Alien Metals: in search of deep value stocks

Good morning investors of FTSEAIM.CO.UK and welcome to your stock of the week! Today, I'm going to cast a critical eye on retail favourite Alien Metals (AIM: UFO), a company like so many in this sector which seems perennially on the verge of delivering tomorrow's jam today.

Before we get into the details, I do insist on the usual caveats. As your thousands of eyeballs start to collectively roll upwards, it's worth remembering that the basics — like investing from a position of financial resilience or diversifying your investments — which may be old hat to you, may be new news to a new investor attempting to navigate the junior resource sector for the first time.

Alien Metals shares have lost two-thirds of their value over the past year and have been falling from all-time highs for longer than that.

Of course, this kind of share price action is fantastic news if you happen to specialise in finding underloved shares with strong fundamentals and weak sentiment. Alien now sports a £13 million market capitalisation and a set of projects that could arguably be sold on the market, right now, for substantially more.

This is part one, covering the iron ore. Tune in within the next fortnight for part two.

Let's dive in.

Alien Metals: the flagship

The vast majority of FTSE AIM mining sector businesses pin their hopes on a single company-making asset, and Alien is not an exception to the rule.

Alien's flagship is the 90%-owned Hancock Iron Ore Project, and while there is some uncertainty surrounding the company, what is clear is that the iron at this asset will be mined, processed and sold at some point. It really is only a matter of time — which is perhaps little comfort to long-term holders but helps a lot if you're new to the stock.

Alien has conducted significant exploration across the asset:

- Maiden drilling consisting of 3,350m over 53 RC holes targeting the Sirius Extension, Kalgan and Western Ridges targets
- Phase II drilling in June 2021, covering 2,175m over 40 RC holes
- Phase III drilling in November 2021, 1,146m over 46 holes, both infill and extension targets
- Phase IV drilling, 2,237m of RC holes, facilitating maiden ore reserve
- Phase V drilling, 13 diamond core holes over 1,049m adding to the 2082m already drilled at the Sirius Extension.

There is a JORC Resource on the asset for **8.4Mt @ 60.20% Fe (including an upgraded indicated resource of 4.5Mt @ 60.2% Fe), and a mining inventory of 3.9Mt @ 58.5% Fe** — with ore reserves of 1.9Mt @ 60.2% Fe. That's a very high grade of iron, and a perfectly reasonable resource size.

To understand why an indicated resource matters, click here.

Alien subsidiary, Iron Ore Company of Australia (IOCA) boasts a strategic landholding covering 75km2 at Hancock and released a development study for the asset only in February. Key stats for the base case include:

- Mine rate of 1.25 million tonnes per annum (with only 20% of tenement explored)
- 8Mt mineable resource
- 6 year mine life
- 1:2.2 strip ratio on ridge orebodies, 1:0.8 on Sirius (incredibly low)
- Open pit operation
- Simple mining, mobile crushing, screening and processing
- AU$28 million capex requirement
- C1 operating costs of less than US$65/t FOB
- Opex all in US$85/t
- Pre-tax net present value of AU$146 million (10% discount rate)
- Pre-tax IRR of 133%

The key positive to understand is that building this mine is (and for the love of God, please don't come back to bite me) going to be quick, cheap and relatively easy.

This is a direct shipping ore project, which in technical terms means that all the bits of a mine that require that dreaded word, 'optimisation' simply aren't going to be at site. Alien is literally going to blow up the rock with explosives, crush it down to manageable size, screen out some of the waste, and send the resulting rock out of the gate.

Somebody else with deeper pockets can do all the fiddly bits.

And for context, 62% iron ore is currently trading for an elevated US$120/tonne (Hancock will produce 60% grade so this will be slightly lower) but regardless the profit margins are fantastic. $120 is only a little above the long-term five year average for iron ore.

If you assume the high case over the base case, you have a 10Mt mining inventory with additional tonnage and extended mine life both possible — and the pre-tax IRR could jump from 133% to some 228%.

It's probably important to note that other than continued exploration of current targets, Alien also has the Mallina target (Hancock West) to the west of the Hancock Mining lease application — the company describes it as a 'classic host for further iron ore deposits to be located,' with similar geology and iron ore formation to the Sirius deposit.

