IDEAS

A miner that's primed to dig out a profit

This prospective miner is about as safe as can be before a resource company actually hits production

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By **Alex Hamer**

The London Stock Exchange has had its fair share of mining disappointments: some companies that promised a quick route to production 10 years ago are still talking about pulling financing together and getting that last permit signed before they can really get going.

Tip style
GROWTH

Risk rating
HIGH

Timescale
MEDIUM TERM

Bull points

- **Vares mine completion on track**
- **Quick payback forecast**
- **Expansion options**
- **High metals prices**

Bear points

- **Pre-revenue**
- **Development and mine risks**

This has happened in countries ranging from Spain to Ethiopia, but also plenty of times in so-called 'tier one' mining nations such as Australia and Canada.

That's why those interested in the space should spread risk: put simply, pre-revenue miners can offer good returns but also might crash and burn. With that in mind, the balance of risk feels high but just about right for **Adriatic Metals (ADT1)**, which is aiming for production at the Vares project in Bosnia and Herzegovina by the end of the year.

With construction over halfway complete and the often-difficult financing deals completed over a year ago, the prospective miner of base and precious metals has a clear runway ahead of it.

Currently trading at 181p, the company's market valuation has ticked up this year alongside steady and stable progress reports from Vares. Often junior miners' share prices peak before the dreaded financing process, during which companies will often dilute shareholders and sign up for expensive debt. In the case of Adriatic, whose share price has more than doubled since the group listed in 2019, the hype seems far more warranted – in large part because management has already secured a credible financing package to build the mine and get to first ore.

Yugoslav expertise

Vares' history goes back more than a generation. When Bosnia was part of Yugoslavia, the state heavily explored its various territories for mineral deposits, largely focusing on lead and zinc. Since the collapse of the communist bloc, commercial mining enterprises have long seen the value in following in the footsteps of the Yugoslav geologists.

In Adriatic's case, the town of Vares itself was home to iron ore mining, which stopped in the 1980s. The infrastructure left behind – industrial rail, water and power sources – mean viable mining activities can be pursued today anew. Another nearby deposit, Veovaca, was mined in the 1980s through an open-pit operation. While it does not feature in the current mine plan for Vares, Adriatic has the rights to restart operations there.

The project Adriatic is currently building includes the Vares processing plant and underground workings to access the Rupice mineral deposit. This site was previously explored in the 1980s but did not lead to commercial-level production.

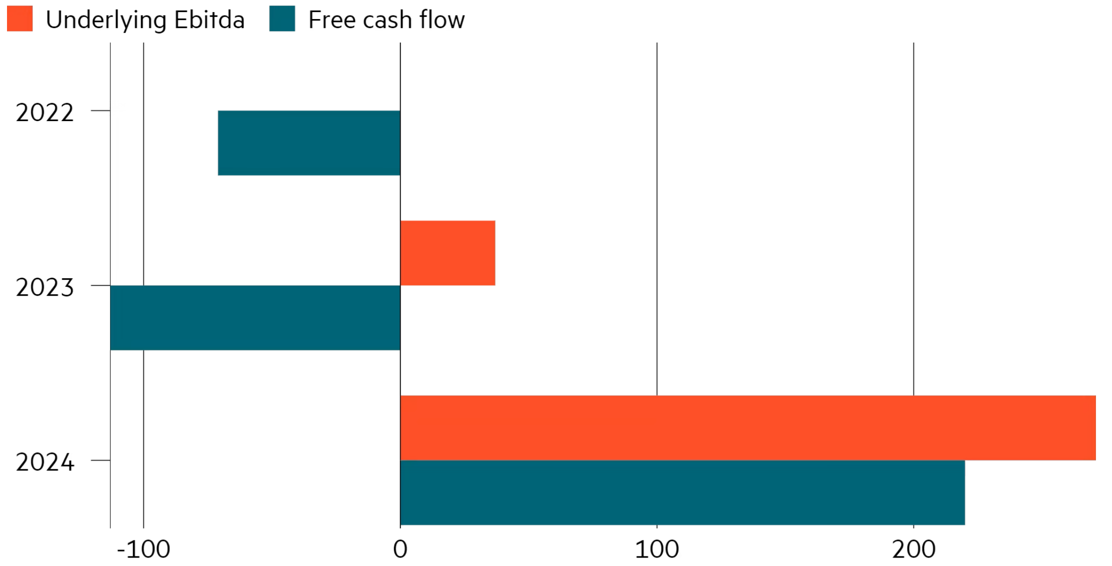
Since 2017, Adriatic has defined the deposit through drilling, and designed an underground mine that would produce lead-zinc and silver concentrate. Specifically, this will see the ore crushed at Rupice, trucked 25km to the Vares plant and then turned into the two concentrates, which will be shipped out of a Croatian port. A study in 2021 put the overall mine build cost at $170mn (£138mn), for a 10-year mine life. But chief executive Paul Cronin said this month that recent drill results covering an area outside the existing mine plan backed "Adriatic's growth strategy to achieve at least a 20-year mine life at Rupice".

The period between Adriatic first drilling Rupice and pulling together a 2021 feasibility study was remarkably quick, and helped by previous exploration. A $245mn total financing package was secured at the end of 2021, split between loans, equity and a copper offtake.

The key financier in this endeavour is Orion Resource Partners, which provided the loan, $52mn in equity funding and the copper offtake cash. The $120mn loan is being drawn down in stages, and at the end of December Adriatic announced it had received the first $30mn tranche. The $22.5mn in offtake cash is expected to land in January too. Critically, the $170mn build cost estimate has remained mostly intact since 2021, despite rising prices for almost everything. In November, Adriatic put the figure at $173mn.

