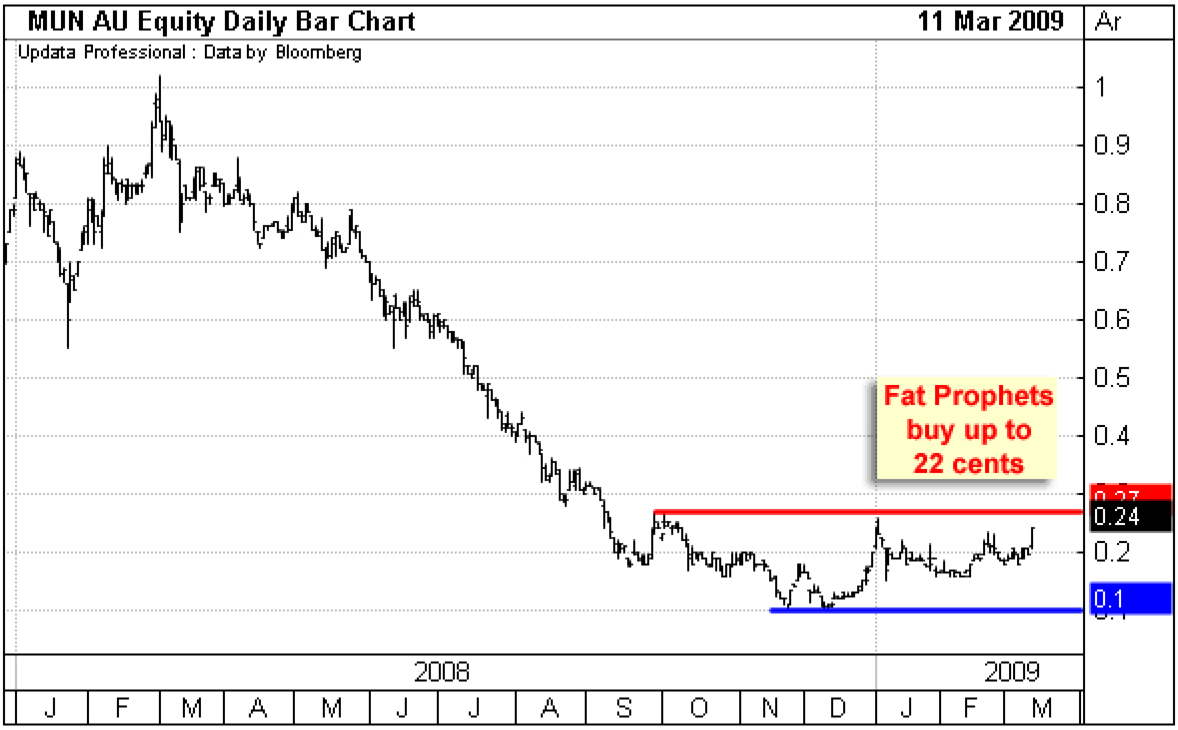
Mundo Minerals 11 Mar 09

MUN AUD $0.22

It's all about operational consistency

Being an emerging gold producer doesn't necessarily guarantee immediate sharemarket success, even in the midst of the current investor clamour for precious metals. Companies must first prove their production credentials to investors, especially given the poor track record of many junior gold companies in Australia over recent years. Mundo Minerals is no exception, as the company looks to establish consistent production from its new gold mine in Brazil.

