Golden chance to end disconnect between the metal and the equities

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Gold prices are at record highs, but share prices of gold producers languish *Source:* Bloomberg

MERGER and acquisitions among the gold developers and producers, which many argue has to come because of the "disconnect" between gold prices and gold equity values, might finally be upon us.

But not in this market, not just yet, anyway. As with most shifts in investor attitudes in the sector, the Canadians are leading the way. Toronto-listed Yamana Gold made an agreed $C414 million ($400m) bid for Extorre Gold, a Canadian-listed company that has the Cerro Moro gold-silver project (2.4 million gold equivalent ounces) in Argentina as its focus.

The deal was secured with a massive 68 per cent premium to Extorre's ruling market price, which makes it indicative of just how much gold equity values in Canada -- and all other key mining markets -- have become disconnected from the higher values at which still historically high gold price suggests they should be trading. The disconnect is the subject of constant debate in internet chatrooms. The rise of exchange-traded gold funds is often cited as the reason, as is the slow response of gold producers to meet investor demands for greater cash dividends. Then there is the broader risk-off approach to investing in anything while Europe sorts out its debt woes.

That last point has naturally enough been a good thing for gold, with its haven status. At its New York close of $US1628 an ounce, the metal is showing a gain of $US88 an ounce, or 5.7 per cent, on its level of 12 months ago. Yet equity gold values have been smashed by as much as 80 per cent. The hope now is that Yamana's move might just demonstrate that enough is enough.

It could be argued that Extorre is a special case, given the sovereign risk concerns about resource investment in Argentina thanks to President Cristina Fernandez de Kirchner's recent populist response to high energy prices -- expropriate the 51 per cent stake owned in the nation's biggest energy group, YPF, by Spanish oil company Repsol.

But the reality is that Extorre's share price was being beaten up, along with the rest of the sector, long before heightened sovereign risk in Argentina became an issue. Just ask the band of ASX-listed West African gold stocks that have seen their share prices trashed in the past 12 months.

West Africa gives special meaning to the term sovereign risk. But again, sovereign risk and the gold price have not been at fault in the West African saga: it has been the broader risk-off approach of investors in response to the mess in Europe. Yamana has exploited the situation. Others can now be expected to follow. And there is no reason to suspect this market will be the exception.

Crusader looks good

CRUSADER Resources is not hanging out for a takeover bid, one that would take advantage of its share price slump from a $1.50 a share in July last year to 79c at the close of trade yesterday. It wants to become a gold producer in Brazil from its 2.3 million ounce Borborema project in the first half of 2014, as well as pick up cashflow from its ready-to-go Posse iron ore project in the country.

Posse is just waiting on some final clearances and could be in production later this year, throwing off some $2m a month in free cashflow. But today's interest is Borborema. Crusader is within weeks of releasing an updated resource estimate on the deposit, which will include a reserve estimate that will be fed in to a bankable feasibility study (BFS) to be completed in the December quarter. That, in turn, will lead to the securing of financing for the development to proceed.

Borborema is not the highest grade deposit around (1.06g of gold a tonne). But what it lacks on that front, it more than makes up for in terms of proximity to existing power and road infrastructure, and access to a pool of skilled workers and service providers from the region's tungsten industry. Those guys don't charge anywhere near what their Aussie counterparts do.

The market is expecting the BFS to confirm robust economics for a 150,000-ounce-a-year mine that could be expanded over time, as Crusader sets about extending the known mineralisation, as well as unlocking the region's highly rated exploration potential. More to the point, operating costs of $US580-$US620 an ounce is the expectation. Cash margins of more than $US1000 an ounce at the current spot price for gold yields some impressive valuation metrics for the company, which apart from Posse (say $10m-$30m in value), also has cash of $9.5m to get it through to completion of the BFS without any dramas. Petra

Capital, for one, reckons Crusader is trading on forward price/earnings ratio of 1 and that it has a net present value of $3.01 a share.

As pointed out earlier, Crusader is not on the lookout for a takeover bid. But it is these sort of discounts to NPVs in the gold developers sector that have become too large and too entrenched for the more fleet-of-foot Canadians to ignore. You have got to assume the same thought process must be running through the minds of Australia's cashed-up gold producers.

Crusader's share register is more institutional than most. Canada's Dundee dominates with a 20 per cent stake and is open to offers, particularly if the sort of premium that secured Extorre for Yamana is on offer.

Ambassador drilling

GIVEN the shake-down in both oil and equity markets, Tino Guglielmo's $16m December float of 20c shares in Cooper Basin explorer Ambassador Oil & Gas is doing well to be trading at the 18.5c a share it closed off at yesterday.

The relative strength of the explorer is simple to explain: Guglielmo ensured it hit the ground running, so much so that it is about to participate in the drilling of two oil wells in the Cooper.

The hope is that success in what are considered low-risk wells will give it a handy cashflow while it chases down the big time gas potential of its wholly owned PEL 570 permit in the Cooper's Patchawarra Trough.