



[DAILY NEWS](#) Sep 17, 2014 5:09 PM - 0 comments

Rick Rule and Brent Cook deliver keynote address at Precious Metals Summit

By: *Salma Tarikh*
2014-09-17

BEAVER CREEK, COLORADO — In a keynote address at the recent Precious Metals Summit, Sprott US Holdings chairman Rick Rule and well-known geologist Brent Cook cover industry-specific issues, the realities of exploration, and how to conduct due diligence before making an investment decision.

Rule kicked off the conversation by explaining his “reasonably bullish” outlook.

“Bear markets are the authors of bull markets, knowing that ought to make anybody pretty optimistic, assuming we get through the bear market,” Rule says.

“People point out that our market, measured by the TSXV, is down 75% and they act as though that is a catastrophe. But I would suggest to you that makes the market precisely 75% more attractive than it was before it fell.”

Rule notes what he has learned from more than 35 years of investing in natural resources is “that all markets, particularly mining markets, move when they exceed expectations.”

"I would like to ask you to think yourself about how this market could not exceed expectations. Expectations for this market are so low. I think the challenge is to get under the bar not over the bar."

Providing some relief is the recent uptick in merger and acquisition activity and companies closing financings.

'Self-inflicted' wounds

Cook, the editor of Exploration Insights, cautions that the industry is churning through more metal than it is finding and that it is going to get worse. It is becoming tougher and more expensive to find deposits, as most of the near-surface deposits have been found, the mining analyst says. "[This] will lead to a point where producers will need to buy quality deposits."

However, Cook notes people that know how to find deposits are moving on to bigger companies, where their main task isn't exploration, leaving a gap in the technical side of the business, explaining young geologists often don't know how to identify economic deposits. Compounding that problem is the lack of mentors or skilled veterans at exploration firms that could coach these young geologists.

On the financial side, Cook says analysts and financiers sometimes don't understand how a company collected a soil sample or drilled a deposit, leading to a poor assessment of the data that they are presented before making an investment decision.

"The industry has a lot of wounds, and I would suggest to you that most of those wounds have been self-inflicted," Rule adds.

He believes a number of reasons have caused the industry to bleed, including companies paying excessive salaries to their executives, despite poor results; firms spending too much on general and administrative expenses versus project expenditures; and investment banks financing marginal projects just to collect a fee on it.

"There are probably 3,000 junior exploration firms worldwide ... How many of them do we really need? Wouldn't we really, all of us as a group, be better off financing the best of the best, and letting the rest of them pursue other employment opportunities?"

Touching upon the realities in exploration and how they affect investors, Cook says that people need to understand that an anomaly results from a change in a rock that occurred during the earth's evolution.

"I think it is really important to understand that there are literally millions of anomalies around the world and in very, very unique situations does the structure, the geochemistry, everything come together to form an economic deposit.

"As explorationists our job is to identify an area where we can see an anomaly of some sort, and where the setting is right to form a deposit, and then most importantly as rapidly as possible evaluate that as to whether there is or is not an economic deposit."

Cook says companies repeatedly raise money to test anomalies and don't recognize when to quit, leading to a waste of money. This goes back to financiers not understanding geologic systems and that you could have 20-million-oz. anomalies that are just not viable.

Investing tips

Given that roughly 1 in 1,000 prospects actually turn into economic deposits, Cook says he's always looking for "what is the fatal flaw" in a project. That could be assessing whether a deposit is big enough or has the right metallurgy to go into production or simply if there are any holes in a company's thesis, he says.

To improve your odds of success, Cook suggests investors should invest in companies that know when to quit and recognize when a project won't work.

Rule reveals one of the most valuable questions he could ask a company during due diligence is, "What's the most important unanswered question that you have?"

"How will you answer it? How much time will it take to answer it? How much money will it take to answer it? Do you have that much money? In other words, will you ever get to a yes answer?"

If so, "What is the next round of questions proposed by a yes answer? And how will you know when and if you fail, so you can conserve the rest of the cash?"

Although admitting that not all of his investments have been profitable, Rule says the more he employs the simple methodology of understanding what the unanswered question is, the better the investment is.

He also stresses that a company's expertise should be relevant to the task on hand. For example, Rule says a management team that excelled in "operating a gold mine in Archean terrain in French-speaking rural Quebec" may not be successful in "exploring for copper-gold porphyries in tertiary volcanics in Spanish-speaking Peru."

"When people tell me that their expertise is applicable in fashions like this, because after all it is all mining. I am able to say, 'Yeah, proctology and dentistry are both medicine, but if you choose the wrong practitioner, it leaves a bad taste once in a while.'"