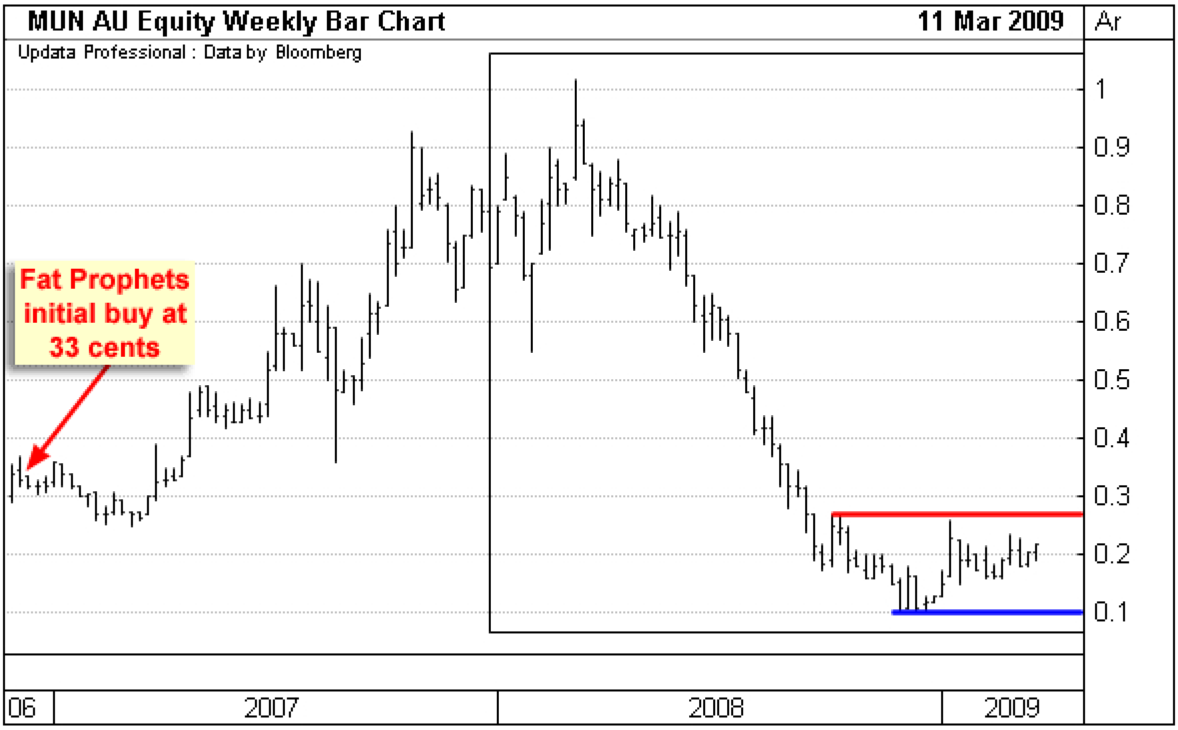
Fat Prophets initially recommended buying Mundo Minerals at 33 cents in November (Fat Mining 51). Our last review of the stock was during September (Fat Mining 142).



From a charting perspective, there has been an encouraging improvement in the outlook for Mundo Minerals over recent months. As evident on the daily chart, although prices declined to a low of 10 cents in November, downward momentum has since eased, giving way to a period of consolidation and base-building.

At the extremes, prices declined by over 90% during 2008, from a high of $1.02, to a low of 10 cents. Considering it will take some time for investor confidence to turnaround, several more months of consolidation and basebuilding are still likely.

Nevertheless, given the close proximity of support between 16 cents and 10 cents we believe downside risks from here are limited. A break above resistance at 27 cents would provide an initial boost to upward momentum.



Being an emerging gold producer doesn't necessarily guarantee immediate sharemarket success, even in the midst of the current investor clamour for precious metals. Investors are understandably gun-shy, given the dramatic fall-out in financial markets over recent times, so companies have to overcome inherent investor wariness before their story will receive proper market acknowledgement.

Companies must first demonstrate their production credentials and a consistent track record of production before a re-rating will eventuate. This is the case no matter how promising the story may be. Australian resource investors, particularly the gold bugs amongst us, have seen numerous instances over recent years of Australian-based gold companies failing to deliver on their production promises.

In fact, the smaller end of the Aussie gold sector has probably been one of the biggest value-destroyers for shareholders over recent times. So again it's understandable that investors are suitable wary of new players. This brings us to Mundo Minerals.

It's worth pointing out for the uninitiated that the value in emerging Brazilian gold player, Mundo Minerals, is not as a speculative resource play; rather as a long-term generator of wealth for shareholders. The company's ambition is to build a high-quality, mid-cap gold producer.