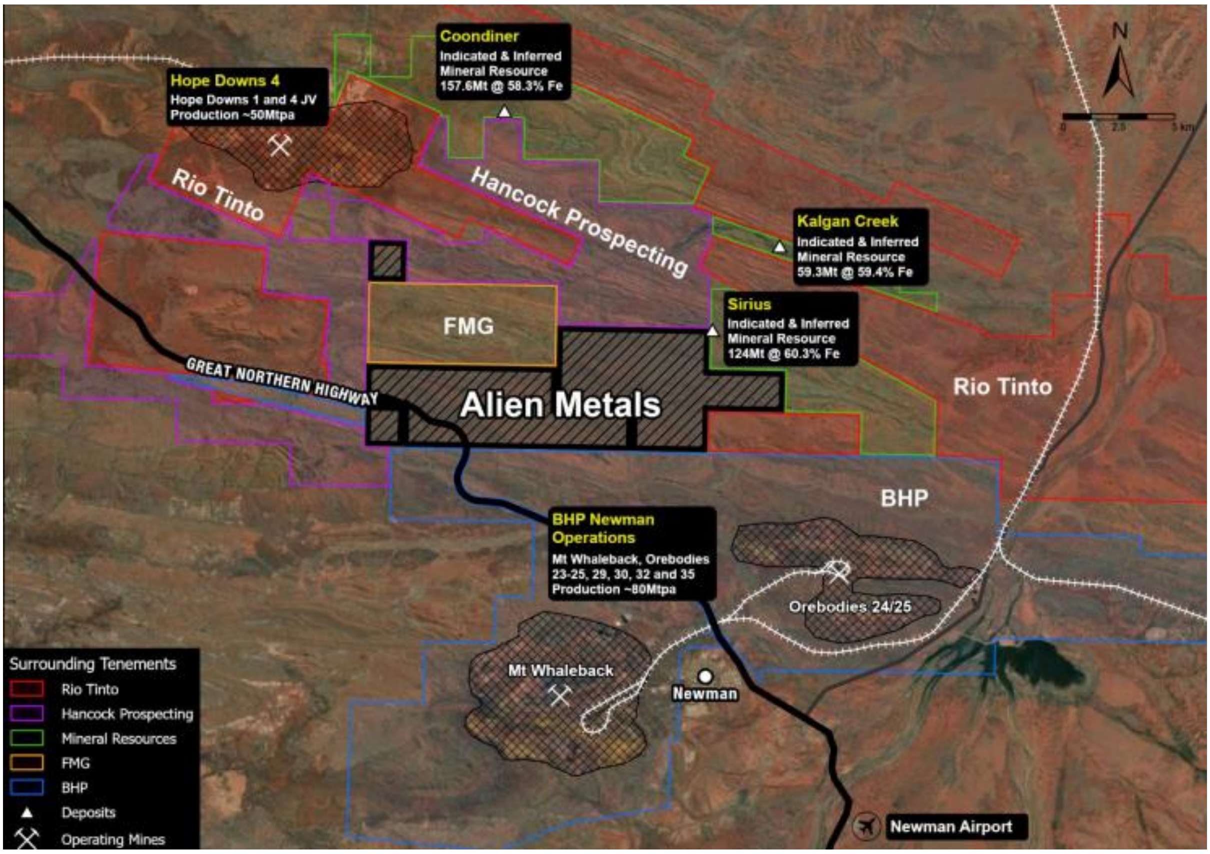
Independent experts consider a large tonnage exploration target may be present, and exploration should start up at some point in Q4 2024.

But for perspective, the base case has a 5.2x NPV/capex multiple, which rises to 12.3x under the high case (though of course the reality is probably somewhere in the middle).

But the best news is that the payback period is less than 12 months under all scenarios. This is understandably very compelling.

At this juncture, it's also worth noting Hancock's neighbours — just look at that map. If you were going to pick a spot on a map to have an iron ore deposit, it would be hard to find anything better.

Rio Tinto, Fortescue, Hancock Prospecting (Gina), BHP, Rio again — the titans with their world class deposits are clustered around Alien and it would not be hard to see a buyout once operations get underway. Indeed, Rio and BHP both explored Alien's tenure at one point.



