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Kyrgyzgold & Turkgold – Best Ideas for 2019

By Daniel McConvey, Rossport Investments LLC, daniel.mcconvey@rossport.com
Investment Strategy: specializing in the metals and mining sector, long/short (long bias) investing in equities and related futures positions

In June I wrote a thought piece on the importance of mine site visits as part of our investment process (published on the Hedge Connection blog). This article is a follow up as this month we traveled to Kyrgyzstan and Turkey to visit the flagship operations of two Canadian listed gold mining companies in which we are invested. We came back with stronger conviction on the upside on both companies.

One of the companies I will call Kyrgyzgold, has its flagship large open pit mine 4,000 meters high in the mountains of Kyrgyzstan. It has been a very profitable mine for many years. However, politics have discouraged exploration for almost a decade and the mine plan currently has production falling off a near cliff in the next five years.

Visiting the site, looking at the landscape, talking to managers on the ground and Kyrgyz people close to the country's politics I concluded that this mine is very likely going to be in operation for decades longer. On the downside, underground potential is more challenged than I thought due to the weak nature of the rock. However, on the upside, the orebody is much bigger than what is included in the current life of mine plan. Open pit expansion potential appears large and we learned that the importance of this mine to the economy is very material thus making permit approvals for expansion likely.

The second company I will call Turkgold. Turkgold's sole open pit mining operation is in the semi-arid mountains of eastern Turkey. After depleting most of its easier to treat ore around 2015, the company decided to build a pressure oxidation facility to treat more difficult sulfide ore. That facility is in the process of being commissioned. Pressure oxidation circuits involve high pressure, high temperature and thus significant risk especially during ramp up. An explosion of one early pressure oxidation facility in Nevada 20 years ago did all but bankrupt the company involved. Turkgold's just completed facility cost it substantially more than its current market capitalization. In building it, Turkgold went from a material net cash position to a material net debt position. Scheduled repayments of that debt start in months.

Clearly there is start up risk. However, if Turkgold can execute on its pressure oxidation facility and generate the free cash flow suggested by its technical reports, it should be able to pay down a material portion of its debt over the next two years. If this happens we believe the share price may double.

Visiting the site, we were able to grow our conviction that the startup will be a success and appreciate the very substantial near mine upside exploration potential which could add material value. Pressure oxidation is something I have experience with from my years at Barrick Gold. Barrick helped pioneer such circuits. At Turkgold's mine site, I was able to visit the just commissioned first of two pressure oxidation circuits. The facility was tidy and operating as expected. The facility's substantial auxiliary circuit parts (mills etc.) had been commissioned and tested for a couple of months thus de-risking these parts of the operation. The key managers answered all my detailed questions satisfactorily. Whilst there are still some unknowns regarding the ramp up and cost projections we are currently investigating, I believe the risk/reward versus the current valuation is attractive.