ADRIATIC METALS' QUICK FORECAST ROUTE TO FREE CASH

Million USD



NB: Figures are forecasts
Source: RBC Capital Markets

Paying it back

Taking on debt is one thing, paying it back is another. Reassuringly, the company has forecast an extremely fast payback period for the cost of Vares – less than a year.

The strong economics are by optimistic price forecasts from the company, including $25 an ounce (oz) of silver, lead at $2,300 a tonne and zinc at $3,000 a tonne for the 10-year life of the mine. Macquarie Bank puts the long-term zinc price at $2,350 a tonne ($2,650 for 2023), and lead at $1,850 a tonne, although it is currently trading at almost $2,150 a tonne. Lead, zinc and silver are the key contributors to earnings, although gold will also contribute 14 per cent of sales as per a November forecast. The net present value of the Vares project could be dented by sharp downturns in base metals prices, therefore, but this is a risk for any asset.

Variable price expectations aside, the mine should be in the black fairly quickly: RBC Capital Markets analyst Tyler Broda forecasts $220mn of free cash flow in 2024, as well as a net cash position by the end of the year.

Broda's internal rate of return (IRR) estimate is 98 per cent against the 134 per cent from the 2021 feasibility study, but this is still a strong number. While IRR expectations vary between project type, Mark Bristow of Randgold Resources fame used a flat hurdle rate of 20 per cent for gold mines, so an IRR close to three digits is nothing to sniff at. And while Adriatic has limited analyst coverage, the shared outlook is positive: all four predict earnings in 2024. BMO, another Canadian bank, sees a cash profit of $213mn next year, while Stifel analyst Andrew Breichmanas is more optimistic with a forecast of $300mn.

But all those numbers don't mean much if the mine itself doesn't hit production. "Every quarter of construction progress will... aid in derisking," notes Broda. If all goes well, first concentrate production will arrive in the third quarter and ramp up from there.

What next

Building a mine isn't easy. Even reopening a mine can be tough – it took **Atalaya Mining (ATYM)** many years to get into production even as a brownfield operator, while a company we had suggested was close to production in 2019, **Pure Gold (PUR)**, fell in a heap when the gold simply was not there at its Ontario underground mine. A positive example in another former Yugoslav state is **Central Asia Metals' (CAML)** Sasa lead and zinc mine in North Macedonia, that was already in operation when the company bought it.

So despite those cautionary tales, it is worth thinking about what happens once Vares is up and running. Adriatic already announced strong drill results this month for an area called Rupice Northwest, and the exploration team at the company is now working on joining this zone to the existing deposit, which would mean a potentially significant extension to the existing orebody. Underground mines often stay in operation for many years beyond the initial mine life, as workings expose new areas of mineralisation. This isn't always a given, however. "The sheer size of Rupice NW has meant that further drilling will be required to define the mineralized system," notes Cronin.

Outside Bosnia, Adriatic also owns the exploration rights to two former lead-zinc mines in Serbia, acquired in its all-share purchase of Tethyan Resources in 2020. These are very early-stage in development terms, however, without a defined resource.

In either case, talk of reinvesting as-yet-absent cash flows may be premature. The key risk investors are taking on at this point is Vares running into difficulty, meaning they will be eyeing an update before the end of this quarter with keen anticipation. More broadly, price conditions are positive for zinc and silver, while lead is benefiting from a tough lithium-ion battery supply chain, according to consultancy Wood Mackenzie. This means high lithium prices have slowed the auto industry's transition to Li-ion batteries. This dynamic won't last forever, but will give a quick boost to Vares' early-stage profits should it persist into 2024.

Put into rough numbers, forward earnings forecasts make Adriatic still look like a good deal at 181p a share. While a consensus earnings forecast of 2.25p per share for 2023 puts the company on a pricey near-term valuation, the expected explosion in profits thereafter could quickly reduce that price/earnings ratio to less than four. CAML - which pays a dividend and has a long record of success, to be clear - sits at 9 times and Atalaya is at 8 times. Dig in.

Company Details	**Name**	**Mkt Cap**	**Price**	**52-Wk Hi/Lo**
	Adriatic Metals (ADT1)	£516mn	181p	195p / 94.7p
Size/Debt	**NAV per share**	**Net Cash / Debt(-)**	**Net Debt / Ebitda**	**Op Cash/ Ebitda**
	42p	£53.4m	-	-

Valuation	Fwd PE (+12mths)	Fwd DY (+12mths)	FCF yld (+12mths)	P/Sales
	33	-	-12.5%	-
Forecasts/ Momentum	Fwd EPS grth NTM	Fwd EPS grth STM	3-mth Mom	3-mth Fwd EPS change%
	-	854%	47.2%	198.1%

Half year to 31 Dec	Sales (£mn)	Profit before tax (£mn)	EPS (p)	DPS (p)
2020	nil	-5.70	-2.99	nil
Year End 31 Dec	**Sales (£mn)**	**Profit before tax (£mn)**	**EPS (p)**	**DPS (p)**
2021	nil	-10.39	-4.72	nil
f'cst 2022	nil	-11.69	-4.08	nil
f'cst 2023	42.1	1.45	2.25	nil
f'cst 2024	283.3	181.4	52.7	nil
chg (%)	+573	-	-	-

source: FactSet, adjusted PTP and EPS figures

NTM = Next Twelve Months

STM = Second Twelve Months (i.e. one year from now)