

Small caps

Opportunities at the smaller end of the sharemarket

Move over, big boys

When precious metal explorers start turning a profit and their outlook turns from hopes and dreams into solid production prospects, then it's time for savvy investors to sit up and take a look, Trevor Hoey writes.

There's been a strong run in the price of gold, and there is little to suggest it is likely to ease. At the end of April it became evident that economic conditions in Europe were worse than expected, resulting again in a significant increase in gold prices.

Large goldminers such as Newcrest Mining (NCM) and Lihir Gold (LGL) tend to grab most of the headlines and could be hit by the new resources super profits tax on miners. But some emerging small producers have the potential to boost output substantially in the next few years, such as Catalpa Resources (CAH) and Silver Lake Resources (SLR).

Silver Lake made a maiden profit in 2008-09. Catalpa should reach the same milestone in 2009-10, as production rises to 130,000 ounces a year.

■ Catalpa Resources

The company has two producing assets. The first is a 30 per cent stake in the 100,000 ounces a year Cracow goldmine in Queensland operated by Newcrest. Catalpa's share of production in the 12 months to December 31, 2009, was 31,233 ounces. Current reserves, combined with likely increases from recent exploration success, are expected to support sustained production at this level.

Catalpa holds a pre-emptive right to acquire Newcrest's 70 per cent stake in Cracow if the larger miner decides to exit the project. Given that Newcrest is looking at large acquisitions such as Lihir Gold, and devoting about \$2 billion to its Cadia East project,

a decision to divest the Cracow asset would not surprise.

Catalpa's other asset is the Edna May project in Western Australia. It was brought into production ahead of schedule in April, and is expected to produce 100,000 ounces of gold in 2010-11. The company has had exploration success in areas near Edna May, and management believes there is potential to boost production to 150,000 ounces a year and extend the mine life beyond nine years.

If Catalpa does acquire Newcrest's stake in the Cracow project, it could be producing 250,000 ounces a year in the medium term, making it an important mid-tier player.

If it doesn't get Newcrest's stake, management has indicated it is likely to pursue an acquisition or develop a third project that would boost production to at least 250,000 ounces a year.

Based on consensus forecast for 2010-11, Catalpa's price-earnings ratio is about 7 times earnings.

■ Silver Lake Resources

While the gold explorer recorded its first profit in 2008-09, it is currently in its first full year of production and earnings are expected to increase significantly in 2010-11. Management expects to record a net profit of \$10.7 million in 2009-10 based on a production target of about 65,000 ounces.

The company is well on track to achieve this goal, given that it has recorded production of 23,150 ounces for the three months to March 31, 2010.

By 2011-12, management expects to treble output, as it brings the Murchison project in WA into production. Based on these forecasts, Silver Lake will be producing about 200,000 ounces of gold a year, which will make it a mid-tier WA goldminer.

Its Mount Monger project is already in production, and management is targeting sustained production of more than 200,000 ounces a year by 2014. This looks feasible given its resource base and the exploration success it has had in and around its Daisy Milano and Daisy East tenements in WA.

The company has much of its infrastructure capital expenditure behind it. It has doubled capacity at its WA Lakewood gold processing facility to 600,000 tonnes a year for about \$4 million.

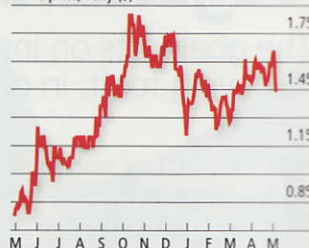
While the milling infrastructure at its Murchison project requires further development, management believes that its completion will not be capital intensive. Furthermore, it can be completed in time for Silver Lake to commence production of 50,000 ounces in 2011-12, increasing to 100,000 ounces a year in 2012-13.

As an investment proposition, Silver Lake is essentially a 2010-11 story. Consensus forecasts indicate that it should achieve earnings per share of 22.4¢ in 2010-11, which suggests the company is trading on a conservative P/E multiple. **Si**

Trevor Hoey uses socio-economic trends to identify stocks with the best potential for growth.

▶ CATALPA RESOURCES CAH

Share price, daily (\$) 1.75



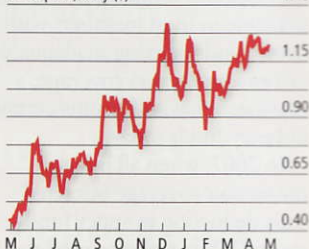
FAST FACTS

Market cap	\$263.6m
Dividend yield	N/A
Hist. earnings per share	-3.7¢
Hist. price-earnings ratio	N/A

If Catalpa gets the chance to buy Newcrest's stake in Cracow, it will become a mid-tier goldminer.

▶ SILVER LAKE RESOURCES SLR

Share price, daily (\$) 1.40



FAST FACTS

Market cap	\$218.1m
Dividend yield	N/A
Hist. earnings per share	8.0¢
Hist. price-earnings ratio	15.3

The company is well on track to reach its 2009-10 production target of 65,000 ounces of gold.