

Rule, Cook on navigating today's choppy waters



BY SALMA TARIQH

BEAVER CREEK, COLORADO — In a keynote address at the recent Precious Metals Summit, Sprott US Holdings chairman Rick Rule and geologist Brent Cook dug into the realities of the exploration game and how best 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 said.

“People point out that our market, measured by the TSX Venture Exchange, 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 noted that after more than 35 years of investing in natural resources, he has learned that “all markets, particularly mining markets, move when they exceed expectations.

“Think to 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 has been the recent uptick in mergers and acquisitions, and the number of companies able to close financings.

Cook, the editor of *Exploration Insights*, cautioned 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.

He said this could “lead to a point where producers will need to buy quality deposits.”

But Cook warned that people who 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. He says young geologists often don't know how to identify economic deposits. There is also a lack of mentors and skilled veterans at exploration firms who could coach young geologists.

On the financial side, Cook said that 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 added.

Rule argues that the industry has bled for a number of reasons, 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 fees.

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

“It is really important to understand that there are literally millions of anomalies around the world, and only 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 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 money wasted. This goes back to financiers not understanding geological systems and that you can have 20 million oz. gold anomalies that are not economically viable.

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Keynote speakers Rick Rule (left) and Brent Cook at the Precious Metals Summit in Colorado.

Investing tips

Given that maybe 1 in 1,000 prospects turn into economic deposits, Cook says he's always looking for the "fatal flaw" in a project. This 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 the odds of success, Cook suggests investors should invest in companies that know when to quit, and recognize when a project won't work.

Rule says one of the most valuable questions he could ask a company during due diligence is: "What's the most impor-

tant unanswered question that you have?"

He also asks: "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?"

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

While admitting that not all of his investments have been profitable, Rule says the more he understands what the unanswered question is, the better the investment is.

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

He says that "when people tell me 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.'"