A project mining agreement has been executed with the traditional owners, and a miscellaneous licence has been granted through the Mallina tenement, conceding access to the Great Northern Highway, enabling site infrastructure access for imminent construction. The mining lease has also been granted, leaving the way clear for the mining proposal and heritage clearances — with construction and operations contractors already hand-picked....

And now all that is left is for negotiations with offtake and finance partners to conclude, I'm assuming in the near term — with ongoing discussions for export capacity through UTAH point (that includes an MoU with E25) which is the last component needed in the transport plan.

For context, the asset is just 17km from BHP/Rio mining hub Newman, and 412km from Port Hedland (where you send iron ore to go to China). Opex costs could even be reduced further by utilising ultra quad trucks, a plan currently under negotiation — with conditional approval already granted for an intersection construction. Another option is third party rail, which is only 100km away.

Understanding technical detail

Okay, so let's break down what this all means. Mallina hugely adds to the resource potential of Hancock. The company has also secured a bunker at Utah Point in Port Headland — allowing for the stockpiling of iron ore — and has signed an MoU to secure a berth at the port, an impressive move given that space is fiercely contested.

Contractor REGROUP has been selected as the preferred primary contractor, responsible for construction, mine operations and haulage, while RCSC is the preferred crushing and screening operator. These are two extremely well known contractors in the space.

The heritage agreements have been signed with Karlka Nyiyaparli Aboriginal Corporation and cover the entirety of IOCA's Hancock tenements.

Let's also consider the minimalism of the project properly, because it needs to be highlighted. This is a direct shipping ore (DSO) operation. The ore is dug up/blasted out of the ground, crushed, and then shipped to the customer via road or rail. That's it. There are no tailings to worry about. No upgrading. Virtually no technical risk.

The ore is simply hauled to a ROM pad and blended to get the necessary grade and impurity combination. Processing is just a mobile dry crushing and screening plant. Then the product is loaded onto quad trailer road trains and taken to the bunker at the port — and then dunked on a ship bound to customers.

At present, the idea is for a single shift to process 1.25Mt of iron ore but moving this to a continuous operation could increase production to 3Mt per annum — which would be economic if the exploration at Mallina produces the goods.

A competent 10-year-old child could put this Lego set together, and the contractors have done this 1000 times before.

The AU$28 million capex costs is broken down into AU$18 million on roads and site access, AU$2.5 million establishing the site, and AU$6.5 million for owners' cost, contingency and working capital. It's important to note this is exceptionally low capex compared to most operations, including those with lower grades that are in operation nearby.

But you could be looking at US$25 million in free cash flow per year. Alien's market capitalisation is a paltry £13 million.

Next steps & comparators

I don't like to put price targets on companies at FTSEAIM.CO.UK, but what I can do is look at what other companies in the area are up to, amid a potential value disconnect.

To start with, the company's corporate presentation implies that Hancock is planned to be funded during Q3 — or within the next four months at most.

Of course, there's tons of exploration to be getting on with at the asset — including at Mallina — which has an informal exploration target of between 20Mt and 40Mt. Add that to the current NPV of Hancock and the value disconnect fast becomes apparent.

Arguably, CSA Global considers that the Alien has only really scratched the surface of what's at Hancock, noting:

- Tenement E47/3954 — significant exploration potential identified, in addition to the 8.4Mt Mineral Resource outside of the known Mineral Resource area.
- Tenement E47/3954 — walk up drill targets, with a potential to increase the existing Mineral Resource

- Hancock Project Tenements E47/3954 and E47/5001 — significant strike lengths of Weeli Wolli Formation BIF and Boolgeeda Iron Formations identified and yet to be adequately explored.

Alien has also indepdently completed an additional internal review of Project Tenement E47/5001, identifying 'significant underlying geological lithologies that are suitable hosts for iron ore mineralisation and exploration potential.'

It's worth noting that in April, the Western Australian Department of Mines granted the mining lease (M47/1633) for the project, giving security of tenure for a 21 year term through to 17 April 2045, and allowing for site development to commence in 2024.

The company has also made no secret of the fact that it would prefer to be a non-operator, with a JV partner coming in to manage the site, leaving Alien highly capitalised and with no management risk.

