as ever to attract the big guys to our projects, but there are just too many properties out there, and too few shoppers. I think that this has come to be due to the conspicuous absence of juniors looking to participate in JVs. There are really relatively few exploration companies who actually research and stake their own ground. Most rely on the grassroots efforts of companies like EPL, RFM, RMX and others to come up with the stories, with the JV juniors bucking up the cash. In financially challenging times like these, the JV juniors are basically out of the picture, blowing the supply/demand balance out of the water. If we are lucky enough to get a major's attention, the deals seem to be much less generous than in the past, as well."

Tim continues "For our part, we are making a big push to find a partner during the Sullivan workshop in November. Hopefully one of the global base-metal majors will like what they see, and we can get back up to speed. If our Sullivan stuff (which has excellent potential and great drill targets) doesn't catch anyone's eye, then I am skeptical of the future."

John Kaiser who is likewise skeptical of the near term future of exploration and metal prices, puts the farm-it-out or hold 100% debate is as follows:

"Companies playing the statistics game like Altius, who generate multiple projects have to farm out. Companies with a large concept driven project (a contiguous area) should keep 100% and take the equity dilution in the hope that they find something that spawns a buyout auction (i.e. Diamondfields Voisey's Bay). Once they start to broaden their exposure they should pursue farmouts.

A junior farming into another junior's project, or a major's just plain sucks. Farming out a majority interest to another junior also sucks. Farmouts to majors should either delay vesting of any interest until a production decision with deadlines in place, or, if staged vesting is unavoidable, there should be claw-back provisions for the juniors if work stops and a production decision is not made. Just as the majors demand back-ins in case a junior finds something big on a project they option from a major, the juniors should be able to back-in for at least a substantial majority stake if the project does not merit further work by the major because a discovery is not world class. The junior's back-in (i.e. dropping a major down to a 20% carried from a 60% WI) should cost nothing (unlike the majors' back-in when the junior is successful) because it should be a penalty suffered by the major for not making a world class discovery. I think this is important because I agree with you that down the road metal prices will soar, and there will be very few world-class deposits left to discover. In this setting, the smaller projects formerly shunned by the majors will become development candidates and it would be nice if the juniors who generated them are in a position to auction them off or develop them".

The terms of the "deal" struck in a joint venture are obviously critical to the junior and at some point it may serve the junior and its shareholders better to tap the equity market despite the price and dilution. All too often, contention and problems arise as the joint venture progresses. Although anticipating the myriad of potential scenarios before exploration begins is next to impossible, if both parties recognize these points from the outset, disappointment seems less likely.

1. Both party's perception of the geologic target and potential economic value should correspond. A reasonable minimum exploration expenditure over a fair time frame should reflect the likely cost of testing the target hypothesis. Both parties should be after a quick go, no-go decision.

2. A major needs to be able to acquire a significant portion of a discovery commensurate with the risk and costs the project will eventually incur. Until a deposit is delineated, the property is little more than a piece of dirt the junior is particularly fond of.

3. The junior needs to retain enough exposure that if their property produces a major discovery it has a significant impact on the share price. If the discovery does not meet the major's goal, the major should divest allowing the junior to move it forward if possible.

4. My preference is to see the junior operate and test the target in at least phase one of the program. All too often a major seems to send a geologist who is unfamiliar with the mineral system to drill holes where a geophysicist in the head office directs him.

Alan Savage is positioning Doublestar for higher metal prices and points out that "my experience has been somewhat parallel with the comment of your reader in that 30% to 50% of a project has never generated the investor interest that, right or wrong, 100% generates. You would think that a 50% interest in a given project would generate one-half as much interest as 100%. In practice, 50% interest generates about 15% as much investor attention as 100% does. And yet, two 50% interest's generates twice the likelihood of success that one 100% interest generates".

"Accordingly, I have the following comment. If the junior miner has a strong, liquid balance sheet, then it can afford and practice the better course (the Southwestern jv course). If the same miner is under-funded it is required to follow the "neck-or-nothing" course in order to generate the interest to get the funds to assume a more carefully reasoned business plan."

