The Art of Betting on Maybe: Junior Miners as an Options Trade

written by Anthony Milewski | September 10, 2024

After nearly twenty years in the commodity sector, I still get a chuckle when I meet a fresh-faced hedge fund manager from New York or Connecticut claiming to be a “value investor” in the mining space. The reality? They’re likely about to get smoked.

You Don’t Own Mining Stocks—You Rent Them

Many investors on platforms like MINTWIT, CEO.CA, and Hotcopper.com.au don’t fully understand what they’re getting into. These forums are filled with stories of disappointment, often because investors misjudge the risks. As Warren Buffett famously said, “Risk comes from not knowing what you are doing.” Misunderstanding what you’re buying or using the wrong investment framework is a recipe for disaster.

In my early career as the head of origination for one of the largest mining funds, I reviewed countless mining projects. The number one factor for any project’s viability? Commodity prices. At certain prices, every project can be profitable; at others, none can. This is the core truth in mining.

So, How Can You Profit from This Knowledge?

Consider some of the sector’s most significant success stories, like Uramin. Investors acquired historic drilling data on an African uranium project, and 18 months later, the company sold for nearly USD$2.5 billion without drilling a hole. Or look at lithium—left for dead, and then almost overnight, billions in market cap were created. The same goes for uranium.

Timing Is Everything

Today's low-grade deposits could be tomorrow's high-grade. To make money trading junior miners, you need to understand what you're trading. Junior mining stocks aren't like NYSE or NASDAQ-listed companies. Think of them like options. Trading these companies is a game of timing, discipline, and a bit of nerve.

Junior Miners as Options

Junior mining stocks are essentially "call options" on large, out-of-the-money deposits. Like options, these stocks come with time decay—"theta." Hold on too long without a commodity price move, and you risk dilution. It's critical to manage your holding period wisely.

How This Applies to Junior Miners

Spoiler alert: about one in three thousand exploration projects ever becomes a mine. Your favorite junior mining CEO probably won't be building one, no matter how convincing his pitch is. His job is to sell a dream. Yours? Stay disciplined. See junior mining stocks for what they are—either heading toward zero or 20x returns, with little in between.

Buy the Dream, Stay for the Commodity Move, and Sell on Volume

Most junior miners don't generate cash flow, and only a few ever will. Remember the scene from *Silicon Valley*: "If you show revenue, people will ask, 'how much,' and it will never be enough. But if you have no revenue, you can say you are 'pre-revenue' and be a pure play." That's the essence of junior mining.

Without a commodity price increase, holding a junior miner guarantees massive dilution. However, if you time it right and the commodity price moves in your favor, the returns can be staggering.

Pricing the Options

When it comes to junior miners, pricing the “option” is all about timing the commodity cycle. Buy in too early, and you’ll be crushed by dilution. But if you nail the timing and the commodity moves, the stock price can skyrocket. Our team constantly evaluates these opportunities, focusing on commodities first and looking for companies with solid leverage to those commodities.

Stay tuned for more insights next month!