Let's say the company gets financing on favourable terms via a term sheet within the next few weeks. They could get an operation up and running in less than 12 months, and perhaps as few as six. Arguably, this time next year, Alien Metals will be producing iron ore — generating millions in free cash flow.

Or they just sell it for many multiples of the current market cap.

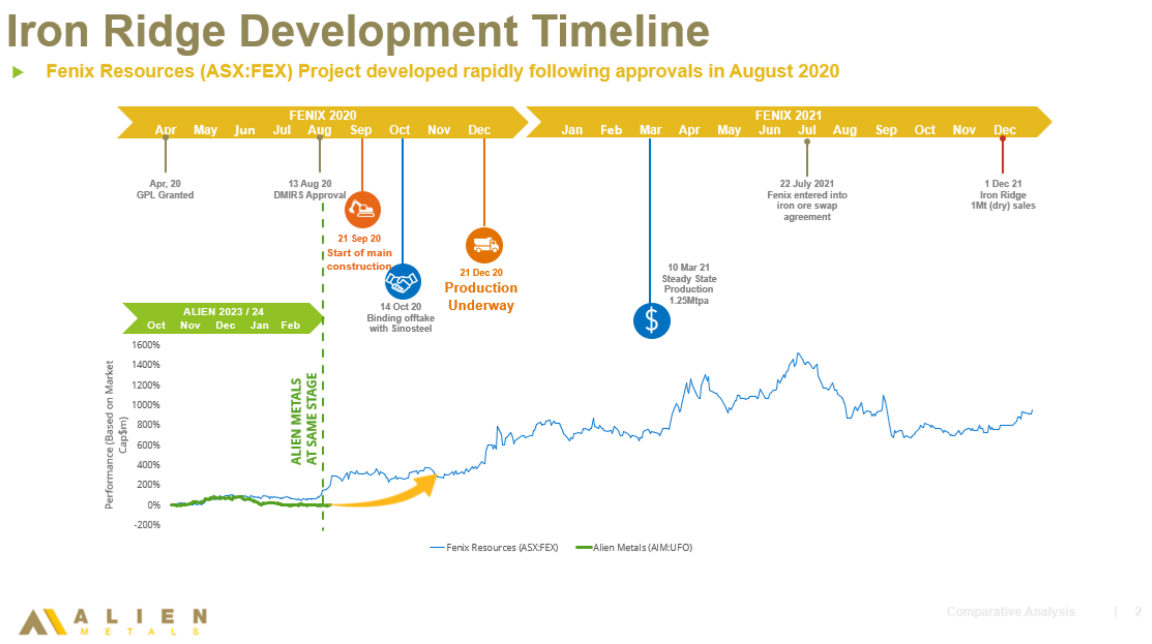
In terms of comparators, there are several companies that are worth mentioning. I'd advise potential investors to look these up in depth.

1. Fenix Resources (ASX: FEX)

Let's consider, briefly, the Iron Ridge development timeline. Another Western Australia DSO project, with similar grades and tonnage (9.8 Mt @ 64.4% Fe) — main construction started in September 2020, production started in December 2020 and first sales occurred in February 2021. This means that on a comparable timescale, Alien could be circa nine months from profitability.

It's notable that Alien has appointed CSA Global to consult on Hancock, as this firm was integral to Fenix's success and rise to AU$250 million.

The company even has a chart detailing the possible performance. Just look at that share price —



2. Macro Metals (ASX: M4M)

Macro sports an AU$113 million market capitalisation and has 10 projects, mostly in the iron ore space. But they're all exploratory and none are close to production.

5. Arrow Minerals (ASX: AMD)

Controls the Simandou North Iron Ore Project, with first assays coming back with a circa 60% grade in May 2024. Close to Rio Tinto's Simandou deposit. Five rigs turning, producing hundreds of samples. Market cap of AU$19 million, but only in the exploratory stage.

6. GWR Group (ASX: GWR)

Recently sold the remainder of Wiluna West, which held 130.3 million tonnes at an average iron grade of 60% Fe, including 69.2M tonnes of Probable Reserves at 60.3% Fe, to Gold Valley West for AU$30 million and a $2 dmt royalty.

