



The Changing Dynamics of Gold Stocks - Eric Coffin

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GEOFF CANDY: Welcome to this week's edition of Mineweb.com's Gold Weekly podcast. Joining me on the line is Eric Coffin - he's the co-editor of the Hard Rock Analyst family of publications, all of which can be found at HRAAdvisory.com. Eric gold has been floating with the \$1,500 level for much of the last few days and it looks almost inevitable that we're going to see a breach through that level in the near future. How important is that \$1,500 level?

ERIC COFFIN: It is important to a lot of people - it's not very important to me personally but I know it's been a target for a number of people - I suppose for us our target this year was \$1,450 to \$1,500 - in there somewhere - it's one of those round numbers that if it gets through there you'll probably see a bit more buying on the large cap gold equities because we saw that when it went through \$1,400 - the large caps had kind of stalled a bit but they started to pick up steam again when it got through another \$100 mark, if you will.

GEOFF CANDY: If we look at the equity market though the gold stocks don't seem to have done as well as the gold price - why is that?

ERIC COFFIN: If you look at the long term trend - if you go back to the start of this bull market about 10 years ago when gold was sitting at \$280 - gold stocks generally - I'm talking about larger producers - carried PE ratios in the 30 range which was quite high in relation to the rest of the market. And at those gold prices, people were buying the in-ground reserves if you will, rather than the earning stream. They were paying a premium to get a call on a higher gold price. Now that gold has gone to almost \$1,500 that premium that people are willing to pay for the call on higher prices is getting smaller and smaller and gold stocks are simply beginning to trade more in line with PEs of other business sectors and we think that's pretty much the way it's going to be going forward. As much as it would be nice to see our producer gold stocks go back to 30 PE ratios, I wouldn't count on that happening any time soon.

GEOFF CANDY: How much of that also has to do with the fact that it's very difficult these days, particularly on the large producers side, to find a pure gold play because so many of the new ounces are coming as copper porphyry for example or polymetallic deposits?

ERIC COFFIN: That may be part of it - I know there are certainly gold bugs that only want pure gold deposits and certainly if you look at companies like Barrick, the fact that some of the gold was coming out of porphyry's (that also produced copper) was like the dirty secret that they weren't talking about for years. It was obvious if you went to look at the deposits that that is what they were but there but they always kind of avoided saying that. Goldcorp did the same thing, reporting gold equivalent ounces and cash costs and just ignoring the fact that they were also producing copper, which is kind of ironic because copper has actually had a bigger move than gold has, and a lot of the high margin producers are actually mixed. By and large, that's probably how it's going to be going forward. I mean I think any of the large producers - offer them 20 million ounce deposit that's pure gold, that's one they're going to take first if the economics work - but the truth of the matter is that for a company like Anglo American or Newmont or Barrick or Goldcorp to grow production at the rates that all of them say they're going to try to do, you're pretty much left with things like porphyry - it's not just a matter of grade it's a matter of what can you mine at a large enough scale to be able to produce four or five or six or 700,000 ounces a year. As wonderful as some of the high grade deposits are, and we've had a soft spot for the high grade stuff, it's difficult to operate one of those as an underground operation on that kind of scale. You need something big, bulk tonnage, and generally speaking most of the things we're working on these days are porphyry's and again that's just how it's going to be - with copper at \$4.30 that's hardly the end of the world.

GEOFF CANDY: Having said that then, where are those answers going to come from, given that the scale of them needed by the big players...

