

# Markets still grimy despite bath

**A**fter a run that caught many analysts by surprise, commodity prices appear to be on the ropes as investors switch their focus from the upside inflation risk to downside growth risk in the US.

Despite the dream run resources have enjoyed since the dark days of October 2001 — giving rise to hopes of an eternal boom — voices of dissent are becoming increasingly vocal.

“This commodity cycle has now reached middle age — the textbook foundations of the upswing are not as strong as they were and financial conditions are becoming less attractive to speculators,” ICAP, the world’s largest specialist intermediary broker service to commercial and investment banks, said recently.

A weakening outlook for world growth in general has seen stock markets around the globe, including the Australian Stock Exchange, take a bath. The red ink has been heaviest among mining and exploration stocks as punters buckle up for a bumpy ride.

But the problems of some of the poorer performing stocks over the past several weeks have had little to do with market fundamentals.

Northern Territory gold producer Giants Reef Mining more than halved in

value after warning of lower production and decreased operating margins after drilling confirmed a significant change in the tenor of gold mineralisation at its Chariot operation.

The infill drilling suggested marked changes in the nature of the orebody below the eight level, indicating the dip moderated and was of lower grade than expected.

The change means Giants Reef will have to switch to a bulk mining approach instead of the long-hole stoping method that has recently brought it success.

But Giants Reef says upside remains at Chariot, which is still open to the west below 12 level.

One of the most spectacular falls from market grace has been Andrew Forrest’s Fortescue Metals Group.

Earlier in the year Forrest had appeared to be getting the better of his many critics, putting “binding” contracts in place with a trio of Chinese state-owned companies to build Fortescue’s ambitious \$1.85 billion port, rail and mine iron ore project in Western Australia’s Pilbara region.

Financing was going well, with Fortescue’s 10% upfront payment for the project already in the can and its share price indicating all was well with

its universe, touching a record \$5.50 in March, from around 50c in the third quarter of 2004.

But the carefully woven tapestry began to unravel with comments to the press in Beijing by its lead Chinese contractor, which claimed its contract was not binding and questioned the quality of Fortescue’s iron ore resources.

Fortescue was able to halt the immediate slide in the share price at around \$3. Although Forrest has taken the fight up to its contractor, with the revelation Fortescue has been in parallel negotiations with other contractors and financiers, the episode has reinjected a level of scepticism no developer needs.

Compounding problems, it was revealed that one of Fortescue’s first customers would make its pre-payment in steel rather than cash.

The initial capital cost estimate of \$1.85 billion now seems conservative in light of recent cost increases, although Fortescue says it is balanced by higher iron ore prices, while the definitive feasibility study originally scheduled to be completed in the third quarter of 2004 will now not be completed until the third quarter this year.

That delay alone will push first production out by six months from the

## man of the moment

After years of trying to convince a sceptical market of the benefits of lateritic nickel, Heron Resources chairman Ian Buchhorn finds himself in unfamiliar but welcome territory.

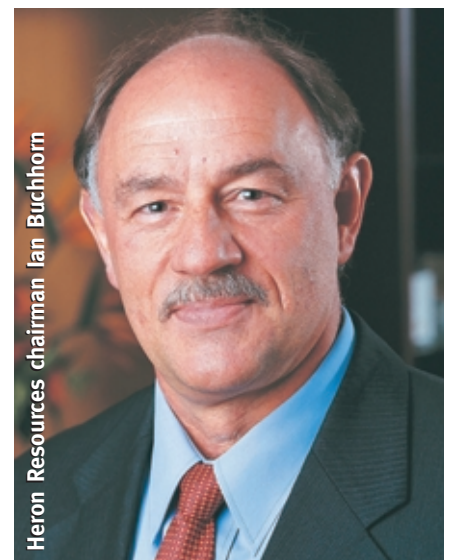
A deal with the western world’s biggest nickel producer, Inco, has secured for Heron the experience and deep pockets needed to develop its 903 million tonne nickel laterite tenements near Kalgoorlie.

It also made the mining world sit up and take notice.

And take notice BHP Billiton certainly did. Barely a week after Heron

announced its tie up with Inco, BHP set the rumour mills working overtime by snatching an 11.2% stake in Heron from the departing OM Group.

Theories abound as to whether BHP, which is developing its own nickel laterite project further south at Ravensthorpe and has a \$9.2 billion bid on the table for WMC Resources and its WA nickel business, wants to get its hands on Heron’s massive resource. Or maybe it just wants to prevent Inco gaining a foothold in BHP’s own backyard. Whatever the reason, Heron has been transformed from an unloved



Heron Resources chairman Ian Buchhorn

fourth quarter of 2006 to the second quarter of 2007.

Nickel explorer Falcon Minerals has also fluttered back to earth after soaring high on the back of a nickel, copper and platinum group metals discovery with WMC Resources.

Falcon shares ran up 70% after the Collurabbie discovery last August, but more recent drilling in the Olympia zone was not as good as expected.

Falcon maintains its share price slump back to the 40c level, from \$1.47 in December, was due more to the market correction than any change in the stock's fundamentals.

