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FAR EAST CAPITAL
The Mining Investment Experts

Weekly Commentary

17 April 2015 *On Thursday's close* *Analyst: Warwick Grigor*

63 carat diamond emphasises the calibre of the Lucapa Diamond project

Grade and quality is confirmed with 63 carat stone

Lucapa announced the recovery of a 63 carat Type IIa diamond this week, from its Lulo diamond concession. The significance of this is the enhanced confidence in the project's ability to produce exceptional, high value diamonds on a regular basis. Further, the location of this diamond shows that the high-grade areas extend over a larger area than previously determined.

News flow from Lucapa has been somewhat restricted over the last few months due to the wet season, but that is about to change. Overburden removal during this time has the company now ready to commence mining at the BLK-08 location where it has previously recovered very large diamonds of 131 and 95 carats. The sampling grade was extraordinarily high at 95 carats per 100 cubic metres (cphm), compared to the global project estimate of 10-15 cphm. A recovered grade anywhere from 10-95 cphm should quickly see strong positive cash flows. (*More on Lucapa and diamonds over the page*).

Overview across the sectors

While the negative press has kept the pressure on iron ore stocks, oils stocks have been staging gentle recoveries. Some gold stocks continue with uptrends. Many companies that were previously in downtrends are now travelling sideways along the bottom. The relentless selling has finished, though there is not much oxygen down there at these depths. Individual situations with merit are achieving tentative support – which is the way it should be - but volume continues to be an issue for most companies. Investors continue to watch from the sidelines with no urgency to act, so executives are better off spending the time to make their companies perform operationally rather than promoting prematurely.

The last iron ore companies standing will take it all

The announcement by Atlas Iron that it will close its iron ore mines was inevitable and predictable. The suspension of trading in its shares has left the shareholders with nowhere to turn, but shareholders in other small iron ore companies have quickly voted with their feet. New share price lows have been experienced right across the sector. The last ones left will have to turn off the lights.

The run we had in the iron ore price up to US$190/tonne was a once-off blowout of a cycle. Traders took the price beyond realistic levels in an effort to squeeze everything out of the market. The move to spot pricing was a contributor. Previously, when the iron ore price was based on annual contracts, there was no opportunity for the excesses we saw on the upside. Likewise, there wouldn't have been the opportunity to short the market and drive prices to the painfully low prices being seen today.

The iron ore price will recover at some point, when enough capacity has been knocked out of supply, but only the lowest cost companies will survive thereafter. We said in October 2013, "*the smart money is moving out of iron ore*". Today it is the not-so-smart money that is left in iron ore, having shrunk to micro-sized money. The smart money will stay away for a long time.

Atlas Iron's share price has fallen by 96% and BC Iron's by 95% from their high. The story is same throughout the sector. We are seeing the winding back of the clock and we will eventually end up with only three or four producers listed on the ASX. BHP and RIO will control the market again; game over for little guys.

Look for commodities not bound by the cycle (or for switches to technology)

The problem with resources sector now is apparent. Commodity prices have collapsed right across the board, in bulks and oil. That is where the big money operates. Resources is becoming more of a specialised sector, which is another way of saying that it is being marginalised. We have seen it before, with the level of funds invested in mining shrinking all through the 1990s, to reach a nadir around the turn of the century. Back then we saw many junior companies switching activities as the dotcom boom provided greener pastures. That is not dissimilar to what we are seeing now with technology opportunities being sought after. Flat-lining share prices of moribund juniors can jump 50-100% on the mere suggestion that technology deals are being assessed. Most of the deals will be flawed but there will be some interesting trading opportunities along the way.

Looking outside of the big cycles to make money, and away from commoditised product. Consider diamonds.

If we can't make money in the near term out of cycles and big money flow, then we need to turn to commodities that are not captive to cycles. These are more likely to be those that are not dependent not upon price movements of commodities to be economic. They need to have some geological uniqueness, be it a scarcity or an extremely high grade. The trouble with rising commodity prices is that they open the door to competition as economics of operating a mine become much more favourable. Oversupply eventually kills the boom and we are back to a situation where we are now, with the bulks.

