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RESEARCH

NATURAL RESOURCE CONFERENCE

SURVIVAL GUIDE

**How to recognize resource BS and
find high-quality stocks that can
vastly increase your wealth**

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As of October 2017, there were over 1,135 publicly listed junior resource companies on Canadian stock exchanges.

While Canada is a huge global player in junior resource finance, the industry doesn't stop here. Between the U.S. markets, the Australian markets, and the large London market, there're at least 1,869 additional publicly listed junior resource stocks in the world.

In total, that's over 3,004 stocks for a resource investor to choose from.

The business of finding and extracting raw materials like oil, natural gas, copper, gold, and uranium is a high-risk, high-reward business... and so the unfortunate truth is that most of those 3,004 stocks aren't worth the paper their stock certificates are printed on. An investment in the average natural resource firm often becomes a roach motel for capital. The money will go in, but it won't come out.

If you're reading this guide, it's likely that you've seen or are about to see many of these roach motel companies in a booth or on stage at a large natural resource investment conference.

More so than other industries like retail or manufacturing, the resource industry connects with its investors through conferences. These

conferences act as major money-raising events for many resource companies. At a large conference in my hometown and global mining finance center Vancouver, it's common to see over 200 resource companies with a presence. They are all looking to attract investor capital. They all have a story to tell and stock to sell... from **Aluminum** to **Zinc**.

And you know what? Some of these opportunities are incredible. When a small resource firm executes an aggressive business plan or finds a large deposit, shares can soar thousands of percent. These big scores attract people to resource conferences every year.

But as I mentioned, an investment in the average resource firm doesn't produce a big score. It just sends your capital to "money heaven."

Making it to a natural resource conference can ring up a lot of travel costs. It takes up valuable time. That's why I've written this "survival guide" to help you maximize your return on the money and time you invest into attending a natural resource conference.

Long-time readers know I'm a big believer in the Pareto Principle. It states that 80% of your results come from 20% of your efforts. For that reason, it's also called the "80/20" rule. For example, your business may generate 80% of its sales from 20% of your clients.

The Pareto Principle is alive and well in the resource sector. About 20% of resource operators create 80% of the value in the sector.

I've even taken Pareto's principle a step further. Years ago, I coined the 64/4 Rule – I took the 80/20 Rule and subjected it to Pareto's principle again. The result states that 4% of entrepreneurs create 64% of the wealth (80% of 80% is 64%, 20% of 20% is 4%, hence the 64/4 Rule).

If making a lot of money is your goal in the resource sector, I encourage you to do what I do: Focus on the 4% of superstar entrepreneurs who own large stakes in their own companies. Invest with the best.

This “resource conference survival guide” is a list of key questions I believe any intelligent investor should ask a mining company before considering an investment in it. It addresses critical aspects of a company like project quality, management quality, and balance sheet.

If you put this idea and others in this guide to work, you’ll become a master at spotting BS and avoiding losing companies. You’ll become a master at putting the Pareto Principle to work for your own benefit... and you’ll stand a very good chance of making many, many times any investment you make at a resource conference.

Let’s get started...

How much stock does the management team own?

If a management team doesn’t own their own stock, why should you?

What is the management team’s cost basis? Did they just get millions of shares at the founders’ level of \$0.05 per share, or have they been actively buying stock?

It is always good to see a management team taking down some of its own financing. If management is buying the stock, that’s a good sign. If they’re not – ask them why.

Actual ownership and a stake is very important. Take the case of owning versus renting a car for example...

Have you ever waxed and polished a rental car before returning it?

Chances are good that you've never done it. Chances are good nobody you know has done it. Chances are good nobody, ever, has done it.

If you take a moment to think about why people don't wax and polish rental cars, you can correct a major investment mistake that is probably costing you money right now. And you can vastly improve your investment returns.

People don't wax and polish rental cars for the same reason they don't mow their neighbors' lawns: They don't own them.

Not caring about things you don't own is simple human nature.

You might be thinking I'm just stating the obvious.

But have you ever invested in a company run by executives who owned little to no company stock?

Have you ever trusted your hard-earned capital with managers who don't have skin in the game?

Chances are very good that you have. You probably own some of those companies right now.

Your holdings are the manager's rental cars. And they just nicked a telephone pole while you read the last paragraph.

Don't worry. You're not alone.

