

22 August 2020

On Friday's Close

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Lucapa Diamond Company Research Note

Stepping back from general market comment this week, we have released a detailed research note on Lucapa (LOM). We have frequently commented on Lucapa in previous Weeklies but this time we have sought to come to grips with the fundamental value based on projected earnings from its two diamond mines. We have extracted some of the more salient points from the research, discussing them below.

Focusing on the meaningful numbers

Rather than provide pages of earnings estimate tables we have presented the key bottom lines;

- equity accounted net profits, and
- cash receipts to Lucapa.

Note that the cash receipts are much greater than the net profits due to the repayment of A\$83m of loans to Lucapa, which were used to finance the development of the projects.

We have presented estimates for the next three years but we have also included a column for the aggregated 10 year assumed life figures to give a better feel for the big picture. Note that the assumptions for diamond prices are lower than what we would have used a year ago, owing to continuing uncertainty caused by the virus.

Selling at 68% discount to projected Net Profit stream

We have estimated that the projects will generate A\$140m in net profits for Lucapa over the next 10 years. With the market capitalisation at \$45m, this is a 68% discount to estimated earnings.

Selling at 79% discount to projected Cash Receipts

We have estimated that the projects will return cash of A\$217m to Lucapa over the next 10 years. Again, the market capitalisation is selling at a very large discount, being 79%.

Thus, at current levels, the shares are fundamentally very cheap with nothing in the share price for blue sky appeal from kimberlite exploration or mine life extensions.

What about the kimberlite exploration program?

Previously, before there was a track record of diamond production, the driver for the share price was the allure of a very valuable kimberlite pipe at Lulo. The logic used was that the source pipe for the high value diamonds being recovered in the alluvial mine could be many times more valuable than what investors would place on an alluvial mine.

Lucapa has been searching for the source pipe(s) for five years now, spending in the order of US\$3m p.a. It is difficult to hold speculators attention for this period of time, so the story has gone quiet. Occasionally there is some news that rekindles speculative interest, such as the program to bulk sample the L071 and L072 pipes, but last week's news of a negative result for L072 has dampened the enthusiasm

just now. We will know the results for the second pipe within a few weeks.

It should be noted that the first two pipes being tested in the Canguige catchment were selected for ease of access at the end of the wet season, not because they were the best prospects. More pipes remain to be tested.

While we are quietly confident that the source pipe will eventually be found, it is too difficult to give an exact time frame. We would rather say that success is lurking in the background and concentrate our investment decision on the back of the lower risk, operating mines. That is the focus of the research note. Hopefully, one day, we will come to work and see a release that the pipe has been found, which could give us spectacular share price performance.

Company debt is 3x covered by project debt

Investors have queried Lucapa's ability to service the debt position in the light of the disruptions caused by the virus. In this regard it should be noted;

- the repayments schedule has been renegotiated, providing a moratorium that takes the pressure off the Company for 2020 and 2021, and
- of the three financiers, two of them are sizeable equity holders in the Company. It is unlikely that they would threaten their equity positions by being too aggressive on repayment schedules.

Notably, while Lucapa owes approximately A\$26m to three lenders, the money owed by the two projects to Lucapa is more than three times as much, at approximately A\$83m. Cash flow from the operating mines and the repayment of loans to Lucapa should be sufficient to enable timely repayments of debt.

Mine lives will be much more than 10 years

Our model assumes a 10 year life for each mine. This is more aggressive than what can be calculated on the Lulo JORC resource, because of the rules, but it doesn't take much imagination to see that the available gravels will be much more than what has been announced to the ASX. It would not be surprising to see a mine life well in excess of 10 years.

The Mothae life of 10 years is verifiable on the released JORC resource. There is no speculation here. However, there is additional material not yet reflected in the JORC statement that could support mining for an extended period beyond 10 years. In particular, the resources have been calculated to a vertical depth of 300m, yet the pipe has been modelled to a depth of 500m. In due course this zone will be drilled and brought into the resource statement, but it is not necessary to do this in the near term.

Impact of coronavirus on operations

The Lulo mining operation suspended production for about three months but it is back at near full capacity now. Mothae has been placed on care and maintenance, likely until the end of the year. At this point Lucapa would like to use this downtime to increase the capacity of Mothae from 1.1 Mtpa to 1.8 Mtpa by spending an estimated US\$6m on the front end of the plant. We have assumed that this happens as the number look compelling; payback on capex is less than 12 months.

Disclosure: Nil. Interests associated with the author own shares and options in Lucapa. FEC has received capital raising fees in 2020, from managing a placement and an entitlement issue. There was no fee paid by Lucapa for the preparation of the research report. Estimates are based on reports released by the Company to the ASX, with appropriate assumptions as determined by the author.

