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Alkane Will Shortly Join The Ranks Of The Gold Producers, But The Real Upside Remains In The Steadily Advancing Dubbo Zirconia Project

By Our Man in Oz

Has the share price of Alkane Resources doubled over the past 12-months, or has it been cut in half? It's a trick question, straight from the glass-half-full/glass-half-empty school of debating, because the correct answer is, of course, "both". For anyone who paid top price of A\$2.73 in April the current price of A\$1.14 represents an expensive fall. But, for the astute investor who climbed aboard at A65 cents last year, or even at much lower prices in previous years, Alkane has been a double-your-money star (or quadruple your money if you sold at the top). It's also been something of a puzzle. And that's because a casual observer could be excused for not knowing whether ASX-listed Alkane is a gold, copper, rare earth, zirconium, niobium, hafnium or tantalum company.

Alkane, in fact, fits, all of those descriptions. It has a finger in a number of projects, all of which are coming to boil with the next 12-months. The first cab off the Alkane rank will almost certainly be gold, as the small, but pleasingly profitable, Tomingley development makes its way through the tortuous approvals processes of the New South Wales government. Next comes the big company-maker, in the shape of the Dubbo Zirconia Project, also in NSW. And bringing up the rear is a minority stake in the world-class McPhillamys copper-gold project which is being worked up by the big American gold miner, Newmont.

With so many balls in the air it seemed reasonable for Minesite's Man in Oz to kick off a conversation with Alkane's chief executive, Ian Chalmers, by asking whether he sometimes feels like a juggler. Sitting in Alkane's new offices in the inner Perth suburb of Burswood, Ian's reply was affirmative. "It can seem a little like that sometimes", he said. "We have teams working on all facets of the projects, which is one reason why we had to move into bigger offices. Another is that we have had a steady stream of international buyers and bankers visiting and the old office in East Perth was more than a little cramped. Some bankers who visited referred to it as the cave."

Whatever the conditions at head office, the point for investors is that Alkane is about to emerge from a long absence from the list of Australian mineral producers. Gold from Tomingley will mark the return of Alkane's as a miner. Not big by any measure, the mine will nonetheless be a sweet profit generator from its modest 660,000 ounce resource base. "The current estimate is that we'll be in production for 7.5 years, producing around 370,000 ounces of gold", Ian said. "Depending on the gold price that will generate pre-tax earnings of between A\$167 million and A\$269 million. We're also pretty confident that the mine life will be extended well beyond 10 years." The reason for Ian's confidence is that ongoing drilling continues to yield excellent results from a new structure, Caloma Two, located adjacent to the Caloma orebody which will form part of the development.

Tomingley, however, is small beer compared to the Dubbo project. It's this project which has put Alkane on the global rare earths map – perhaps somewhat misleadingly. In fact, the Toongi trachyte intrusive (the correct geological name for the unique orebody discovered by Alkane the best part of 20 years ago), is a genuinely world-class, polymetallic structure, rich in a number of minerals that are enjoying fast-expanding markets, including zirconia, niobium, tantalum, yttrium, hafnium, and that family of elements controlled by China, rare earths.

But, while it was the rare earth elements that lit the blue touch paper for speculators earlier this year, Alkane has never considered changing the full name of the project – Dubbo Zirconia Project. “It was the excitement about rare earths which put us on a few investor radar screens over the past year, but once you look through to the forecast revenue streams Dubbo continues to be led by revenue from zirconium and niobium”, Ian said.

Last week, Alkane threw a little more light on its emerging flagship when it announced another memorandum of understanding covering future output from Dubbo. Alkane said that an unnamed European company had signed up to produce ferro-niobium in association with Alkane, preferably at a site in Australia, but not necessarily. That deal means Alkane has effectively pre-sold 100 per cent of both the zirconia and niobium that will come out of the first stage of the Dubbo operation, equivalent to 61 per cent of future revenue on the assumption that Dubbo produces at an expanded rate of one million tonnes of ore a year. The rest of the revenue stream will comprise 21 per cent light rare earths, and 18 per cent yttrium and heavy rare earths.

Understanding the nature of the Dubbo orebody, and the painstaking way in which Alkane is constructing the project, from mine design to marketing the thinly-traded but increasingly important metallic elements, can be a challenge for investors. What newcomers need to know is that demand for the cocktail of metals in the ancient volcano which is the near-vertical Toongi structure is so strong that Alkane will almost certainly by-pass the originally proposed start-up production rate of 400,000 tonnes of ore a year and go directly to the expanded design of one million tonnes.

At that expanded output level, as revealed in a freshly completed definitive feasibility study, Dubbo will have an all-up construction capital cost, including contingencies, of A\$893 million, generate annual revenue of A\$508 million, incur annual operating costs of A\$196 million, leaving pre-tax earnings of A\$312 million. That represents an internal rate of return of 30.2 per cent, which looks good against the 16.8 per cent delivered by the 400,000 tonnes per year start-up rate, and means that the net present value of Dubbo is around A\$1.2 billion.

Trips through a financial spreadsheet like that are interesting, but they can also leave investors either breathless or disbelieving. But having had the pleasure of visiting Dubbo, and seen the demonstration plant Alkane has running at the Australian Nuclear Science and Technology Organisation near Canberra, Minesite's Man in Oz can confirm that Dubbo is a very real project that will make waves throughout the global zirconia, niobium and rare earth industries as it moves out of the planning phase and into construction and development towards the end of next year.

From a management and financial viewpoint, Tomingley will be the project which re-ignites the mining culture inside Alkane, reviving memories of the time when it was posting useful profits from its Peak Hill goldmine. McPhillamys, which gets barely a mention in an analysis of the company these days, is an option on a future Newmont copper/gold development, or cash in the bank should Newmont opt to buy out its junior partner. But Dubbo is the real thing, and the upside on offer looks very significant indeed. If that net present value calculation of A\$1.2 billion is correct then Alkane at A\$1.14 is trading at a considerable discount because with 269 million shares on issue the theoretical value of the project, per Alkane share, is A\$4.46. Food for thought.