Investing in a company whose managers have no skin in the game is one of the most common investment mistakes in the world. They don't teach

you this critical investment secret in high school, college, or business school. But once you think of it in terms of rental cars, it's utterly obvious.

Ownership brings a respect and care for expenses, assets, and cash flows that has no substitute. It instantly transforms the mind.

Ownership will turn a salaried manager who thinks nothing of spending \$3,000 on a nice office chair into a guy who will sit on a bucket in order to save a few bucks.

Ownership will turn a conventional "9-to-5" employee into a guy who will happily work Friday and Saturday night.

On a larger scale, ownership transforms a reckless CEO who plays fast and loose with shareholder capital into a watchful, prudent shareholder advocate. It turns a CFO who uses aggressive, very questionable accounting into a boy scout.

Just think of the indifferent, uncaring people you've worked with in the past.

It's virtually guaranteed they didn't own a piece of the business you were in. They might have stolen company property. They probably wasted supplies. They were hard on equipment. They left paper towels on the bathroom floor.

Now, think of all the extremely hardworking business owners you've worked with in the past. They treated equipment with respect. They used supplies carefully. They took pride in their work. They got to work early. If they saw a piece of trash on the floor, they picked it up.

Now take all those little differences and multiply them times a million. That's the difference between a business operated by

managers with no skin in the game versus a business operated by managers who own substantial amounts of company stock.

Which business would you rather own shares in?

What kind of people would you rather work with?

It's an easy choice for me.

That's why when I start analyzing a potential investment or talking to managers about placing money with them, my first question is always **"How much stock do you own?"**

If the answer is "not much" or "zero," my analysis is finished.

I don't want my money treated like a rental car.

Neither should you.

In order for me to consider investing in a company, I need to see management combined with the directors own at least 10% of a company. Or, if it is a very large company, I need to see top executives with a substantial amount of their wealth held in the company's shares.

ONLY AFTER this critical first question is answered to my satisfaction do I move on to the following questions.

TIP: Keep an eye out on insider trading activity where management recently bought stock in the open market. Investors should be attracted to stocks that are trading at or below the price at which insiders recently bought.

Does the management team have a solid track record?

I hear hundreds of deal pitches a year. My built-in warning indicators sound immediately if I don't see:

- ☑ A chairman or CEO with previous success in the industry (merger, buyout or other)
- ☑ Connections to a strong promoter or financier that can guide the company through tough times
- ☑ Exceptional technical lead with previous discoveries (and not just peanut discoveries)
- ☑ Credible directors
- ☑ A team that has delivered multi-baggers for shareholders in the past
- ☑ A team that has actually built a mine (remember that only 1 in 3000 projects ever become a mine)

The more criteria above that matches the pitch, the more I'm likely to listen to what the company has to say.

Does the company live from financing to financing?

Private placements are in high demand with wealthy, knowledgeable investors.

They allow you to buy large blocks of stock at discounted prices... while getting massive upside “kickers” in the form of warrants.

If you forced me to invest for the rest of my life with just one strategy, I would choose private placements. But a company that routinely does private placements for six figures is a red flag for me.

Ask the company how many recent financings or private placements they've done.

If they admit to several dilutive financings a year for well under \$500,000, they are just barely keeping the lights on and paying themselves. There is no chance the company can create any shareholder value.

Move on.

Does the company have a newsletter or institutional following/analysis?

Does the company have a *story factor*?

The story factor is the reason you invest in the company. A good story might involve getting a mining permit, a series of drill holes that will hit bonanza grades, or even a potential takeover.

The story factor is crucial to a company being recognized by both the mom and pop investor and by larger brokerages and institutions.

Is the company marketing itself properly? Is it followed by independent newsletters? Is it being promoted by paid newsletters and advertorials?

A company that has institutional coverage is one that has likely made an impact along promotional lines. When an institution like a bank or brokerage produces an analyst report, others listen... or at least pay attention. If a company representative says **“We have interested analysts and brokerages wanting to initiate coverage”** but lacks concrete evidence of any coverage... or of the ability to gain analyst or publisher coverage...

Move on.

Coverage spreads the word and affects the stock price.

However... it's always a great idea to get in before the newsletter writers and analysts – so some judgement has to be made. I pride myself on being first to a story, so I really don't care if nobody has written the company up yet.

I have enough experience to know what a company needs to do to be successful. The key is this... can this specific company, with their projects, coming catalysts, and the management team, attract others to not just **recommend** the stock, but to **buy** stock?