Titan is introducing technical credibility to a 2 Moz+ goldfield in Ecuador

Titan Minerals (TTM) continues to make good progress in sorting the Dynasty Gold Project in Ecuador. We introduced this company to readers on 23 May 2020, commenting that there was likely to be millions of ounces of gold there, just waiting for decent management to come along. Back then the share price was 8.9¢. It peaked at 17¢ on 10/8/20, but like all other gold stocks some heat has come out of the price with the correction in the gold price. A placement at 6.5¢ early in June raised \$14.5m, thereby providing sufficient funding into 2021. An SPP raised another \$2m.

TTM reported some good intercepts from the first 10 of 41 diamond drill holes, in mid July. The comment was made that the intercepts were generally 3-5x wider than previously modelled. The best three intercepts were 14.5m at 6.43 gpt, 23.6m at 4.01 gpt and 16.6m at 3.49 gpt, all from down holes depths between 100m and 200m. We should probably be expecting more results before the end of the month.

We are looking at a very “busy” project here, judging by the number of veins on Figure 1 in the ASX release of 14 July.

There are three different veins sets to be considered. The geologists are having to step backwards to put all of these in perspective, adding some disciplined science to the task of figuring out what the company really has. The starting figure is a resource of 2.1 Moz in 14.4 Mt at 4.5 gpt but the reality is that this is likely to be at least double the size.

Previously the orebodies supported a small operation treating about 220,000 p.a. at 3.4 gpt, but this was definitely sub-optimal in delivering about 25,000 oz pa. Titan is much more visionary in its expectations, believing the gold field has the potential to be producing 10x this amount when the groundwork has been done. That would make it an institutional grade gold producer.

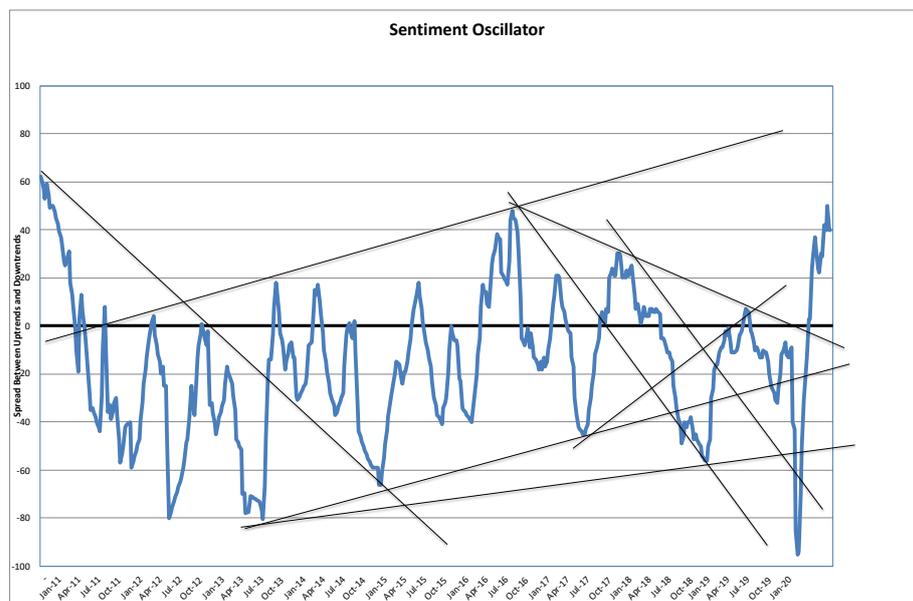
We will see continuous drilling over the next 6-12 months with the view to calculating a revised resource on which scoping studies can be initiated, perhaps by year end. There seems to be good infrastructure and logistics in place already.

The market capitalisation is currently in the \$140-150m range. We would expect it to grow with news flow and better appreciation of what is really there.

There may be big write-downs for gold producers if they mark-to-market at year end.

An important point to remember is that if gold producers are required to value their hedge positions on the marked-to-market basis, the profit statement for the year to 30 June may include a big hit to earnings that might shock some shareholders. Keep an eye out for the first companies that report to see if this is something auditors enforce.

We have added two gold stocks to our chart coverage. Calidus Resources (CAI) has the Warrawoona Gold Project with a resource of 43 Mt at 1.06 gpt for 1.5 Moz in WA. Genesis Minerals (GMD) has 17.2 Mt at 2.34 gpt at the Ulyses Project when the recently acquired Kookynie resource is added to it (8.3 Mt at 1.5 gpt, for 0.4 Moz, at a cost of \$13.5m; \$33/oz).



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Sentiment Oscillator: Sentiment was steady over the week. There were 56% (59%) of the charts in uptrend and 16% (19%) in downtrend on Friday's close.

