Louis James: Are You Ready for an Early Shopping Season?

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COMPANIES MENTIONED

- **Almaden Minerals Ltd.**
- **Balmoral Resources Ltd.**
- **Continental Gold Ltd.**
- Dalradian Resources Inc.
- First Majestic Silver Corp.
- **Fortuna Silver Mines Inc.**
- Osisko Mining Corp.
- **Pretium Resources Inc.**
- Rubicon Minerals Corp.

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THE ENERGY REPORT
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Sometimes hindsight can lead to foresight. Casey Research's Louis James says now that the market seems in agreement that December was the bottom for gold, the value of these companies is becoming evident to investors and majors that could start going on a shopping spree. In this interview with *The Gold Report*, James sees the Osisko bidding war as a harbinger for deals to come, and discusses companies that could offer shoppers real bargains.

Source: JT Long of *The Gold Report*

***The Gold Report*:** Jeff Clark, senior precious metals analyst at Casey Research, recently wrote in an article titled "Time to Admit that Gold Peaked in 2011?" that countered a chart making the rounds showing gold matching its 1980 inflation-adjusted dollars peak in 2011. The chart implies we should expect a decade or more of lower prices. Aside from the fact that John Williams of *Shadow Government Statistics* might have a problem with how inflation was calculated, how are gold's fundamentals different today than they were in 1984?

Louis James: The fact that things are different today than in the 1980s is a really good point. The argument over methodology almost doesn't matter. Even if it were true that the gold price of 2011 matched the inflation-adjusted gold price of 1980, that wouldn't mean that gold has to go down the way it did in 1980. There wasn't a near collapse in the banking sector back then. There wasn't the Lehman Brothers upset. The government did not triple the money supply. We're dealing not with apples and oranges, but apples and whales.

TGR: If history is not a map for the future, is John Williams correct that we are getting ready for hyperinflation?

LJ: History never repeats itself, but it does rhyme. I agree with John Williams. On a fundamental level, profligate governments around the world have been spending beyond their means, and eventually they have to pay the piper. The longer they put it off, the bigger the bill gets. Is it all going to unravel this year? I don't know, but it's impressive that someone as cautious as John Williams seems to think that it will. But whether it happens this year or next, it doesn't really matter as long as you're investing with a long-term view.

TGR: In hindsight, a lot of people have targeted last December as the bottom of the gold market. Do you look at those sorts of things in the rearview mirror?

LJ: On January 6, I published a statement to the effect that both Doug Casey and I thought our market would turn upward in 2014. On February 3, I said in print that the bottom was in December. I wasn't willing to say that until the upturn was reasonably clear, but if we wait too long to take the plunge, it's of no use; when it's obvious to everyone, you lose much of the upside. Those of us who started buying in January and bought aggressively in February have benefited enormously. We were actually able to issue some profittaking calls in March before the market started correcting again.

TGR: What gold number are you using to evaluate whether a company can be profitable for the rest of 2014?

LJ: I have two numbers I keep in my head: spot and the three-year trailing average. It used to be cautious to use the three-year because gold prices were rising and the averages were lower than spot. Now the three-year is $200 above spot, so there are serious perception and credibility issues with using it in print. But I do still look at the three-year, because the low gold prices we have now will not last.

*"**Pretium Resources Inc.** is at the top of my potential takeover list."*

Right now, the price of gold is flirting with cost of production—it's not sustainable. Some companies are using three price scenarios in their feasibility studies: a base case near spot, a scenario at significantly lower prices and another at significantly higher prices. Today, that more optimistic scenario is often the three-year trailing average. I like this approach; I want to see that they have a project that works right now. I want to see that if gold goes lower for a while, they're not going to dry up and blow away in the wind. And I want to see if gold goes higher, how much higher my return will be.

TGR: Are you investing based on the fundamentals of the macro gold and silver market or based on the challenges and opportunities of the individual companies?

LJ: The macro picture sets the stage, but it doesn't help you pick a stock. I'm very much looking at the individual companies.

TGR: It has been a tough couple of years for junior mining companies. Some haven't made it. Is it easier to spot the good ones than it used to be because there are fewer of them?

LJ: Yes and no. The field has not been cleared that much at all; many penniless companies have gone into hibernation—a few have even left the field and become medical marijuana companies—but the oft-predicted tsunami of bankruptcies has not appeared. On the other hand, if you see a company that's got the goods that was previously trading at two or three times its current price—and has the cash to keep advancing—it's not a bad bet that it will rebound with the market. It doesn't even have to hit a new high to make you a bunch of money.