Does the company have a lot of free trading paper (i.e., a large number of shares outstanding)?

Warrants, options, and large numbers of financings can significantly dilute a company's shares.

The best structure for a junior resource stock is that shares are held by strong, long-term hands that are in it for a long-haul event like a buyout or merger.

Long-term hands include insiders like management or funds that want to see the company business plan executed. These are not day traders with very short-term interests.

Tight share structures allow for plenty of stock price appreciation when catalysts occur and the business plan is executed.

Excessive shares outstanding is usually indicative of significant shareholder dilution. Investors want to see companies raise money at

valuations higher than the previous round. If a company is continually raising money at the \$0.05 and \$0.10 levels, current shareholders are going to be diluted and there is little value being created from the funds raised.

Is the company's market cap completely unrealistic?

Compared to other companies with similar programs or assets, how does the market capitalization stack up?

Is the company just being promoted heavily, or is it actually a better set of projects?

It's a good idea to compare the market cap of a company to its peers to determine how it stacks up in terms of metrics like cash costs, cash holdings, ore grades, and reserves, among others.

Does the company change its name ever few years as a flavor of the day (dot-com, uranium, gold, marijuana, bitcoin)?

Flavor-of-the-day companies will chase any bull market. In the late '90s, there were thousands of dot-com companies.

In the early 2000s, there were thousands of biotech companies.

In 2007, there were hundreds of uranium companies on the Toronto Stock Exchange.

In 2017, the cryptocurrency market has exploded, with over 850 coins and new celebrity initial coin offerings announced daily.

In the world of solid companies, there are **Innovators**, **Imitators**, and **Hot Dog Vendors**.

Which one does this management team fall into?

You make the most money with the innovators and even imitators who can improve on what the innovators are doing.

Stay clear of the hot dog vendors that pop up late one night and then disappear the next day.

Does the management team have an extremely generous options policy?

When management teams issue themselves options, this dilutes the company stock.

A lot of dilution limits the upside of a stock's share price.

Options and performance incentives which give management cheap entry into stock is never a good sign. If they won't pay market value for stock, why should you? A company whose policy it is to gift more than a few percent of the total shares outstanding to management is far too generous.

At Katusa Research, we track the exercise price, expiry date, and quantity of options issued for all companies in our database.

Be wary of the expiry date on out-of-the-money options, as expiring options may be replaced with new ones at a lower price. Repricing of warrants and options should never be allowed. A company usually reprices its warrants and options because it can't hit the standard set to achieve them. Why should a management team be rewarded for failure? That's ridiculous and highway robbery at its finest. If a company is

repricing management's options and warrants, it is probably a good idea to avoid the company at all costs.

Catalyst Check - Does the company expect significant drill results (and when)?

Is the company actively drilling the project? Is this a new asset or has the company been drilling the same project for 20 years? Does this drill program expect to extend the areas of known mineralization or is this "infill drilling" which doesn't expand the resource size?

If the company has been drilling the project for a number of years and the resource isn't growing, then likely it is just trying to drill holes to create enough excitement to finance another year of salaries. If this is the case, move on – there're better investments out there. If the company is actively drilling a fresh project, that's terrific – keep reading and asking questions.

The company might release news saying it just drilled 100m of 6.1 grams/ton of gold. Awesome!

But is that in a cherry-picked location in a terrible asset that will never become a mine (i.e., located in an AK-47 Indicator country)?

The oldest geologist trick in the book is to drill your best hole first.

Are the more recent holes of similar quality mineralization? If they aren't, it's likely the team just targeted the #1 target to get a quick payday. Avoid this type of company at all costs.

Infrastructure and jurisdiction play significant roles in the success or failure of a project. A company may have a high grade, large orebody. However, if it's on the side of a mountain and 500 miles from a road or town, it's going to be very expensive to bring workers and ore down from

the project. These types of infrastructure costs can quickly take a great project and make it uneconomic.

Jurisdiction plays a huge role too. A government that is pro mining and does not take a large ownership in the mine is always favorable.

If the company meets these checklist items, keep reading; if not, move on to your next company.

A major fatal flaw that many amateur investors make is misunderstanding an orebody.

Everyone always says grade is king, but almost as important as grade is how deep the orebody is. An orebody that averages 2 grams per ton gold near surface is far more valuable than an orebody which hosts 2 grams per ton gold 800 meters below surface.