One of the most difficult ways to make a buck in mining is to find a diamond mine. The challenge is about 1,000 times more difficult than finding a gold mine. This provides a natural barrier to entry into the diamond producing sector, with 99% of companies failing at the exploration phase. Diamond prices have a minimal impact on entry into the sector and so diamond price cycles are driven more by factors relating to income and marketing than to diamond supply. The variety of grades and quality of diamonds mean that there is always room for superior quality production, though you will often witness a number of lower grade and lesser quality diamond mines that have a marginal existence. Just as they say in the gold sector – grade is king.

Lucapa Diamond – positive cash flow is imminent

We continue to regard Lucapa as the most exciting, quality diamond project we have observed in the last 30 years based not on hype, but actual recovery and production. Two recent ASX releases on the 8th and the 16th of April have strengthened our enthusiasm. We have mentioned the release of the 16th above. We comment on the earlier release below.

Even though the wet season tends to impede production, and in particular access to the high grade areas, Lucapa was able to exceed budget in the three months to 31 March, producing 1,335 carats with large diamonds including sizes of 26.7, 23.4, 20.3, 19.8 and 15.1 carats in size. Several of these have been confirmed to be the rare Type IIa gem quality that command premium prices. The recovered grade for the quarter, of 10.34 carats per 100 cubic meters, is consistent with the past results and the mining plan.

It would be fair to ask why the Lucapa share price is back to where it was a year ago given the following milestones where achieved over the past 12 months;

- Capital raisings of $16m
- Granting of 35 year mining licence
- Appointment of experienced, ex-De Beers and Gem Diamond executives
- Confirmation that four kimberlite pipes are diamond bearing
- Average sale prices around $7,000/ct
- Successful completion of technical due diligence conducted by a lending institution

On any assessment you would have to say that Lucapa has been hitting its targets. Yet, the market still doesn't fully appreciate the company. Maybe it is because of perceptions around Angola, but that country has been stable for more than 10 years. It happens to host the best quality diamonds in the World. Maybe it is because of confusion as to what is the priority; alluvial or hard rock diamond projects. By focusing on the statistical uncertainties that are inescapable with alluvial mines, are people losing site of the potential of a good hard rock discovery to take capitalisation of a project to US$1bn and more? Maybe the market thinks that the $15m standby debt facility is a negative, though the ability to raise finance without diluting shareholders has got to be a positive.

The highest risk phase of the diamond projects are behind the Company. The discoveries have been made and now it is more of an evaluation process. It is about optimisation of the development programs for the alluvials, and finding out just how rich the kimberlite pipes will turn out to be. Most other diamond companies fail well before this time as the promotion rarely matches the delivery. These are the companies that leave investors licking their wounds. Lucapa has progressed much further down the path towards certainty.

Diamond company valuations are not perfect

Assessing stocks in isolation gives no yardsticks to assist in the investment decision. It is always better to make a comparative analysis in order to better understand the situation. Look at other companies in the sector and see where the differences are in valuations and try and figure out why.

By way of comparison, there is a diamond exploration stock called Newfield Resources (NWF) that owns the Allotropes Diamond Project in Sierra Leone. It has just announced the commissioning of a DMS plant designed to process alluvial gravels identified over the past six months. The DMS circuit is only small, with capacity of 10 tph, though the front end feed rate could be higher. (Lucapa's capacity is 150 tph).

The anomaly in the market place is the differences in market capitalisations of the two companies. NWF, at a much earlier stage of development, has a market capitalisation of $150m, 3-4x that of Lucapa. It doesn't yet have a mining licence, and for all of the enthusiasm that it espouses, there doesn't seem to have been any diamond production reported to the ASX. It is all about prospective gravels.