Because there are many opportunities today to buy companies that have already produced extraordinary discoveries, there are far fewer grassroots-type projects in our portfolio. It's not that we don't like early-stage exploration—those companies actually have the most explosive upside potential—but that with so many less risky, quality plays on sale, it's just too tempting to go with the safer bets.

TGR: One of the big takeovers that has been in the news lately is the bidding war over Osisko Mining Corp. (OSK:TSX). Is that setting the stage for a lot more merger and acquisition (M&A) activity?

LJ: It was a wakeup call. Industry observers were wondering when the M&A was going to start heating up. During the downturn, there was evidently a mindset that there was no hurry: Why pay X today when they might be able to pay 0.75X in a month or two? Since the market appears to have bottomed in December, that logic is now reversed. With the bidding war over Osisko, more companies may now feel that they have to step up the tempo, or risk losing out.

TGR: What companies are most attractive in this kind of environment?

LJ: Each company will go after assets that meet their own profile of quality and budget.

One company at the top of my potential takeover list is Pretium Resources Inc. (PVG:TSX; PVG:NYSE), Bob Quartermain's company in British Columbia that has one of the biggest, high-grade deposits in the world. There are very few million-ounce-plus deposits that are such high grade. This one has more than 10 million ounces (10 Moz) of Measured, Indicated and Inferred ounces. It's the sort of project that produces robust margins, such as the very robust 35.7% internal rate of return in the company's preliminary economic assessment (PEA).

This has to be a very interesting target for potential shoppers like Goldcorp Inc. (G:TSX; GG:NYSE), which lost the bidding war for Osisko, and now has about $3 billion burning a hole in its pocket.

TGR: Is it more attractive to companies that are in the area already?

LJ: You might think so, but there isn't much production in northwest British Columbia. The area is prolific for discoveries, but there are few producing assets at the moment.

To continue the thought of what else Goldcorp might want to buy, now that someone else grabbed Osisko, another top pick that fits the bill is Rubicon Minerals Corp. (RBY:NYSE.MKT; RMX:TSX). It has a high-grade deposit—not as large, nor as high-grade, as Pretium's, but it's substantial and it's only seven kilometers from the head frame at Goldcorp's Red Lake gold mine. It doesn't get any more in your backyard than that.

TGR: It looks as if Rubicon's share price is down quite a bit from last year. It's essentially on sale.

LJ: Yes, indeed. This current pullback can be a blessing; it creates an opportunity for those late to the game.

*"**Balmoral Resources Ltd.** has several years of very successful drilling."*

But it's not just Rubicon; most stocks in our sector have retreated significantly since their March highs—though still they remain well above December's lows. It's definitely a shoppers' market.

TGR: Where else are you seeing potential?

LJ: Another pick along the lines of "large, high-grade discovery in hand and cashed up" is Continental Gold Ltd. (CNL:TSX; CGOOF:OTCQX). Its primary asset is a large, high-grade gold discovery in Colombia. It had more than 5 Moz in all categories when we first bought, and just upped that to more than 7 Moz, and I think it may soon have a shot at the 10 Moz mark.

Some investors are a little uncomfortable with Colombia, which has opened up a great deal, but remains a challenging place to work. That's not unreasonable, but the country has proven itself to be a jurisdiction where people can work if they do things right. At the end of the day, it comes down to margin; will it pay for all that's necessary and still produce a great return? Continental has the goods.

TGR: What else is interesting you right now?

LJ: Another one of my favorites is less on the radar: Dalradian Resources Inc. (DNA:TSX). Dalradian has a large, high-grade deposit in Northern Ireland. It's not a mining jurisdiction that a lot of people are familiar with, but that doesn't make it a bad mining jurisdiction. In fact, the government there has permitted Dalradian to go underground for bulk sampling, which means the company has an exploration mining permit and will soon be blasting tunnels. If locals were afraid of the project, it would have never gotten that permit.

The political risk that is assigned to this story is overdone. It's worth more than the market is giving it. It's very high-grade, more than 10 gram per ton (10 g/t) material. Parts are up in the 20 g/t area. Very exciting potential margins, and the market doesn't seem to get it yet. The proof will be in the pudding soon enough.

TGR: How about a long-term play?

LJ: Balmoral Resources Ltd. (BAR:TSX; BAMLF:OTCQX) does not have a resource in hand, but it has several years of very successful drilling. It may, in fact, be on to two completely different, large, high-grade deposits, one gold and one nickel-copper-platinum-palladium. Shares are way up on spectacular drill results, so I wouldn't chase the stock, but I do expect more of the same from this summer's exploration program.