"In our case, at Doublestar, we have never in our five-and-one-half years of existence had above $200,000 in our accounts. In other words, insufficient funds to follow either course effectively. Consequently, we have taken a third course which is simply to spend our brainpower in acquiring metal-in-the-ground projects against which to lever the funds which must surely come to us as this worm turns".

David Watkins, Atna Resources, lays out their strategy to build a company by generating cash flow through mining, which will in turn fund exploration.

"I think you missed the 3rd option for funding: generate your own cash flow. Your 1st option, diluting, is something every business should work to minimize or at the very least, ensure that it is accretive and adds value. Unfortunately, too few explorers have too little exposure to the ravages of dilution and consider raising funds for exploration as a job protection scheme not substantially different from approaching a board of directors in a larger corporation. Your 2nd option, JV, is an intelligent approach and it blows my mind that so few companies, including the large ones, see this as a business strategy. Too often, it is a desperate, ill thought out, last gasp to either salvage anything or a greedy attempt to scam someone on a one shot deal".

"However, the 3rd approach, creating cash flow, gives the best of all worlds:
a) it creates the opportunity to minimize dilution - you can go to the market on your own timing
b) it integrates well with the JV approach i.e. they are complimentary strategies
c) optimal exploration conditions can be created - a systematic long term approach is the key to exploration success, both in terms of team building, consistency, and focus, persistency, and continuity in the most potentially productive areas.
d) it broadens the investor base, creating a far more attractive vehicle with more leverage to exploration success".

"I could probably think of a dozen other reasons to compliment these. The true key, however, is to have management that understands and believes in exploration as a means to create wealth. And that is where Atna stands - short term, we will get cash flow; meanwhile, we will continue to generate new exploration opportunities and do our damndest to bring other people's money to the table for exploration. Once we have cash flow, we will be strongly positioned to maximize value from ensuing discoveries, be it through selling them or developing them. There is real value in options"!

"I think that the key is low cost entry to cash flow. That translates to metal production: Au as dore or Cu as cathode is best because of marketing and capital issues. Au can work as open pit or high grade

underground and Cu as oxide production to cathode. Industrial minerals are OK if established operations with an existing market exist i.e. not having to get into too much market development cost and risk".

Despite my well documented aversion to yellow trucks and mines (02-09-01sheet) and the fact that very few exploration groups successfully make the transition from explorer to miner, there is precedence. First Quantum (FM.T) is a good example, having started with a very profitable copper and sulfur operation in Zambia and now being involved in some of the biggest copper deposits in Africa. Barrick also springs to mind, having acquired Camflo to get some cash flow, then moving on to Mercur, Holt-McDermot, and then their blow-out exploration success at Goldstrike. Goldcorp is another good story: they acquired cash flow from industrial minerals (limestone) while they kept operating a dog of a gold mine but used the cash flow to keep up exploration until their current success. Richmont is a small operator that has successfully run for a number of years - the difference here is that they purposefully kept small. But the platform could have been used to do the same thing.

The feedback I received on this topic was all appreciated. What about deals and dealing with majors and juniors? Where's the balance?

Be sure and let me know how the following Baked Camel recipe goes over with the kids. I'm told you can add a couple of rabbits if you are expecting a crowd.

Baked Camel

Categories: Meats
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Main dish
http://www.ichef.com/cgi-bin/findrecipe.cgi?cat=Main+dish&Find=Find&scope=All+Recipes

Crowds
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Yield: 400 servings
1 lg Camel
2 lg Sheep
4 lg Turkeys
20 lg Carps
200 md Sea-Gull Eggs
400 lg Dates
Banana-Leafs

Cook the eggs, peel them. Scale off the carps. Fill the carps with the dates and the eggs. Fill the turkeys with the Carps. Fill the sheep with the turkeys. Fill the camel with the sheep. Dig a large mould, give in about 500 kilos of charcoal and light them. Wrap the camel in the banana-leafs and give into the mould. Cover with earth and bake for two days. Serve with rice.

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