You can get the visualization very quickly by looking at the intercepts of the drill results. Drill results should always state not only the width of the intercept but also how deep the mineralization is below surface.

Catalyst Check - Does the company expect to receive a Pre-Feasibility Study or Bankable Feasibility Study?

These studies provide an in-depth look at all aspects of a project. These reports cover geology, metallurgy, social and environmental studies along with project economics.

Every company trumpets its project economics. Project economics drive the value of the company.

The first thing you can do is open up the feasibility study and look at the metal prices the company is using for its base case scenario. Are the

metal prices realistic, or are they pie-in-the-sky prices? Even better, was the economic study done 10 or 12 years ago using metal prices which are now too low? What kind of discount or premium is the company trading at relative to this Net Present Value calculation?

Is the company in a lawsuit or violating rules with a governing body?

Ideally, you want to be involved in a company that has its hands clear of legal disputes. A company that is tied up in a legal battle is an expensive saga that is usually only worth avoiding.

To avoid the drama of one company suing another, companies should have the ability to earn into at least 75% if not 100% ownership of the project.

If a company is spending money to earn into the project, ask what the terms are once the money is spent. Does the company have to give the previous owner a royalty on any production? If so, how much?

Is the mining region pro mining or against it? How far along is the company in its permitting process? Getting mining and environmental permits can take years and millions of dollars in legal fees.

How does the company perform relative to its peers? Is it lagging and misunderstood, or is it over-performing and overpriced?

What is the trading activity like in the company? Is it actively traded every day, or is trading very sporadic? Liquidity is crucial for entering and exiting positions.

Savvy analysts use peer analysis to directly compare “apples to apples.” Compare your potential investment against other companies at similar stages of development. Compare not only the reserves and resources, but also the project’s Net Present Value (NPV) along with cash and debt.

Is the geologist the main focus of the company? Has that person ever put a mine into the ground?

Is the company dependent on hopium (i.e., when a management team or shareholder simply hopes for the best without any further rationale)?

Does the geologist love rocks so much that this person spends all their time digging and looking and not actually finding anything?

If this is the case, it’s time to move on. Stick with the Pareto principle and follow people who have proven discoveries under their belt. These people know how to be part of a core team that delivers value for shareholders.

Are the cash costs and estimates reasonable or pie in the sky?

Compare these cash costs to companies with similar projects in similar areas.

If a management team tells you it has negative cash costs, a) they are probably lying and b) you should ask what prices and recovery rates they are using for the financial model.

Is the company being honest with its *True Netbacks*?

In the oil and gas sector, the producer should include all cash costs in its netback calculation. Oil and gas companies commonly report their lease operating expenses along with transportation expenses.

A savvy oil and gas investor must also include costs such as interest payments, general and administration fees, consulting and management fees plus cash exploration expenses.

Is the exploration budget/thesis reasonable?

If a company is championing its exploration plan, ask what the budget breakdown looks like. What percentage of the budget is going to resource delineation via drilling, and what percentage of the budget is going to consulting fees and desktop studies?

True wealth is created by the drill bit, so don't let companies milk you for your hard-earned money with fancy stories and pitches. If a geologist is afraid to drill more holes, move on.

Another sneaky thing management teams do is to set up deals with the drilling companies and get kickbacks. Ask what the relationship is between the CEO or COO and the drilling company. Many industry CEOs will receive cash kickbacks from their drilling friends. This is a red flag. Avoid companies like this at all costs.

Where are the company offices? Are they fancy?

The more money that is spent on fancy office space, unnecessary employees, and espresso machines, the less money there is available to create shareholder value.

Are there any big blocks of shares / options / warrants coming free for trading soon?

Companies try to increase promotion of their company when newly issued shares come free for trading. Why? So that retail investors can buy the stock the insiders are selling. Avoid this by asking when any shares from financings are coming free for trading and buy after that time period. Most financings on the TSX and TSX-V come with a 4-month hold period. Once that period is about to end, there is usually selling pressure on the stock price.

Does the company pay for promotion?

Promotion is an important part of getting a stock on the radar of institutional and retail investors.

However, paying for promotion only gets you so far. A company with a world-class project shouldn't have to pay for promotion. The fundamentals should speak for themselves.

