

# Seeking Alpha $\alpha$

## High Conviction: An Inexpensive Miner With Unique Business Model

by: Adrian Day

March 16, 2010 | about: [ABX](#) / [AEM](#) / [AUJ](#) / [FCX](#) / [GDJ](#) / [GDX](#) / [GDXJ](#) / [GG](#) / [IAG](#) / [KGC](#) / [NEM](#) / [NGD](#) / [NXG](#) / [PZG](#) / [RTP](#) / [VGMNF.PK](#)

Adrian Day is Chairman and CEO of Baltimore-based [Adrian Day Asset Management](#), a registered Investment Advisory firm that specializes in global diversification and gold equities for individual and institutional clients. A native of London, after graduating with honors from the London School of Economics, Mr. Day spent many years as a financial investment writer before entering asset management.

We recently had the opportunity to ask Adrian about his single highest conviction holding in his portfolios.

### What is your highest conviction stock position - long or short?

Our long position in **Virginia Mines** ([VGMNF.PK](#)) ([Toronto: VGQ](#)). I know many Americans prefer to use the U.S. exchanges, but personally I try to avoid the pink sheets whenever I can. Virginia, for example, is far more liquid in Toronto; as I write, it has a 5 cent spread in Toronto, versus a 16 cent spread in the U.S., where the daily turnover is also far lower.

Virginia is a resource exploration company. It minimizes the three biggest risks in this notoriously high-potential/high-risk endeavor. First, one of the biggest risks facing the exploration and mining sector is political (including social and environmental). Virginia is focused on the Canadian province of Quebec, which typically ranks at the very top of low-risk jurisdictions for mining.

The second risk is that exploration is long odds. How do you improve the odds of success? Virginia pursues a prospect generator business model, finding targets and at appropriate times joint-venturing them out to other companies who spend the money in return for a piece of the property. It can do this over and over again, unlike the typical exploration company which is constrained by cash, and build a portfolio of properties. It's a little bit like having 20 half-lottery tickets instead of one ticket.



And last, another risk in exploration is running out of money before you've found anything. By having partners spend the money, Virginia can hold on to its cash; in fact, it usually manages the programs and earns fees for doing that. Virginia now has over \$40 million in cash, a very healthy balance sheet in this business.

### To what extent is this an "industry pick" as opposed to a pure bottom-up pick?

It's a little bit of both. Virginia is a great company with a great business model that can do well in any environment. However, if I don't like the overall industry, I might have one or two small specific companies, but would not have a large position. In this case, the gold and resource markets provide a very strong tail wind for a great company.

### Can you describe Virginia's competitive environment? How is it positioned vis a vis its competitors?

A company exploring for gold is really competing against every other company around the world that is also exploring for gold. Given that it's very inexpensive to initiate exploration -- ground can be acquired by staking in many countries and initial

exploration can be just a matter of an experienced geologist walking the ground looking for outcrops or other indications of mineralization -- it's a very competitive environment indeed. There are perhaps 3,000 public exploration companies currently listed.

Virginia has a competitive edge in its chosen province of Quebec since it has been operating there for 15 years, has been very successful, and has built an enviable reputation as a strong, technically competent and ethical partner. Thus Virginia has become the "go-to" partner. But that's a competitive edge it has to work at every day to keep. It also has a competitive edge in that it has hard assets to back up its market valuation.

It is very difficult to put a hard valuation on exploration. After all, if a drill program of, say 30 holes costs \$2.5 million, finds nothing much of interest, the property is worth next to nothing. If your first hole is a discovery hole, then the property might be worth \$20 million, \$50 million, \$100 million. How do you put a value on that? An exploration property is really a liability (in that you have to spend money on it) as much as an asset.

The traditional model for exploration companies (and most of Virginia's competitors) is to raise equity money on the back of something that for one reason or another is interesting (a gold outcrop, adjacent to a known mineralized property etc.), spend that money in the ground, and then go back to market to raise more money. If the initial exploration program has been encouraging, then you can raise money easily and at a higher price. If it's been discouraging, then it's more difficult to raise more money, and if you can raise it, it's at a lower price. The typical exploration company is "valued" on a prospective value -- if this, if that, then the property could be worth so much.

Virginia, by following the joint venture model, avoids the repetitive equity raisings and dilution. This approach has enabled it to build hard assets which can be valued. In short, we can value these hard assets, and Virginia is selling below them, below NAV. The rest is more of a soft valuation: how much for management, reputation and so forth, and how much for properties that at present have no real value but following exploration might.

#### **Can you talk about valuation? How does Virginia's valuation compare to the competitors?**

Virginia is very inexpensive. It has two primary assets on which a hard value can be put. The cash, of course (and some marketable securities), but a royalty it holds on a property it sold a few years ago to Goldcorp ([GG](#)), one of North America's largest goldmining companies. The resource on this property was just raised 77% to 9.4 million ounces. The royalty has a NAV, on a discounted cash-flow basis, at current gold prices of upwards of C\$130 million. That and the cash along is in excess of the market cap (\$167 million).

So we have all the gold resources Virginia has discovered on other properties, its 100% "ready-for-development" zinc property, and numerous joint ventures and wholly owned properties. It is difficult to put a valuation on an exploration property, but Virginia has hard assets to back up its share price.

#### **What is the current sentiment on the stock? How does your view differ from the consensus?**

I am very bullish. Though the stock has risen a lot, Virginia is now undertaking four drill program on gold targets (close to the Eleonore property it sold to Goldcorp); we will have results over the next several months. So this is a very good time to get in.

Sentiment is generally positive on the company, but many feel the stock either is not exciting enough or is not cheap enough. They miss the increase in valuation on the royalty following the jump in resources, the higher gold price, and that production from that mine draws ever nearer. I believe their valuations on the royalty are out of date.

#### **Does Virginia's management play a role in your position?**

Absolutely. President Andre Gaumond has been the key driver of the company and is extremely well respected in the industry. He remains enthusiastic and wants another discovery. Having said that, there is good bench strength.

#### **What catalysts do you see that could move the stock?**

A discovery or a series of encouraging results on its drill programs this winter/early spring would certainly see the stock start to move. It would remind investors of the move after the company started reporting positive results at Eleonore.

More definitive progress by Goldcorp on mine development at Eleonore would also drive attention to the company. A pre-feasibility study is expected to be announced in the next couple of months and that's a first step towards a mining decision.

#### **What could go wrong with this stock pick?**

I distinguish between short term stock volatility and a fundamental problem. We could see a temporary correction in the stock caused by a sharp drop in the gold price. If we have seen the top in the gold price for some time, then the stock would likely

move to a new level; its actual value would be less, since its royalty would be worth less, and the market perception would be less.

Specific to the company would be loss of senior management (though they have several strong people and the company's valuation is backed by hard assets), disappointing results at all of their drill programs this year (which would be a delay rather than the end of any advance), or if for some reason Goldcorp decided not to pursue building a mine at Eleonore.

It might be, for example, that Goldcorp decides to put all its resources into developing other mines and to keep Eleonore on the shelf. That would be a strange decision, but would certainly reduce the value of the royalty.

**Thank you, Adrian.**

My pleasure.

**Disclosure:** Adrian Day is long Virginia Mines

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Adrian Day is a British-born writer and money manager, a graduate of the London School of Economics, who has made a name for himself searching out unusual opportunities around the world, with two books on the subject. His money management firm, Adrian Day Asset Management, he specializes in... [More](#)

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