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New Century faces last century history

For several years, because the Century zinc mine was on the verge of closing, investors were urged to buy zinc related equities. Now, investors are being encouraged to back the mine's re-opening.

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The latest iteration of the Century zinc mine in Australia is set to run for at least six years

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Production of zinc in concentrate from the Century mine in northern Queensland averaged 430,000 tonnes in the two years before the mine closed at the beginning of 2016. From the third quarter of 2018, New Century Resources intends processing tailings from the old operations.

The new addition to the S&P/ASX 300 index expects to be at its targeted annual operating rate of 264,000 tonnes of zinc in concentrate by late 2019 with enough material to keep going for over six years.

Beyond the immediate renaissance lies the possibility of exploration led expansions, underpinned by cyclically strong cash flows, bringing still larger tonnages to the market.

New Century offers one of the purest exposures to the zinc market since the demise of Pasminco, the Century mine's first operator, in 2001.

In a slightly disconcerting parallel, Pasminco itself was formed as zinc metal inventories were falling for the seventh consecutive year, mine production had stalled and metal prices were touching then historically high levels.

New Century Resources - with a current market capitalisation of A$610 million (US472 million) - has a feasibility analysis that puts a value on the restarted Century mine of A$1.31 billion based on a zinc price of US$1.25/lb (compared with $1.47/lb currently).

The company's price and output assumptions imply a bond equivalent cash yield of 26% a year from an investment today for the duration of the operation, better than returns typically found among companies at a similar point in the development cycle and well ahead of relevant investment benchmarks.

> **The overall risk profile is toward the low end of what is feasible, limiting potential reliance on risk reduction to cushion adverse metal price movements**

Valuation is, not surprisingly, highly leveraged to the zinc price assumption. At today's zinc price, the return would jump to around 37%. At the average zinc price for 2014-16, the return drops to 10%. A US$0.72/lb zinc price would produce a zero return.

A halving, and a zero return, would still leave zinc prices above cash costs for 75% of global industry output and within range of a normal cyclical downturn in the market price for the metal.

After the company listed in its current form in July 2017, the New Century share price appreciated sevenfold within three months. The rapid and so far sustained share-price rise implied a zinc price assumption of US$1.05/lb, according to the PortfolioDirect valuation model.

Exceptionally high and unusually low prices are both typically discounted by equity investors. An implied discount to cyclically strong prices of 25-30% is not an unusual equity market positioning. In other words, New Century Resources is close to being fully priced in the absence of another upward leg in zinc prices.

Already buoyant expectations and the company's intense return sensitivity to metal price variations makes investment decisions more than usually difficult.

Declining risk profiles as development proceeds and targets are met will frequently underpin strengthening value propositions. The benefit from lowered risk can sometimes mitigate negative effects from changes in metal prices.

To its credit, the company's risk reduction opportunities are unusually limited.

New Century is well positioned financially with A$52.8 million in cash available to facilitate development as well as an agreement for debt funding of A$58.0 million. These amounts should be sufficient to finalise the company's current development plans.

Beyond the modest initial funding to permit production to recommence, the company intends using cash flows to meet working capital and site rehabilitation needs.

The prior operating history of the Century mine and the company's rehabilitation commitments should minimise any potential regulatory delays affecting the start-up of operations.

Those risks normally attaching to market development are as low as they can get for a new mine. The closure of Century has cultivated the ground for its resurrection. The shortfall in mine production created by several closures, including that of the Century mine itself, provides the market opening. Potential buyers will get a concentrate with which they are already familiar.

A relatively swift start to production means investors will not have long to wait before they know whether the business plan is working.

The overall risk profile is toward the low end of what is feasible, limiting potential reliance on risk reduction to cushion adverse metal price movements.

One of the three-most-significant zinc-market inventory reversals in the past 50 years is the backdrop to the launch of the company. Unusually, zinc metal inventories have been contracting even as demand has been growing at a historically slow pace.

International Lead Zinc Study Group (ILZSG) estimates show zinc usage having risen at a 1.7% annual rate between 2010 and 2017, a full percentage point below the long-term average for the industry. Output - both mine and refined - grew at 1%

Reported stocks of metal have declined for five consecutive years, according to the ILZSG data. The research group's inventory estimate for the end of December was equivalent to 3.7 weeks of 2017 consumption, the lowest such measure of stocks since 2008 and almost identical to when Pasminco was launched in 1988.

Zinc mine output has already started to rise. Production would be nearly 9% higher in 2018 if the output rate in the last quarter of 2017 is maintained.

A speedy fall in zinc prices after more aggressive production strategies have loosened supply constraints would not be unusual.

To keep downward pressure on inventories, demand for metal would have to at least match the strengthening supply growth. Recently weak growth in demand suggests that possibility although there is a looming impediment to a resurgence in metal demand.

The primary driver of metal use - global economic growth - is already very near its peak, as both the World Bank and International Monetary Fund have concluded.

A judgement about the likelihood of history repeating is critical to any assessment of the investment attractiveness of New Century Resources.

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