

Thursday, August 26, 2010



HALLGARTEN & COMPANY

Portfolio Strategy

Christopher Ecclestone
cecclestone@hallgartenco.com

Model Mining Portfolio: Performance Review - August 2010

Model Mining Portfolio

Minor Tweaking through the Dog days of August

- + Gold has bounced back above \$1,200 per oz.
- + Molycorp (MCP) has pulled out of its post-IPO swoon and is back above the issue price. Other REE names have perked up helped by MCP and by the soaring price of the metals since the Chinese clamped down on export quotas last month.
- + The Australian election results remain unclear but were seen as a repudiation of the Mining Profits Tax proposal and seem likely to doom it to oblivion or severe watering down
- + The Baltic Dry Index has gone soaring again. Either this is a reaction to being extremely oversold, another speculative pump & dump or a genuine revival in the bulk commodity trades. The strong base metals in July might imply it is the latter
- ✗ Base metals have started to go flaccid again after a strong run in July due to revived fears on the durability of the economic recovery
- ✗ Financing is very tough for juniors with many having to yield up a pound of flesh to get any new money in the door. This may signal that drilling efforts need to be cut back to match the (un)willingness of investors to throw money into bottomless pits
- ✗ Talk of a double dip recession could be a real downer for base metals and for precious metals (on deflation talk). Gold has not registered this reality yet

The Month That Was – tracking upwards again

The portfolio had a satisfactory month as some special situations combined with a firmer gold price to give the model portfolio a lift.

The notable features were:

- The BHP bid for Potashcorp electrified the price of our relatively recent addition Amazon Mining, which has a very accessible (near-surface) and low cost potash deposit in Brazil. The move caused the stock to rise to a 100% gain over our entry point though it has eased back and is up around 70% now.
- Another recent addition, Yukon Nevada Gold went crazy as it finally started to sink in with institutional investors that this was a new gold major that had been hiding its light under a bushel. The company hit 65 cts and was up 146% in a little over a month and still has rocket fuel

left. It pulled back to the mid-50cts mark and we dove in for another 100,000 shares. Our 12-month target is what we believe to be a conservative \$1.50.

- Pelangio, the down in the dumps Ghanaian gold explorer that border the signature mine in the Ashanti gold belt awoke from its lassitude and is also up 100% from where we entered a couple of months back. This company is still at half the level
- The Zinc ETF is up 8.2% from our entry point but was higher during the month as zinc once again headed towards the dollar per lb mark that we predicted in our June zinc/lead review. It will rise again.
- Callinan Mines (up nearly 80%) is pushing towards new territory as well while investors await some sort of evolution of the HudBay situation
- The specialty metals stocks continue to languish. The Molycorp IPO has now firmed up demand in the REE sector which helped move the hapless Great Western up a tad and then we threw it overboard.

We have the feeling that being positioned in base metals is the next attractive space to pursue. Nickel in particular would appear to be prospective for a move. Likewise Moly sector interest has been mooted and deserves more attention from those who sustain bullish sentiment towards steel.

The Model Mining Portfolio had a valuation of \$4.313mn on the 22nd of July 2010 and now stands at \$4.512 mn with \$2.6 mn of net cash.

Portfolio Changes

There were no additions or subtractions from the portfolio until recent days when we bit the bullet on some changes we had long been contemplating.

- Closing our Long position in Century Mining. Sold 300,000 shares in CMM.v at CAD 39cts at 8:14 AM on August 20th
- Adding a Long Position in UCore Rare Metals. Purchased 200,000 shares in UCU.v at CAD 40 cts at 8:11 AM on August 20th
- Adding a Long position in Labrador Iron Mines. Purchased 25,000 shares in LIM.to at CAD \$4.61 at 8:08 AM on August 20th
- Closing our Long position in Great Western Minerals. Sold 400,000 shares in GWG.v at CAD 25 cts at 8:05 AM on August 20th
- Added to our Long position in Yukon Nevada Gold. Purchased 100,000 shares in YNG.to at CAD 54 cts at 3.18 PM on August 25th

We have been talking for some time of ditching the Century Mining position. It had shot past our target price when we weren't looking and then by the time we noticed it had shot itself in the foot by missing a reporting deadline and being suspended by the TSX. That made up our mind to exit. We waited for it to retest highs and it didn't. Recently it started to fade. In light of the sterling run at Yukon Nevada we thought we could afford to take a smaller gain on Century and exit stage left.