Last September, NWF reported that four microdiamonds have been recovered from historical drill core. These microdiamonds were recovered from less than one gram of residue from an initial 7.5 kg sample. What does this mean? Firstly, "historical" core means that someone else drilled it. Who was it? Did they not recover any macro or microdiamonds? What did they conclude? Did they drop the property or was it taken off them? Secondly, the sample size is tiny at one gram. Maybe it is a bit much to be declaring the pipe to be diamondiferous at this point, especially since there was no disclosed quality control over the handling of the samples. It is all very theoretical and speculative.

Many investors are scared off by diamond exploration. Most of them don't know the questions to ask so they are invariably led by the statements of promoters. Very few mining analysts understand diamonds, so the broking industry is not good at advising investors regarding diamonds. Hence, many errors are made.

Both Angola and Sierra Leone are known for good quality diamonds. Both countries have had turbulent periods of civil war in past decades. Perhaps NWF will end up with some really good diamonds eventually, but they are still in the very high-risk stage of the project. It is too early to talk of success just yet. It is where Lucapa was a few years ago. Since then Lucapa has spent more than $50m, which is more than its current market capitalisation. The challenge for NWF will be to maintain enthusiasm, and a high share price, for the next couple of years while it carries out field programs. It will have to report very good results indeed. Over the same time frame Lucapa expects to achieve a strong cash flow from commercial alluvial diamond production (having already successfully completed the testing phase). The kimberlite pipe assessment is being led by macrodiamonds, not microdiamonds, and this has the pipes at a much higher confidence levels.

So, the point is that the risk reward ratio of two companies is out of alignment with the market capitalisations. The lower risk company is selling at a massive discount to the higher risk company. There must be an arbitrage opportunity here.

Sentiment Indicator: There has been a useful improvement in sentiment over the last week. There were 27% (23%) of the stocks in uptrend and 38% (42%) in downtrend.

Key Indices

Stocks			Trend Comment
All Ordinaries	XAO		Return to highs
Materials	XMJ		
Metals and Mining	XMM		Breached steep uptrend
Energy	XEJ		

Detailed Chart Comments

NB: Only the bold comments have been updated. Comments in grey type are from previous weeks and will be less relevant.

Stocks	Code		Trend Comment (updated comments in bold)	Main Interest
ABM Resources	ABU		Back to lows (on capital raising)	gold exploration
Alacer Gold	AQG		stronger, but hitting resistance line	gold – production
Alicanto Minerals	AQI		New low	gold exploration
Alkane Resources	ALK		down	gold, zirconia
Alliance Resources	AGS		collapse	uranium
Acacia Resources	AJC		Sideways at the bottom	coal
African Energy	AFR		Correction back to downtrend line	coal
Alara Resources	AUQ		Sideways at the bottom	zinc
Altona Mining	AOH		Sideways after capital return	copper
Amex Resources	AXZ		down	iron sands
Anatolia Energy	AEK		stronger	uranium
Anova Metals	AWV		Easing a little	gold
Atlas Iron	AGO		suspended	iron ore
Attila Resources	AYA		suspended	coal
Atrum Coal	ATU		Testing uptrend	coal
Aura Energy	AEE		Back to lows	uranium
Aurelia Resources	AIM		holding uptrend	gold/base metals
Australian Bauxite	ABX		Back in uptrend	bauxite
Avanco Resources	AVB		sideways	copper
AWE	AWE		Breaching downtrend	oil and gas
BHP	BHP		Crashed lower	diversified
Base Resources	BSE		Sideways at lows	mineral sands
BC Iron	BCI		Falling again	Iron ore
Beach Energy	BPT		Rising gently	oil and gas
Beadell Resources	BDR		Secondary downtrend	gold
Berkeley Resources	BKY		Rising off its lows	uranium
Broken Hill Prosp.	BPL		New high	minerals sands
Buru Energy	BRU		Breached downtrend	oil
Canyon Resources	CAY		Testing downtrend	bauxite
Carnegie Wave	CWE		Rising again	wave energy
Cassini Resources	CZI		downtrend	Nickel/Cu expl.
Chalice Gold	CHN		Testing downtrend	gold
Cleveland Mining	CDG		Rising within a wedge	gold
Consolidated Tin	CSD		Still in downtrend	tin
Crusader	CAS		Sideways at lows	gold exploration
Cudeco	CDU		Still suspended	copper
Dacian Gold	DCN		At highs	gold exploration
Doray Minerals	DRM		Steep uptrend breached	gold