The company has been meticulous in its development, assembling what we consider to be one of the sector's best and highly-regarded boards and management teams. We can confidently predict that the rewards for shareholders will come in the form of capital growth and dividends, driven by long-term production and exploration success.

Having said that, the returns have not yet become apparent for shareholders. The market seems for now ambivalent to the Mundo story, most likely because of the commissioning problems the company encountered in delivering first gold production from its flagship mine, Engenho.

A number of issues have impacted projected production and just as importantly cash flows from the mine, leading the company to scale back its initial mine production estimates. The disrupted cash flow profile saw the company raise $4 million through a debenture issue from major shareholder Anglo Pacific last year, although comfortingly there has been no need for further capital raisings.

Given the company's relatively tight capital and cash position, investors can be forgiven to some extent for staying away. After all, there are many instances of resource companies running out of cash in the current environment. And in Mundo's case the cash position has been impacting shareholder sentiment.

Despite the company's December quarter cash flow statement that showed an operating cash outflow of $1.66 million and cash on hand of just $1.9 million, the company has maintained production with around $8.7 million worth of unsold gold on-site.

More importantly, from mid-December Mundo began to access the higher-grade Galeria ore body, meaning around 50% of production between January and June 2009 will come from this higher-grade orebody, instead of the lower-grade Bola ore body that was mined in the project's first few months of operations. From the middle of this year onwards, we anticipate that Galeria will account for the majority of the ore mined at Engenho.

So with consistent operational performance at Engenho over the next few months, any perceived financial risks should begin to recede. And along with a lower risk profile, investor confidence should well and truly return. Indeed, the company has provided a recent positive operational update and put forward a series of production scenarios that underline just how attractive the outlook is.

First of all the company achieved its key production parameters during January and February, with the Engenho mine's financial contribution exceeding expectations. Secondly, given that calendar 2009 will be the first 12-month period of full production, Mundo has released earnings guidance based on forecast 30,000 ounces of production from Engenho, with different gold price and currency assumptions.

In summary, based on these different assumptions Mundo expects to generate EBITDA (earnings before interest, tax, depreciation and amortisation) in the range of $12.58 to $18.5 million and net profit after tax of $6.9 to $12.9 million.

We expect currency movements between the Brazilian real and Australian dollar to be relatively benign, and even using the company's most pessimistic gold price scenario of US$840 at an exchange rate of US$0.70 (AUD$1200/oz), Mundo expects to generate net profit of $6.9 million.

At a current market capitalisation of around $35 million, such an outcome places Mundo on a price-earnings (PE) multiple of just 5 times. Utilising the more bullish forecast of A$1473/oz, net profit would come in at $12.9 million for a price-earnings multiple of 2.7 times. This is truly cheap, but reflects the risks in the eyes of some investors that the company may not achieve its production targets.

No resource company is without risk, particularly an emerging producer in the ramp-up stages. However, given the quality of the company's board and management team and their operational track record, we believe an attractive risk-reward opportunity has materialised. Engenho should generate a relatively low-risk, sustainable cash flow over an extended period and provide a strong base from which the company can develop its other assets.

Accordingly, Mundo Minerals will remain held within the Fat Prophets Mining & Resources Portfolio. For Members without current exposure we recommend the company as a Buy up to 22 cents. Members should remain patient and try and purchase stock as close as possible to this level.

Disclosure: Interests associated with Fat Prophets declare a holding in Mundo Minerals

Snapshot MUN

Mundo Minerals

Mundo was formed to acquire and develop gold assets in South America, with a particular focus on Brazil and Peru. The corporate strategy has a focus on medium to high-grade deposits that can be brought into production quickly and which also have the potential for reasonable mine life. The company recently poured its first gold at its 100%-owned Engenho gold project in Brazil and is aiming for budgeted production of 2,500 ounces per month during 2009, in turn generating full-year production of 30,000 ounces.

Market Capitalisation	**A$35m**