Detailed Chart Comments

NB. Only the bold comments have been updated. Comments in grey type are from previous weeks and will be less relevant. Please note that this list is a cross section of the market. It IS NOT a list of recommendations.

Indices	Code	Trend Comment	
All Ordinaries	XAO	testing resistance line	
Metals and Mining	XMM	correcting lower	
Energy	XEJ	sideways	
Stocks	Code	Trend Comment (updated comments in bold)	Main Interest
Alpha HPA	A4N	new high	HPA
Adriatic Resources	ADT	pullback	zinc, olymetallicp
Aeon Metals	AML	new high	copper + cobalt
Alkane Resources	ALK	pullback	gold, zirconia
Alicanto Minerals	AQI	surge to new high	base metals, sliver, gold
Allegiance Coal	AHQ	sideways	coking coal
Alliance Resources	AGS	pullback	gold predevelopment
American Rare Earths (was BPL)	ARR	pullback	rare earths
Apollo Consolidated	AOP	breached uptrend	gold exploration
Arafura Resources	ARU	breached downtrend	rare earths
Aurelia Metals	AMI	continuing higher	gold + base metals
Australian Potash	APC	strongly higher	potash
Auteco Minerals	AUT	new high	gold exploration
BHP	BHP	pullback	diversified, iron ore
Base Resources	BSE	breaching downtrend	mineral sands
BBX Minerals	BBX	higher	gold exploration
Beach Energy	BPT	testing downtrend	oil and gas
Beacon Mining	BCN	still beneath resistance line	gold production
Bellevue Gold	BGL	new high again	gold exploration
Blackstone Minerals	BSX	rising	nickel
Blue Star Helium	BNL	down	gas, helium
Breaker Resources	BRB	still in LT downtrend	gold exploration
Buru Energy	BRU	sideways	oil
Buxton Resources	BUX	turned down at resistance line	nickel exploration
Calidus Resources	CAI	sideways at highs	gold
Capricorn Metals	CMM	breached uptrend	gold
Cardinal Resources	CDV	surge on takeover bid	gold exploration
Central Petroleum	CTP	breaching downtrend	oil/gas
Chalice Gold	CHN	surge to new high	nickel, copper, PGMs, gold exploration
Chase Mining	CML	hit resistance	nickel/copper/PGE
Chesser Resources	CHZ	off its highs	gold exploration

Cobalt Blue	COB		on support line	cobalt
Dacian Gold	DCN		rallying	gold
Danakali	DNK		rising	potash
Davenport Resources	DAV		still in longer term downtrend	potash
De Grey	DEG		higher again	gold
E2 Metals	E2M		at highs	gold exploration
Ecograf (was Kibaran)	EGR		sideways	graphite
Element 25	E25		off its highs	manganese
Emerald Resources	EMR		breached uptrend	gold
Euro Manganese	EMN		at lows	manganese
Evolution Mining	EVN		sideways	gold
First Graphene	FGR		sideways	graphene
Fortescue Metals	FMG		drifting lower	iron ore
Galaxy Resources	GXY		rising	lithium
Galena Mining	G1A		rising	lead
Galilee Energy	GLL		breached uptrend	oil and gas, CBM
Genesis Minerals	GMD		uptrend	gold
Gold Road	GOR		down	gold
Graphex Mining	GPX		hitting resistance	graphite, turning to gold
Highfield Resources	HFR		breached support	potash
Hillgrove Resources	HGO		still in downtrend	copper
Iluka Resources	ILU		higher	mineral sands
Image Resources	IMA		higher	mineral sands
Independence Group	IGO		down	gold
ioneer (was Global Geoscience)	INR		down	lithium
Ionic Rare Earths (Oro Verde)	IXR		gentle uptrend	rare earths
Jervois Mining	JVR		surge higher	nickel/cobalt
Jindalee Resources	JRL		surge out of downtrend	lithium
Kin Mining	KIN		down	gold
Kingston Resources	KSN		new high	gold
Kingwest Resources	KWR		testing downtrend	gold
Legend Mining	LEG		testing downtrend	nickel exploration
Lepidico	LPD		testing downtrend	lithium
Lindian Resources	LIN		higher	bauxite
Lithium Australia	LIT		new uptrend	lithium
Lotus Resources	LOT		new high	uranium
Lucapa Diamond	LOM		pullback on exploration news	diamonds
Lynas Corp.	LYC		new high	rare earths
Mako Gold	MKG		pullback	gold exploration
Manhattan Corp	MHC		breaching support line	gold exploration
Marmota	MEU		strong recovery	gold exploration
MetalTech	MTC		testing uptrend	gold
MetalsX	MLX		sideways	tin, nickel
Metro Mining	MMI		down	bauxite