Looking back

While I specialise in finding shares where sentiment is low and fundamentals are strong, it's worth considering the issues shareholders highlighted repeatedly to me:

Why is Alien now exploring for silver and PGMs rather than focusing solely on Hancock? Why is there still no CEO in place, and why did the previous CEO leave without warning? Are you planning on listing on the ASX anytime soon? Why has the deal for Hancock taken so long?

The general answer — and I would like to conduct a podcast to put these questions to management publicly — is (in my words) that while the silver and PGMs are the subject of the next article, a deal to get Hancock over the line is hopefully forthcoming within the next few weeks. This deal will involve the counter signatory being the operator of Hancock and therefore there will be little for Alien to do other than sit back and reap the profits.

It may simply be the case that the company is almost ready to focus its operational capacity at other projects.

There's no new CEO because the company is once burnt, twice shy. Filling the role with just a figurehead would be a mistake and they would rather operate without a CEO for now than fill the role for the sake of it. And not having one saves money. In terms of the previous CEO exiting, there isn't much any company could say other than that it was a disappointing outcome for all concerned.

Alien is actively considering an ASX listing, but getting Hancock over the line is currently taking up all available manpower and once a JV operator is signed on, then there will be time to consider this step. And as to how long the deal has taken — my view is that Alien was simply overly optimistic in how long due diligence and regulatory procedure takes.

Iron Ore pricing

This is basic stuff, but it's important to know what you're investing in.

Iron ore pricing is driven by global demand, in particular in China which is the world's largest consumer of the metal. Supply is dictated by production levels of major companies like Rio Tinto, Vale or BHP — alongside disruptions such as operational issues or geopolitical meltdowns.

Iron ore is strongly tied to the global economy; when all is going well, the metal tends to rise as steel demand remains high — and in particular, iron can increase when countries like China or India commit to mass infrastructure projects.

Tied into this is speculative trading on iron ore futures which can amplify volatility in the global market — and also move investor sentiment.

You also need to consider tariffs, taxes and regulations. In particular, Australia has implemented ever stricter ESG requirements on miners, though you could also argue the recently announced 'Future Made In Australia' policies could bring some benefits.

Iron ore is also priced in US dollars, Alien is presumably often working in Australian dollars, and AIM investor profits will be in sterling. This means that fluctuating exchange rates can have an effect on profitability.

Present factors you should be thinking about include:

- Chinese post-pandemic stimulus to boost construction, balanced by stricter environmental regulation
- Russia-Ukraine and the effect of sanctions on iron ore pricing
- The increasingly tense Sino-US political relationship
- Mining disruption in Brazil, a major supplier
- The positive impact on pricing due to the global focus on decarbonisation
- Green steel technology development, which uses less iron ore
- The effect of higher inflation and interest rates generally

But the absolute critical factor to understand is that iron ore pricing is effectively dictated by Chinese demand. There's good news on that front; the People's Bank of China has now removed the national minimum mortgage interest rate and lowered downpayment rates, while reports indicate the government is closer to enacting a program to acquire unsold property inventory at reasonable prices.

Add in the CNY 1 trillion in long-dated bonds about to be sold, and these measures together have significantly improved the outlook for distressed Chinese property developers, which are the major purchasers of ferrous metals in the communist country. Accordingly, recent data shows that Chinese steel export volumes surged by nearly 30% for the second month in a row in April.

On the other hand, Beijing is continuing to control crude steel output with ESG requirements, including a plan to reduce the carbon dioxide emissions of key industries by an amount equivalent to about 1% of the 2023 national total.

Finances, Management & Shareholders

Guy Robertson is the Chair — Guy has nearly 40 years of experience across the ASX, NZX and AIM markets. Guy holds board positions in Hastings Technology Metals, Artemis Resources and Metal Bank.

Alwyn Vorster is the Technical Advisor —he's held positions including Interim Chief Executive Officer of Hastings Technology Metals, Managing Director of BCI Minerals and Managing Director of Iron Ore Holdings, as well as senior roles with Aquila Resources and Rio Tinto Iron Ore. Under Vorster's tenure at Iron Ore Holdings, the company's market capitalisation increased multiple times, and he received the coveted Diggers and Dealers award in 2012 as 'Dealer of the Year' for completing multiple tenement and project transactions with large international companies resulting in more than US$500m cash and royalty value.