Duketon Mining	DKM		down	nickel
Endeavour Mining	EVR		Bounced out of downtrend	gold
Energy Resources	ERA		Just holding trendline	uranium
Evolution Mining	EVN		rising	gold
Excelsior Gold	EXG		Strong rise	gold
Finders Resources	FND		Back to trendline	copper
First Australian	FAR		rising	oil/gas
Fortescue Metals	FMG		down	iron ore
Galaxy Resources	GXY		Steep rise, then correction	lithium
Geopacific Res.	GPR		downtrend	Copper/gold exp.
Gold Road	GOR		Steep uptrend breached	gold exploration
Gryphon Minerals	GRY		Down again	gold
Highfield Resources	HFR		Strongly higher	potash
Highlands Pacific	HIG		rising	copper, nickel
Hillgrove Resources	HGO		sideways	copper
Hot Chili	HCH		down	copper
Iluka Resources	ILU		Testing uptrend	mineral sands
Independence	IGO		rising	gold, nickel
Intrepid Mines	IAU		Sideways	copper
Investigator Res.	IVR		downtrend	silver
Karoon Gas	KAR		rising	gas
Kasbah Resources	KAS		New low	tin
KBL Mining	KBL		Sideways at the bottom	copper/gold/zinc
Kibaran Resources	KNL		Rising	graphite
Kimberley	KDL		down	diamonds
King Island Scheel.	KIS		rising	tungsten
Kingsgate Consol.	KCN		down	gold
Kingsrose Mining	KRM		Secondary downtrend	gold
Lamboo Resources	LMB		down	graphite
Laramide	LAM		Still down	uranium
Lucapa Diamond	LOM		down	diamonds
Macphersons Res.	MRP		breached uptrend	silver
Medusa Mining	MML		Uptrend	gold
Merlin Mines	MED		edging higher	diamonds
Metals of Africa	MTA		rising	zinc expl/graph.
MetalsX	MLX		Still in uptrend	tin, gold
Mincor Resources	MCR		Hitting resistance	nickel
Minera Gold	MIZ		New low	gold
Mount Gibson	MGX		Base forming	iron ore
MRL Corp	MRF		Recovery in price	graphite
Newfield Resources	NWF		rising	diamonds
Northern Minerals	NTU		Breached uptrend	REE
Northern Star Res.	NST		Strongly higher	gold
Oceana Gold	OGC		Secondary downtrend	gold
Oklo Resources	OKU		Surge then pullback	gold expl.
OM Holdings	OMH		Drifting lower	manganese
Orinoco Gold	OGX		down	gold expl'n
Orocobre	ORE		down	lithium
Oz Minerals	OZL		rising	copper
Paladin Energy	PDN		Testing downtrend	uranium
Pacifico Minerals	PMY		down	gold exploration
Pacific Niugini	PNR		rising	gold
PanAust	PNA		Rising on takeover bid	copper/gold
Pancontinental Pet.	PCL		down	oil/gas expl.
Panoramic Res	PAN		down	nickel
Panterra Gold	PGI		down	gold production
Paringa Resources	PNL		Short term uptrend	coal
Peel Mining	PEX		stronger	copper
Peninsula Energy	PEN		down	uranium
Perseus Mining	PRU		At lows of broad uptrend	gold
Platina Resources	PGM		Sideways	PGMs, gold
Red Mountain	RMX		Testing downtrend	gold exploration
Regal Resources	RER		Still in downtrend	copper
Regis Resources	RRL		Slump back to lows, then recovering	gold
Renaissance Min.	RNS		down	gold
Resolute Mining	RSG		Secondary downtrend	gold
Reward Minerals	RWD		Breached downtrend	potash