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Mincor Resources	MCR	orange	sideways near high	gold/nickel
Musgrave Minerals	MGV	green	off its highs	gold exploration
Myanmar Minerals	MYL	green	surge to new high	lead, zinc, silver
Nelson Resources	NES	green	rising	gold exploration
Neometals	NMT	orange	testing downtrend	lithium
Northern Minerals	NTU	green	uptrend confirmed	REE
Northern Star Res.	NST	orange	breached uptrend	gold
NTM Gold	NTM	green	sideways	gold exploration
Oceana Gold	OGC	green	new high	gold
Oklo Resources	OKU	orange	testing uptrend	gold expl.
Orecorp	ORR	green	rising	gold development
Orocobre	ORE	green	steep uptrend	lithium
Oz Minerals	OZL	green	new high	copper
Pacific American Holdings	PAK	orange	breaching downtrend	coal
Pacifico Minerals	PMY	green	off its highs	silver/lead
Pantoro	PNR	orange	breached uptrend	gold
Panoramic Res	PAN	red	down	gold , nickel
Peak Resources	PEK	green	steeply higher	rare earths
Peel Mining	PEX	green	uptrend	copper
Peninsula Energy	PEN	red	down again	uranium
Pure Minerals	PM1	green	rising	nickel/cobalt/HPA
Pensana Metals	PM8	green	surge to new high	rare earths
Perseus Mining	PRU	green	rising	gold
Pilbara Minerals	PLS	green	testing support	lithium
Polarex	PXX	green	uptrend	polymetallic exploration
Ramelius Resources	RMS	orange	breached uptrend	gold production
Red5	RED	orange	rallying	gold
Red River Resources	RVR	green	broken through resistance line	zinc
Regis Resources	RRL	orange	breached trend line	gold
Regergen	RLT	green	recapturing uptrend	gas, helium
Resolution Minerals	RML	green	rising again	gold exploration
Resolute Mining	RSG	green	fallen to support line	gold
RIO	RIO	green	drifting lower	diversified, iron ore
Rumble Resources	RTR	green	rising again	gold exploration
Salt Lake Potash	SO4	green	hitting resistance	potash
Saracen Minerals	SAR	green	on trend line	gold
St Barbara	SBM	green	on trend line	gold
Sandfire Resources	SFR	orange	breached downtrend but heavy pullback	copper
Santos	STO	orange	sideways	oil/gas
Saturn Metals	STN	green	new high	gold exploration
Sheffield Resources	SFX	green	new high	mineral sands
Sky Metals	SKY	red	rallying	gold exploration
St George Mining	SGQ	red	down	nickel
Silex Systems	SLX	orange	breaching uptrend	uranium enrichment technology

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Silver Mines	SVL		off its high	silver
Sipa Resources	SRI		rising	general exploration - Ni,Cu, Co, Au
Stanmore Coal	SMR		new low	coal
Strandline Resources	STA		drifting lower	mineral sands
Talga Resources	TLG		rising	graphite
Technology Metals	TMT		on support line	vanadium
Tesoro Resources	TSO		new high	gold exploration
Theta Gold Mines	TGM		uptrend	gold
Titan Minerals	TTM		new high	gold
Vango Mining	VAN		rising	gold
Venturex	VXR		testing downtrend	zinc
Vimy Resources	VMY		down	uranium
West African Resources	WAF		off its high	gold
Westgold Resources	WGX		pullback	gold
West Wits Mining	WWI		rising	gold
Western Areas	WSA		testing uptrend	nickel
Whitebark Energy	WBE		down	oil and gas
Whitehaven Coal	WHC		secondary downtrend	coal
Wiluna Mining	WMX		softer	gold
Yandal Resources	YRL		breached uptrend	gold exploration
Zinc Mines of Ireland	ZMI		still in downtrend	zinc
Totals	56%	79	Uptrend	
	16%	23	Downtrend	
		140	Total	

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.

Weightings of Sectors Represented in the Company Charts			
Sector	No. of Companies	Weighting	
Gold	35	25.0%	
Gold Exploration	22	15.7%	
Zinc/Lead	9	6.4%	
Nickel	8	5.7%	
Oil/Gas	8	5.7%	
Lithium	8	5.7%	
Coal	5	3.6%	
Mineral Sands	5	3.6%	
Rare Earths	7	5.0%	
Potash/Phosphate	5	3.6%	
Copper	5	3.6%	
Graphite	3	2.1%	
Iron Ore/Manganese	5	3.6%	
Uranium	3	2.1%	
Bauxite	3	2.1%	
Silver	3	2.1%	
Cobalt	2	1.4%	
Tin	1	0.7%	
Diamonds	1	0.7%	
Other	2		
Total	140		

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