How Risky Is It to Invest in Junior Gold Miners?

Description

Gold miners continue to garner a bad rap from many analysts and market pundits because of claims of shareholder value destruction, poor allocation of capital and fraud. One example consistently pointed to by pundits opposed to gold mining stocks as an investment is **Colossus Minerals,** which filed for bankruptcy in January 2014 after a disastrous foray into Brazil.

Some pundits claim that that project amounted to fraud and was a pump-and-dump scheme, involving **Continental Gold** (TSX:CNL) CEO Ari Sussman, who allegedly profited from misleading investors.

While Colossus appeared to be a shambles from the get-go, its failure hinged more on poor execution, a lack of capital and the collapse of the price of gold after its greatest bull market of all-time rather than intentional deception by the miner. Investors should note that junior gold miners are highly speculative investments in an industry riddled with hazards.

Considerable capital is required to successfully develop a gold mine, which is inherently risky in nature. Therefore, development stage gold miners can offer substantial potential upside to investors if the project is successfully executed.

One scenario that sees the risk/reward equation increasingly favour investors is that of Continental Gold, which has experienced a range of issues, including the murder of employees by dissident guerillas and organized crime members due to Colombia's deteriorating security environment.

It also had to raise additional capital to over cost blowouts caused by Bogota implementing stricter environmental regulations, but Continental Gold still offers considerable promise and the opportunity to generate outsized returns.

A highly promising project

The junior gold miner is developing the Buritica ore body located in North Western Colombia, near the city of Medellin. The project has some impressive numbers, including reserves of 3.7 million gold ounces and 10.7 million of silver. Those gold reserves have been assessed to have an impressive average grade of 8.4 grams of metal per ton of ore (g/t). These characteristics make it one of the largest high-grade gold ore bodies currently under development globally.

The impressive ore grades are important to note, as the higher the grade, the more economic it is to extract the precious metal from the surrounding rock. Continental Gold has estimated that on commencing commercial production during the second half of 2020, Buritica will have all-in sustaining costs (AISCs) of around US$600 per ounce produced.

That’s at the lower end of the range for the industry, highlighting the profitability of the mine amid an operating environment that sees gold is trading at US$1,275 an ounce, which is more than double that amount.

The considerable promise held by Buritica is illustrated by the involvement of senior gold miner **Newmont Goldcorp**. Newmont has invested US$159 million in Continental Gold, and if it executes its rights under a US$50 million convertible debenture issued in early 2019, its ownership of Continental Gold will rise to around 28%.

Considerable potential

Continental Gold is also consistently reporting high-grade drilling results for Buritica. The latest shows gold grades as high as 17.32 grams of gold per tonne of ore. This, along with a revised mineral resource estimate released in January 2019 where measured and indicated gold resources grew by a notable 19% compared to an earlier report, underscores the considerable potential held by the property.

Geopolitical risk in Colombia is higher than in many other developed jurisdictions, but not at an alarming level. The overall political, regulatory and legal environment is relatively stable and transparent and Bogota has taken significant measures to improve the internal security environment.

Meanwhile, budgetary issues and an emerging fiscal crisis have considerably bolstered the incentive for Bogota to ensure that Continental Gold is able to successfully execute the Buritica project because royalties and other taxes will fill the government’s strained coffers.

It will also attract further foreign investment from other miners seeking opportunities in Colombia, which it believes has similar potential to South America’s leading precious metals mining jurisdiction Peru.

What does it all mean?

For these reasons, the markets perception of risk regarding Continental Gold appears heavily overbaked and it’s entirely feasible that the miner’s stock could double or even triple once commercial operations begin.

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mattdsmith