What is the political jurisdiction like? (Hint: Use the AK47 Indicator)

Early in my investment career, I really enjoyed the excitement of risking capital in exotic lands like Indonesia. The site visits were exciting. But as I wrote in an educational piece that could save you a fortune called *How To Use The AK-47 Indicator*:

As a new resource investor, it's hard not to get interested in the excitement and drama that comes with investing in far-off lands. After all, many countries in Africa, Asia, and South America are less picked over by exploration geologists. You get to visit new places

and meet interesting people. And the prospect of finding the next giant gold deposit in some jungle is just plain exciting. All these things got me on many plane trips.

Yet, now... after many successes and many mistakes, I tend to avoid places where people hold AK-47s in the streets.

The places where people with AK-47s walk the streets tend to be the places that have very few of the roads, bridges, power lines, railroads, and ports needed to transport raw materials. That kind of infrastructure is critical for turning resource deposits into free cash flow. The places where people walk around with AK-47s also often lack contract laws, property rights, and worst of all, respect for human life.

After doing business all over the world – and in more than a few war zones – I would now much, much rather put my capital to work in countries with long histories of respecting contracts and property rights, and which have the roads, power lines, bridges, and ports that are critical to extracting and transporting natural resources.

I say let the novice investors have all the third-world excitement they want. I'll take the money.

What is the company's exploration budget for the next 12 months?

Is it realistic with the plan?

If the company is drilling, ask how much all-in drilling costs are (drilling + assay + other). Compare that number to other companies in the same area.

If the company is burning cash on exploration within a specific time frame, you can make an educated guess as to when the next company financing will take place.

All gold and silver ounces are not created equal.

A deeper mine needs higher grade ore to make the economics work. Ask the company about metallurgical results. Has the company done adequate testing to prove that the valuable ore can be easily and efficiently milled/processed?

Some questions to ask management include: How deep are the holes being drilled? Where is most of the mineralization? Is it a near-surface deposit or is it deeper? Does mineralization get better as the hole deepens?

Make sure the company is expanding the resource, not just “twinning” holes.

And remember the AK-47 Indicator. Is the project in an AK-47 region? Because if it is, then the gold and silver ounces are riskier to get out of the ground.

Is the government in that area pro-mining? What are the royalties / profit sharing agreements normally like in the country?

This type of detail is important to get a full analysis of the company and the ounces it has in the ground.

Don't be afraid to get technical with management.

What are the catalysts that will propel the share price?

Always ask what is the most important question or item next on management's agenda. If the answer is "We'll need to drill more to expand the resource," that's not a good enough answer.

Ask how the company plans to do that.

For example:

- ☑ How many holes do they plan on drilling?
- ☑ What drill hole spacing are they looking at?
- ☑ Do they need to build roads to the drill pads, etc.?
- ☑ Are they doing RC or diamond drilling?
What size core are they using?

If management can't answer these basic questions, then the company does not have a plan and does not deserve your speculative investment dollars.

Happy hunting,

Marin

JUNIOR RESOURCE STOCK SCORESHEET

Company Name _____ Ticker _____

- Does the management team own a lot of their own stock?
- Does the management team have a solid track record?
- Does the company only finance to improve shareholder value?
- Does the company have a newsletter or institutional following?
- Does the company have a reasonable number of shares outstanding?
- Is the company's market cap realistic?
- The company is not a "flavor of the day"?
- Does the management have a reasonable options policy?
- Catalyst – Does the company expect market-moving drill results?
- Catalyst – Does the company expect to receive a positive PFS or BFS?
- Is the company not involved in a lawsuit or violating the rules of a governing body?
- Is the company out-performing its peers?
- Has/have the geologist(s) at the company put a mine into the ground?
- Are the cash costs and estimates reasonable?
- Is the company honest with its true netbacks?
- Is the exploration budget/thesis reasonable?
- Does the company spend an appropriate amount on administration & overhead expenses?
- The company does not have big blocks of shares, options, or warrants coming free for trading soon?
- Is the company located in a mining-friendly jurisdiction?
- Does the company have a reasonable exploration budget for the next 12 months?
- Can management answer questions relating to metallurgical results, exploration, and testing?
- Are there catalysts that will propel the share price?

FINAL SCORE

(Add the checkmarks up to 22)

Above 15

Company is worth performing detailed due diligence on

7 to 15

Murky, keep on your radar and watch list

Under 7

Use the company brochure for your next campfire

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