Jitters over the longevity of the commodities boom have also been felt among the iron ore juniors, which experienced a healthy surge earlier in the year after CVRD and Rio Tinto, followed reluctantly by BHP Billiton, secured a massive price increase.

Grange Resources and the formerly gold-focused Gindalbie Metals have

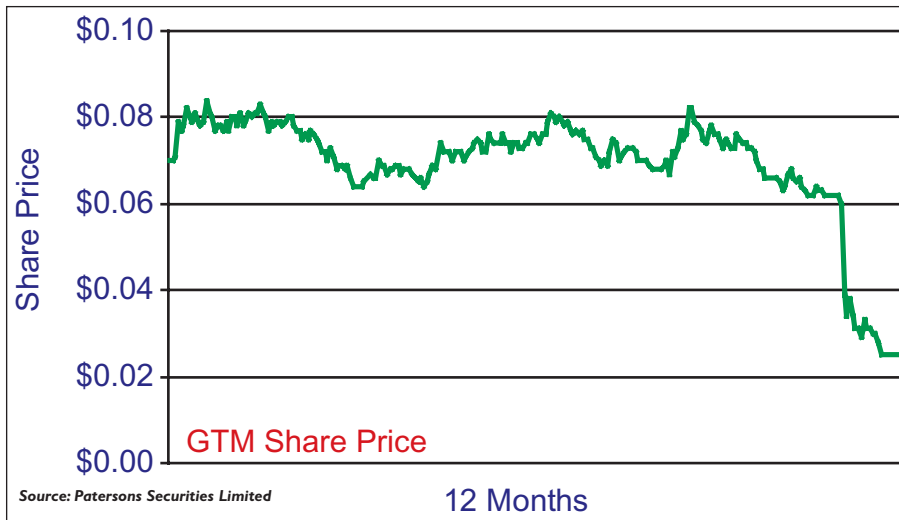
both taken hits in recent weeks as investors cut their exposure.

On the other side of the ledger, Heron Resources is enjoying its time in the sun after nine long years spruiking the benefits of laterite nickel, with two of the world's biggest nickel producers, Inco and BHP, now vying for its affections.

Compass Resources, better known for its Browns polymetallic deposit in the Northern Territory, has also managed to buck the trend with the discovery of uranium on its Batchelor tenements.

It hit 3.3m grading 2.05% uranium oxide at Batchelor's White Extended prospect, while intersections at Whites East included 63.7m grading 0.11% uranium oxide and 13.5m at 0.47% uranium oxide.

A more extensive field exploration and drilling program over the Batchelor tenements is planned during the Northern Territory dry season.



child of nickel laterite pioneers Preston Resources, Centaur Mining and Anaconda Nickel — all of which either failed or barely scraped through technical problems that plagued WA's first generation of high pressure acid leach technology — into the object of desire for two of the world's biggest nickel producers.

Cementing its commitment, Inco has come in over the top of BHP, taking a 10.4 per cent stake in Heron. The issue of 16.5 million new shares to Inco will dilute BHP's stake to 9.98% — not enough to block compulsory acquisition in a takeover bid for Heron.

But BHP's interest did spike Heron's share price to a high of 79c, up from

41.5c, and meant Inco ended up paying more for the stake than it had expected when it started discussing the plan weeks before.

All this interest in Heron has not been bad for Buchhorn personally, driving the value of his stake up to over \$20 million.

But for now he is very much focused on the job at hand, which is ramping up exploration within Heron's vast tenement holdings while Inco funds \$US68 million in feasibility studies.

Buchhorn's days of scraping by with only a million or two in the bank and selling tenements here and there to keep the exploration ticking over are now long gone.

# COMMODITY WATCH



The gold bulls are running again in 2005, with predictions the precious metal will crack \$US500 an ounce in the next year or two.

Gold has benefited in recent years from a clear if fluctuating interest in investor interest, according to Deutsche Bank. This turnaround in sentiment comes on the back of greater transparency and control over central bank sales, a sharp reduction in producer hedging, a sharp fall in world mine production growth in 2004, and, since 2002, a weakening trend in the US dollar, it said.

Instability in the Middle East, record oil prices and rising inflation risks have also driven investors back into the arms of gold.

While a first quarter resurgence in the US currency has given gold a lacklustre start to 2005, Deutsche Bank expects the weakening trend to reassert itself from the second quarter and underpin a rally in gold to \$US459 an ounce in 2005 and \$US490 in 2006.

The bank has lifted its 2007 average price forecast to \$US525 to reflect an expected blow-out in the weakening of the greenback.

Respected London-based consultancy GFMS predicts gold could crack the big \$US500 as early as this year, driven by a new wave of investment demand in the second half.

There is "considerable scope over the next year for an event-driven spike in the gold price towards the \$500 mark," it said. "Gold heading for the \$US500 mark no longer seems fanciful."

Westpac general manager economics Bill Evans is less bullish on the outlook for commodities in general, predicting a slowdown in the world economy will lead to a fall in prices.

But because most of gold's strength over the past 12 months has been due to the weak greenback, and the Australian currency has been relatively strong, he did not expect Australian gold miners to be too badly affected.

While US dollar gold prices would not fall as much as other commodity prices, local gold producers would benefit from the fall in the Australian dollar, Evans said.

