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Five junior miners that could be bargains

If you have an appetite for risk, here are resource plays with strong management and plenty of cash

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There's an old saying that tells investors to buy when there is "blood on the streets." Right now, few avenues are as soaked in plasma as the path taken by junior miners.

The S&P/TSX Capped Materials Index, which tracks miners, has lost 42 per cent of its value this year, falling to its lowest level since the end of 2005. Many junior players have lost more than half their value.

But it looks like the market may have oversold commodities. For example, analysts expect copper to average $2.25 (U.S.) a pound in 2009, compared with a current spot price of $1.68 a pound.

That divergence has got many investors' attention. David Stein, a mining analyst at Cormark Securities, sees "some very compelling opportunities" in the junior mining space. And John Ing, CEO of Maison Placements says junior gold miners are trading at levels not seen "for eight to 10 years." Mr. Ing also thinks in this market, it will be cheaper for the gold-mining majors to buy reserves rather than develop them. But all of them stress juniors are for an investor with an appetite for some risk.

"Definitely be extremely cautious," says Brent Cook, a geologist who spent 25 years in the trade before launching mining newsletter Exploration Insights earlier this year. "It's going to be very tough to raise money for the next year or two, but that's not to say that there aren't bargains out there." Do your homework: Look for companies with lots of cash, and with strong management teams. Here are some names to get you started.

Diamonds North (DDN): This Canadian company is working on the Hepburn project mine, which Mr. Cook feels could be a world-class diamond deposit.

"It's believed to be the best property in the Nunavut area," he says. "Think of the value of Ekati or Diavik (Canada's two largest diamond mines) – that's the goal." Mr. Cook acknowledges that this is a highly speculative play. "It's a home-run or nothing," he says. The company has $12-million on hand – enough to last through only next year, he says.

What he's betting on is that a recent set of drilling results is going to show that Hepburn has enough big diamonds to make it a world-class project. A report on the results is due within the month. Mr. Cook likes the fact that Diamonds North's team has experience at Ekati. And he thinks CEO Mark Kolebaba could be one of the industry's rising stars.

"He's a younger guy, but he has great experience, and he's very aggressive at getting the most out of money," Mr. Cook says.

If the drilling pans out, Mr. Cook expects the big players will come running. BHP Billiton paid $687-million for 80 per cent of Ekati, while Rio Tinto's 60-per-cent stake in Diavik was initially valued at $780-million. Mr. Cook owns shares in Diamond North.

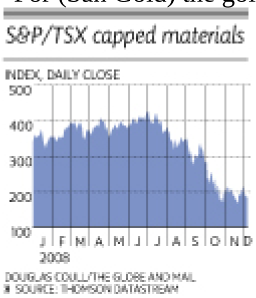
San Gold (SGR): San Gold is off 21 per cent at $1.03 (Canadian) a share this year – but it's lost half its value since the commodities world went up in smoke in July. Mr. Stein believes the drop is overdone. He likes the company because it has the cash on hand needed to develop its key property.

San Gold runs an underground gold mine in Manitoba – Mr. Stein likes that lack of political risk. He expects San Gold to release new resources estimates soon based on a series of drill tests.

Mr. Stein believes the miner has potential for a "big upgrade." Recently the company claimed to have hit a "bonanza" grade zone while drilling. Mr. Stein also likes the fact the Rice Lake mine isn't expected to be too big, producing perhaps 150,000 ounces a year. The Cormark analyst believes right now big is bad – he feels even the majors will have trouble developing billion-dollar properties in this environment.

And there's a last twist for San Gold, in Mr. Stein's opinion: It does all of its business in Canadian dollars. Gold surged to a new high in Canadian-dollar terms in early October because the loonie has dropped alongside the precious metal.

"For (San Gold) the gold price environment has never been as good as it is right now" he says. Mr. Stein has a $2 a share 12-month target on the stock. Cormark has done underwriting for San Gold and it occasionally holds shares of the company to help make markets for its clients.



Eldorado Gold (ELD): Eldorado is a rarity in the current market – the stock is up this year at $7.15, although it has had a 21-per-cent haircut since the July highs. The company is one of Mr. Ing's favourite junior producers.

"Eldorado has good management, a strong balance sheet, a rising production profile and a solid portfolio of potential producers" he says. He likes the fact the company is on the cusp of becoming a mid-range producer: Eldorado is scheduled to produce 300,000 ounces of gold this year. It is working to bring on an additional mine in Turkey and bought the rights to one in Greece earlier this year.