Elizabeth Henson is one of two non-executive directors — an experienced international lawyer, who is also on the board of Future Metals and Alba Mineral Resources. Always good to have one at hand.

Robert Mosig is the second — he was a founder and Managing Director of Helix Resources from 1986 to 2006 and then Managing Director of Platina Resources Limited from 2006 to 2018. The man was 'instrumental' in introducing Lonmin, a major platinum and palladium producer, as a joint venture partner in the Munni Munni project in the late 1990s.

This is a serious team. It's also worth mentioning Richard Shemesian, who through company Bennelong controls 7.24% of Alien's shares. Richard was the gent responsible for changing AIM's iron ore-based Aztec Resources minnow into a beast that sold for AU$300 million.

In terms of the financial position, we know that the company raised £2 million at 0.2p per share in August 2023 — and spent only $500,000 of July 2023's facility.

In mid-March, Alien entered into another short-term facility, with Bennelong, and while the details are freely available in the RNS, the bottom line is that this facility is needed to get the Hancock deal over the line.

In FY23 results the company lost $3,721,000, though this included a non-cash share based payment expense of $216,000, a write down of the carrying value of the Mexico exploration of $794,000, and the write down of other assets totaling $140,000. Excluding these one-off costs, you can calculate the annual loss at $2,571,000, leaving you with a cash burn of circa $200,000 a month. Perhaps a little less without a CEO.

We also know that there was $676,000 cash in the bank at the end of last year — so this would have lasted to about mid-March, hence when Shemesian injected the additional capital. The good news is that while he may end up with a hugely increased position for this cash, the TR1 holder has continuously been a supportive long-term investor.

However, the company chose to place shares at 0.135p yesterday to raise £630,000 before expenses, and it now looks like that facility will not be used. This was a hefty discount, but on other hand, it only represented 6.7% of the total issued share capital once enlarged by the placing — so any bounce should be fast, and

Of course, there is a fair question to be asked on why the company chose to raise at this time when the loan from Shemesian was on the table — and the company-making deal as little as a few weeks away — at which point they could have raised from a position of financial strength.

Regardless, for anyone considering an entry now, fundamentally the company has bought a few more months of cash runway. Therefore, it's a question of whether Alien can get the Hancock deal over the line in this time.

The bottom line

Three weeks ago, Alien announced it had appointed highly experienced mine operator Nathan Douglas as General Manager of Operations for Hancock. The man has over 25 years of experience, including as CEO of Leichardt Industrials Group, Operational Manager at BCI Minerals Limited (Iron Ore) and Dampier Salt Limited (Rio Tinto).

The company is assembling a team to get Hancock over the line — and while the delay has been long and the journey arduous, the finish line is now in sight.

The share price may re-rate accordingly.

Part II covering the exploratory portfolio will be out within the next couple of weeks.

Alwyn Vorster has stepped back from his director role but is still part of the Technical Advisory Board —he's held positions including Interim Chief Executive Officer of Hastings Technology Metals, Managing Director of BCI Minerals and Managing Director of Iron Ore Holdings, as well as senior roles with Aquila Resources and Rio Tinto Iron Ore.

Under Vorster's tenure at Iron Ore Holdings, the company's market capitalisation increased by multiples, and he received the coveted Diggers and Dealers award in 2012 as 'Dealer of the Year' for completing multiple tenement and project transactions with large international companies resulting in more than US$500m cash and royalty value.

For context, Vorster is the ex-MD of BCI iron ore which struck a deal with Australian iron ore major MinRes — involving the sale of BCI projects for an innovative production royalty, with an end result of more than $400m in cash profits to BCI over two to three years — and arguably, a similar strategic result could happen at Alien if all goes to plan.

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It's also worth mentioning Bennelong, which controls 7.24% of Alien's shares. The principals at the company were responsible for changing AIM's iron ore-based Aztec Resources minnow into a beast that sold for AU$300 million. The company was bought by Mt Gibson which is now producing 4mt of DSO iron ore in Western Australia.

The team at Alien have been involved in multiple iron ore companies from exploration to production – not many junior companies have such track records.