TGR: When might it have an NI 43-101?

LJ: Hard to say, with both deposits still in their early days and wide open. Balmoral could have a first stab at estimating a gold resource on its Martiniere gold discoveries, but that could be premature. Fortunately, Balmoral doesn't need to raise money to keep drilling, but if the stock keeps going up, I wouldn't be surprised to see the company raise more while it can do so with minimal dilution.

TGR: Mexico is another country that you've covered quite a bit. What do you think about Mexico after the new mining tax?

LJ: I still like Mexico, but it has indeed just become a more expensive jurisdiction for miners to operate in. There's a chance that the special tax on precious metals mines may get struck down on constitutional grounds. That case is being made in Mexico.

Meanwhile, it means a company needs to have that much richer of a project. That's a good segue into Almaden Minerals Ltd. (AMM:TSX; AAU:NYSE), which just came out with a PEA with an acceptable rate of return. Not a spectacular one, but a decent 20+% rate at current metals prices—even with the new tax in place. That's a good example of a project that is rich enough to pay for all kinds of sins—even sins of the government.

TGR: Did you like Almaden's PEA better than the market liked it?

LJ: I did. The fact that the stock didn't soar on that PEA says that people were not deeply undervaluing it, but it didn't tank either. The stock has performed in step with the sector. Gold has dropped, Almaden has dropped. However, there are new exploration results with game-changer potential on the way.

TGR: What are your thoughts about silver compared to gold?

*"**Almaden Minerals Ltd.'s** new exploration results with game-changer potential are on the way."*

LJ: There are vibes about silver volatility being at near-decade lows and that always precedes a surge. I'm not sure the numbers actually bear that out, other than to say, generally speaking, that low prices precede high prices because markets are cyclical. If we're at a cyclical low, it's not rocket science to say it's going to go up.

That having been said, there are so many new uses for silver out there, I see very strong demand, particularly in solar panel use, which is rising and rising.

My way of looking at it is that silver and gold always move together. Sometimes the ratio stretches. Sometimes it contracts. But they always move together. If you're a gold bull, you have to be a silver bull.

On top of that, silver is an industrial metal, while gold is primarily a safe-haven metal. If the economy is successfully reflated by the governments of the world, then demand for silver rises. You have a safer bet on silver than gold in that respect. If, on the other hand, government efforts to save the collapse of the global economy are unsuccessful, then industrial demand may fall off, but the precious metal safe-haven demand will pick up. Where gold goes, silver goes also. It's a win-win metal.

TGR: Are there some silver companies that you like a lot?

LJ: Many gold companies also produce other metals, like silver or copper. They like to use the term "gold equivalent," or AuEq. Our favorite gold-equivalent is when the "Eq" is silver. Some of the companies we've mentioned already, like Pretium, have been mining electrum, a gold and silver alloy.

Regarding silver companies, I was very happy to see that Fortuna Silver Mines Inc. (FSM:NYSE; FVI:TSX; FVI:BVL; F4S:FSE) and First Majestic Silver Corp. (FR:TSX; AG:NYSE; FMV:FSE), both picks of ours, reported net income last quarter. I'm happy with any miner that has been able to eke out a profit, given the belt tightening that has gone on. That means these companies bit the bullet, did what was necessary and delivered for shareholders. I'm very pleased with them.

TGR: You called this shopping season. Are the discounts steeper and is the quality as good as it used to be?

LJ: I don't worry about such comparisons; I'm looking for, and happy to find, something that is legitimately undervalued. The company should have great management. Its flagship project should have a net present value multiple over the company's enterprise value (or a clear shot at that), cash in the bank to advance, and be delivering excellent exploration or development results. Then the stars are aligned and it goes on my shopping list.

When will we see payday? As above, it could be this is the year—Doug Casey thinks so—but regardless you should come out well if you buy value on sale.

And it could happen very quickly: If the Ukraine situation pushes Russia and the Western countries into an economic tit-for-tat that sends the dollar over the edge, it could trigger the proverbial "it." You don't want to be short when the train is leaving the station.

TGR: Thank you for your time, Louis.

Louis James is at Casey Research, where he's the senior editor of the International Speculator, Casey Investment Alert *and* Conversations with Casey. *Fluent in English, Spanish and French, James regularly takes his skills on the road, evaluating highly prospective geological targets, visiting explorers and producers at the far corners of the globe and getting to know their management teams.*

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