Mr. Ing also points to the firm's low cash-costs – $225 to $260 (U.S.) an ounce. And like many others, Mr. Ing prefers well-capitalized companies. Eldorado had $51-million in cash on the books at the end of the third quarter, one-and-a-half times the amount of debt it holds.

With eight million ounces in reserves, Eldorado is selling for about $260 an ounce – a valuation that Mr. Ing says is on the low side. He points out to Kinross' recent takeover of Aurelian Gold, which he says valued Aurelian at close to $600 an ounce "and they weren't even in production".

Mr. Ing also thinks investors can buy ounces on the cheap right now. He stands by the theory that the U.S. government's decision to make money cheaper, and to pump cash into the system will be inflationary and he says that will drive the yellow metal higher. He expects to see an average bullion price of $1,000 in 2009. Mr. Ing owns Eldorado and he gives the stock his highest buy rating. Maison Placements doesn't make specific 12-month price targets.

Cardero Resources (CDU): Brent Cook is not a macro-economics guy, so he's not too concerned about falling commodity prices. "I look for a good project that a big company will buy," he says. "If you find a major deposit, there's always a buyer."

And Cardero Resources already has a buyer lined up. The company has agreed to sell an iron-ore mine it's developing in Chile to China's Nanjinzhao Group for $200-million. That's $3.50 a share – double Cardero's current price. However, there is a catch: Nanjinzhao can walk away in the next nine months at a cost of $10-million. Of course, Cardero can also look for another buyer.

Mr. Cook says that's a possibility. "I know both Indian and Chinese firms looked at it," he says. He also thinks Vale could be interested because shipping to China from Chile is far less expensive than from Brazil.

China consumed about half of the world's iron-ore last year. Mr. Cook expects Nanjinzhao will make the deal because China has been looking to reduce its reliance on the three big iron-ore plays – Vale, Rio Tinto and BHP Billiton – which, according to industry group Iron Ore Trust Fund, control 69 per cent of the seaborne ore market.

With a preliminary study saying the mine has $4-billion worth of ore, Mr. Cook feels it has the scale to lure a Chinese buyer.

"They tend to look further out then North America does – even with falling iron-ore prices, this makes sense for them," he says.

If the deal goes through, he expects Cardero will use some of the cash to develop a smaller Chilean iron project – which he estimates has a market value of $200-million to $300-million. Cardero's current market-cap sits around $100-million.

Mr. Cook owns shares of Cardero, as he does in any stock he recommends in his newsletter.

NevSun Resources (NSU): This Canadian miner is a favourite of Haywood Securities Analyst Stefan Ioannou. He calls the company's Bisha project in Eritrea "world class."

Mr. Ioannou says the company is ready to start mining, and at very low costs. The last stage is to raise the cash needed to fund the mine.

"It will (cost) about $250-million. Usually to develop a deposit of this size you would expect costs closer to $1-billion," he says.

Part of the reason Bisha is so cheap is that the first stage of the mine involves a very high-grade gold deposit at its surface. Mr. Ioannou estimates that will produce 400-450 thousand ounces of gold per year for the first two years at a cash cost of around $250 an ounce.

“If gold stays above $600, NevSun will make back its capital costs in the first two years,” he says. Bisha will produce other metals as well, diversifying NevSun’s resource base. Mr. Ioannou expects production of 170 million pounds of copper a year for three years at 80 cents a pound, and 220 million pounds of zinc at 20 cents a pound for five years. Those are both less than half of today’s spot prices for the metals.

The last piece of the puzzle is financing. NevSun recently received an $89-million loan from a South African bank. Mr. Iannou says that shows there is a “high degree” of confidence in the project.

NevSun has $60-million in cash in the bank and expects to close a $69-million dollar debt financing by the end of the fourth quarter. At that point, NevSun says it will have the money it needs to move forward with construction.

Mr. Ioannou is a little more conservative – he’s expecting the debt deal to drag on into the first quarter of 2009, and that NevSun will look to raise an extra $20-million in equity.

“That won’t be too difficult for a project of this size, even in this market,” he says.

NevSun expects to be in production by the second quarter of 2010. Mr. Ioannou says early 2012 is a safer bet. He does caution investors that in addition to the funding risk, there is an element of political risk. However, he’s confident that NevSun and the Eritrean government have worked out a mutually beneficial deal.

Haywood Securities has had an investment banking relationship with NevSun. Mr. Ioannou doesn’t own the stock personally. He rates NevSun a “sector outperform” with a 12-month target price of $2.75 (Canadian) a share, compared with 50 cents at present.

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