Rex Minerals	RXM		Downtrend again	copper
RIO	RIO		Hit resistance	diversified
RNI	RNI		New low	copper expl, gold
RTG Mining	RTG		lower	gold expl.
Saracen Minerals	SAR		higher	gold
St Barbara	SBM		Strongly higher – issue coming?	gold
Sandfire Resources	SFR		Breaching downtrend	copper
Santos	STO		Sideways at lows	oil/gas
Senex Energy	SXY		Rising again	oil/gas
Sheffield Resources	SFX		sideways	mineral sands
Silver Lake	SLR		New low	gold
Sino Gas & Energy	SEH		Testing downtrend	gas
Sirius Resources	SIR		Falling back to long term support line	nickel expl.
South Boulder	STB		rising	potash
Sthn Hemisphere	SUH		down	copper
Stavely Minerals	SVY		down	Copper exploration
Strike Energy	STX		down	gas
Sunbird Energy	SNY		Breached downtrend	gas/CBM
Sundance Energy	SEA		breached downtrend	oil/gas
Syrah	SYR		Breached uptrend	graphite
Talga Resources	TLG		Correcting following placement	graphene
Tap Oil	TAP		Down heavily	oil/gas
Tiger Resources	TGS		Base forming	copper
Toro Energy	TOE		Heading lower towards support line	uranium
Triton Minerals	TON		Surged through downtrend	graphite
UraniumSA	USA		Secondary downtrend	uranium
Valence Industries	VXL		down	graphite
Venture Minerals	VMS		New low	tin, iron
Westwits	WWI		Back to lows	gold exploration
Western Areas	WSA		down	nickel
Totals	27%	38	Uptrend	
	37%	52	Downtrend	
		139	Total	

Split of Companies Charted Amongst Commodities (approx.)

Gold	27	(20%)
Copper	20	(14%)
Oil/gas	13	(9.3%)
Gold exploration	12	(8.6%)
Uranium	10	(7.2%)
Graphite	8	(5.7%)
Nickel	6	(5.2%)
Iron ore	5	(4.4%)
Coal	5	(4.4%)
Tin	4	(3.0%
Diamonds	5	(3.0%)
Mineral Sands	4	(3.0%)
Bauxite	2	(3.0%)
Zinc	2	(1.5%)
Silver	2	(1.5%)
Other	14	
Total	139	

Guides to Chart Interpretations

- Charts usually go pass from one trend (up or down) into the other via a period of indecision and uncertainty during which the trend can either recover or change. This period is signified by the orange colour. The orange represent both the greatest risk and greatest reward possibilities.
- Once a chart is in confirmed up or downtrends it is not uncommon for 10-20% of that trend to have already transpired.
- There are trends within trends. The focus of this chart review is the immediate trend that affects the sentiment i.e. it can be a downtrend within a long-term uptrend.
- Not every chart warrants a new comment every week. The new comments are in bold type. Grey type comments may be dated.

- Individual charts provide a single view. It is valuable to look at charts of other companies in similar commodities, and the overall sentiment is also very valuable. Not many stocks can swim against the tide.
- We periodically add or delete charts, some times for obscure reasons. If a chart consistent gives poor signals or is very erratic, we may delete it. Sometimes we add a chart because we want to see what all the fuss is about. We do have a preference for charting stocks that we cover in our research as well.
- Errors and omissions may occur from time to time, especially in fast moving markets.

Amber Lights in Tables: Just a reminder if when the amber light is used in the table – it is when the charts are ambiguous or when there is a change of trend taking place. If a chart is breaching a downtrend it can either be a positive sign or a trap. Only once it has done more work can it be confirmed as a new uptrend. Maybe it is a new uptrend (or conversely a new downtrend); the risk takers can decide to jump on board early (or sell). They will maximise their profits (or minimise their losses if indeed it is the start of the new uptrend (downtrend). More risk-averse investors should wait a little longer, being prepared to give up some of the gains in return for greater certainty.