ERIC COFFIN: I think a lot of them will come from porphyry's - we'll increasingly see the gold producers doing deals on large porphyry deposits and their preference is going to be gold dominant ones and they'll probably try to stick with that, because they do recognise that a big part of their audience is people who want a "gold" stock. But there are a couple of areas - West Africa where there are a number of things being drilled that look like they could have some size. Go back to Indonesia where there is stuff there that looks like it's got some size and in some of those cases the

large deposits are copper gold, though there are gold only systems too. I think the other change that you're going to start seeing (it's actually surprised David and I that this hasn't happened quicker) a lot of these areas like West Africa have always been an oxide-gold dominant production area - in other words it's all heap leaching. Companies would drill down to the sulphide boundary and then pretty much ignore the rest of it. In places like West Africa and Mexico you're going to see companies go back and revisit these things because at \$1,500 if you've got a gram per ton deposit that's bulk tonnage or a gram and a half that's bulk tonnage, you can probably start looking pretty seriously at putting a big mill on it and not just stopping production when you hit the sulphides at depth, but in fact getting it all out - running it through a mill because you get higher recoveries. And if you look at current gold prices the dollar per tonne value, even at a gram per tonne, is similar to the copper porphyry's that people have been mining for decades and making money on. Gold producers basically just want heap leach for a long time, but those days are probably over too. I think we'll see the big guys building more mills and that's how they're going to increase production.

GEOFF CANDY: Would that increase costs as well, because clearly that's another problem.

ERIC COFFIN: It will but when you're doing big high volume open pit production, the one cost that that tends to leave you open to, that small underground deposits don't, you're a bit more dependent on power costs - which isn't of course a great thing with oil at a \$105/bbl, but you've got big copper producers who are producing and making pretty good money at 0.3% or 0.4% copper which, at today's prices, is \$25 to \$35 a tonne, at \$1,500 gold that's less than a gram. So I don't see any reason why you shouldn't get similar economics when you put on a mill because when you put a mill on a lot of these deposits you not only increase the production rate, your recoveries overall are probably going to go from say an average of 65% to 70% recovery to say 85% to 95% recovery - and again when you're dealing with \$40 or \$50/gram gold, getting another 0.2 or 0.3 out of it because you put a mill on it, you're talking \$10 or \$15 and that's probably going to carry most of the costs of mill production, as long as the deposit is big enough to justify building the mill in the first place.

GEOFF CANDY: Looking at the big producers, we've seen Barrick split and African Barrick Gold - there's been a lot of rumours floating around about the fact that AngloGold Ashanti might do similar things and then on a smaller scale you've got something like Exeter Resource and their spin-off ExTorre doing remarkably well - in fact better than the parent company. Do you think that this is a trend that we're likely to see more of, where these big guys, purely because ounces are slightly harder to come by now, start focusing in specific areas and perhaps spinning off or unbundling?

ERIC COFFIN: Yes that will be some of it, it gives the producers a way to allow investors to focus on geographic areas that they like. It's also a way for producers to unbundle political risk, if they perceive it or if they think the market does because if you look at a company like Goldcorp for instance which always carries good value - carries a good PE - part of that is of where they operate of course - all of their operations are essentially in North America and Mexico and there seems to be some benefit in that because every time you turn around something is started in some country or somebody gets elected that's going to start this, that or the other thing that might be harmful to the mining sector. I think you're going to see some of these guys spin off that way to create some geographic units that allows them to give people a choice of risk return levels if they're not comfortable with political risk in different areas. There are some areas that the market really latches onto - Argentina being one of those areas. West Africa is another one of those areas where people are seeing a lot of growth potential and the majors are viewing that as a way to give people specific products if you will, not just one size fits all gold producer.

GEOFF CANDY: I know you're on record as saying that the Yukon offers some interesting potential. Are there any other geographic areas that you like at the moment?

ERIC COFFIN: We like West Africa - it's one of those areas where there are people working diligently in growing resources and in several gold mines have gone into production and in fact nobody seemed to care for a long time - it's only been in the last - I would say - year that you're starting to see them really get traction again out of places like Ghana, Burkina Faso, Mali. Argentina is another place that we like a lot because it's similar to the Yukon in the sense that there are very large epithermal gold systems that are being discovered, but there's also large areas that are really very unexplored. It's a very big area - there's not a lot of outcrop in some of these areas. Quite a few of these areas in Argentina that have had are relatively recent volcanic ash falls and there's not a lot of obvious outcrop. People who have gone in there have been able to build quite large ounces in these large epithermal systems and because that's a relatively lightly explored area we think that the Yukon, Argentina and West Africa - all three of those areas are going to generate a bunch of new deposits.