Great Western has finally been ejected because we felt its presence was a conflict of interest with other things happening in the Rare Earth space. We don't get the feeling it will be taken over as fast as some of the other players in the sub-category. The stock has struggled off its bottom despite not having deployed the funds from its last financing to the purposes it had signaled. It also managed to lose Toyota as a JV partner that was a major misstep. It has up-ticked in recent weeks by trotting out the same press releases from last year relating to the Steenkampskraal off take agreement, which seems more theoretical than practical.

To replace GWG and keep a foothold in Rare Earths we added **UCore Rare Metals**, a company that owns the Bokan Mountain deposit situated at the southern most part of the Alaskan panhandle, on the southern end of Prince of Wales Island. It is approximately 60 km southwest of Ketchikan and 130 km northwest of Prince Rupert. The Bokan Mountain project covers 30 sq. km (19 sq. miles) and includes the former high-grade Ross Adams uranium mine, which is Alaska's only prior producing uranium mine.

UCore was originally a uranium story until the REE wave came in. The USGS has estimated that there is in excess of 11 million pounds of U3O8 remaining in situ. UCore may the focus switch to REE in early 2010, after the first wave of the REE furor and claims to have one of the largest combined heavy & light rare earth deposits in North America with secure mineral title and no land claim issues. A number of our cornies in the REE space have visited the site of late and can attest that the entire old mine workings and the road network remain intact. Compared to some of the more "advanced" Canadian REE properties which are quite literally in the middle of nowhere this site has access to deep water shipping and rail facilities across the channel in British Columbia.



The company feels that the deposit has near term production potential and we would tend to agree in light of its favorable logistics and near surface nature. Reputedly five Cas have been signed with interested predators. The company has at hand an extensive historical database containing previous exploration and mining data. It also has initial drill assays from a 2007 campaign that include 3.9 meters grading 2.43% and 50.24 meters grading 0.47%. The former is interesting while the latter is not.

So this is uranium rich, but reportedly not in the Rare Earth portion of the deposit which makes for much easier development. This company is ripe for taking over, with Molycorp and Rare Earth Elements being the most likely predators in our minds. Indeed we even thought REE might take UCU over and then both are swallowed by Molycorp.

Labrador Iron Mines is a stock we met at a conference earlier this year and watched as its mine advanced towards production and its stock price slid on “problems” with the First Nations in the area. Sounds rather like a tussle over jobs being allocated to the local population, which is only to be expected.

The company’s main project is in western Labrador and north eastern Quebec and is comprised of twenty direct shipping (DSO) iron ore deposits forming part of the historic Schefferville area iron ore district where mining of adjacent deposits was previously carried out by the Iron Ore Company of Canada from 1954 to 1982.

LIM plans mining in varying stages, the first of which comprises the James and Redmond deposits located in close proximity to existing infrastructure. Phase 1 properties have an estimated 18mt tonnes of contained iron-ore and should be exploitable over six years while the Phase 2 & 3 properties have an estimated 72 mn tonnes to be exploited over an 18 year LOM.

Mining operations will be by conventional open pit mining methods. The ore excavated is estimated to contain around 56% to 58% iron and it is expected that the beneficiation process will enhance the product grade to around 65% iron and remove unwanted material. Thus far building of the 4.5km rail spur line from the Sept-Iles/Schefferville main line to LIM's processing site at Silver Yards has been completed.