GEOFF CANDY: Looking at broad brush strokes now, can a case be made for the mid-tier producers over the juniors or the juniors over the majors, or indeed the majors given this current environment - is there a certain sector that you're looking at specifically or is it at a case-by-case level?

ERIC COFFIN: We tend to focus on pre-production stories. A lot of companies that we started following have found things and have gone into production so they're still on the list and they're producers now. Large producers are

basically going to trade with the gold price so you're buying a call on the gold price. With a junior you've obviously got a higher risk level. What we like about juniors if you pick the right ones, you're not just getting a call on the metal prices you're getting, more importantly, an option on the company's ability to make a discovery. All things being equal, a company that's discovering and growing deposits is going to get you a lot more returns than a company that's simply in production and is going to follow the gold price. Some of those producers have better growth rates and they'll give you higher returns as well. But the really large returns generally come from a company that has making discoveries and is growing assets because you can basically add value faster that way than you're likely to just waiting for the gold price to go up \$10, \$50 or \$60, but they're higher risk - that's the trade-off.

GEOFF CANDY: Sure - just to close off with, given what we've seen with gold and in particular what we've seen with silver over the last couple of months, there does seem to be some sort of expectation that silver has perhaps got a bit more to run than gold over the coming years. The silver-gold ratio is quite good at the moment - is that something you follow, and if so what's your feeling of it at the moment?

ERIC COFFIN: We don't attach any particular importance to the ratio. I know a lot of people do and a lot of them in our line of work if you will that insist the silver-gold ratio has to go back to where it was 50 or 60 years ago. I don't see any particular reason why it has to do that - it might do it, but I don't see why it has to do it. Silver is a relatively small market. A lot of people are believers that that ratio has to close in and the advantage it has as a small market is you don't really need that many large believers to move the price. It's really not that big a trading market and there are in fact some really big believers in the silver market who believe silver should be at \$50 or \$60. Some of those groups if they decide to back up their beliefs with dollars - it's probably going to go to those prices because they're big enough to probably do it themselves.

GEOFF CANDY: Finally, if we look at where we are in the macro-environment given what's going on in the US and in Europe as well, are you still bullish on the gold price and following that, some gold equities as well?

ERIC COFFIN: I am and as I noted earlier our main focus areas are trying to find people that are making discoveries because they can get some gains even if the gold price is flat. I'm not expecting gold to go to a million dollars or anything, but there's still some upside to it. Part of what I'm seeing really is - you're seeing China tightening, you're seeing much of the developing world tighten - that's making the market nervous because they're not sure whether they're going to overshoot and pull their growth rates back enough to really slow things in the developed world. If you look at places like the States in particular, most of the good news has been coming from export orientated sectors that are selling to those countries. My personal sense is that the ECB and probably Beijing as well - they're going to be much firmer when it comes to trying to control inflation which simply means they're much more likely to increase interest rates. China tightening is 'baked in the cake' - there's going to be some more rate increases there. The ECB is threatening to do some more rate increases if inflation numbers don't improve. I don't know whether that's smart or not, but nonetheless they're threatening to do it. There is rumbling about it by the US Fed but personally I highly doubt you're going to see a rate increase in the US this year. So at least in terms of the US dollar price that's quite good for gold and silver, and commodities in general because if you widen that interest rate spread between the US and Europe and other areas, you're simply going to drive more capital flows and probably weaken the US dollar and that in and of itself should be good for the gold price. There are also all sorts of political and fiscal risks which means there's still quite a bit of insurance buying in the gold area. It seems every day you turn around and something else comes out of left field that freaks everybody out and I don't think that's going to change any time soon. So there are lots of things that underpin the gold price right now.

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