Construction is currently underway and LIM hopes to achieve plant start-up before the seasonal shut down of operations at the end of November 2010. It is targeting achieving full-scale commercial production in April 2011 and plans production of two million tonnes of iron ore during that calendar year (the company has a June FY). At the end of the June quarter 2010, the company had \$41 million in cash and cash equivalents with no debt.

We have not had iron ore exposure in the latest iteration of the portfolio and most of the Australian names seem more fully priced than the little understood Canadian names. LIM is also a past-producing area so largely a known quantity. Its discount to other better known companies on the other side of the world would seem to be a product of the Canadian capital markets not being iron-ore savvy and the lingering shadow of the First Nations’ disruption. Our twelve-month target price is \$7.50.

Conclusion

The dichotomy between juniors and majors could not be better illustrated than in the recent M&A “outburst” in the mining space. Small miners are merging because there is not enough money to finance them. This is a winding back of the clock to early 2009. Meanwhile, big miners (notably BHP-Billiton) are having such wads of cash thrown at them that they can sally forth and attack some large targets as PotashCorp. To effect this the company rustled up a \$45bn credit line on the quiet and in super-fast time.

The parallel to this is in the precious metals space where we have recently highlighted the two-speed nature of the gold space with majors being consecrated by their inclusion in the GDX and a mix of majors and minors being favoured by the GDXJ while everyone else in the sector is left outside to rattle their begging bowls at investors passing by in the vain hunt for attention and/or funds.

This is the dominant dynamic at the moment. The price of gold and base metals almost do not matter. It is whether a company and its project(s) are financeable. This produces cognitive dissonance for investors (and analysts) who don't get it why perfectly worthy companies are sinking and almost untouchable despite being in production or having millions of ounces of gold in reserves. This conundrum is not about to be solved. One almost suspects that a massive inflow of extra money into the mining space would only go towards puffing up the chosen few rather than being a tide that lifts all boats as the mining market was pre-2008.

Mining Model Portfolio as at: 25-Aug-2010

Security	Date of original rec.	Currency	Price		Portfolio Weighting	Increase in Value	Target Price	
			Avg.	Current				
Long Equities								
Large Caps	Nyrstar (NYS:BT)	09/28/09	Euros	8.17	8.29	4.9%	1.5%	\$11.30
	Thompson Creek Metals (TC)	01/15/10	USD	15.20	8.42	4.3%	-44.6%	\$20.00
Corporate Actions	Platinum Group Metals (PLG)	02/11/10	USD	2.02	1.71	5.8%	-15.3%	\$3.80
Mid-caps	Troy Resources (TRY.ax)	05/29/09	AUD	1.58	2.57	6.1%	62.7%	\$3.00
	Capstone Mining (CS.to)	05/29/09	CAD	2.32	2.46	3.7%	6.0%	\$5.00
	Labrador Iron Mines (LIM.to)	08/20/10	CAD	4.61	4.30	3.4%	-6.7%	\$7.50
	Yukon Nevada Gold (YNG.to)	07/20/10	CAD	0.26	0.34	3.2%	29.5%	\$1.50
	Zinc ETF (Zinc.L)	01/15/10	USD	7.04	7.62	2.6%	8.2%	\$11.00
	Dynasty Metals (DMM.to)	05/29/09	CAD	3.89	3.85	9.5%	-0.9%	\$5.50
Gold Juniors	San Anton Minerals (SNN.to)	05/01/09	CAD	0.25	0.20	3.0%	-20.0%	\$0.60
	Pelangio Exploration (PX.v)	05/12/10	CAD	0.21	0.42	6.7%	100.0%	\$1.20
	Goldgroup (GGA.to)	06/02/10	CAD	0.68	0.75	3.6%	10.3%	\$1.35
	Adamus Resources (ADU.ax)	10/22/09	AUD	0.44	0.56	4.2%	27.3%	\$1.20
	Golden Band Resources (GBN.v)	04/13/10	CAD	0.28	0.31	1.0%	10.7%	\$0.65
	Oromin (OLE.to)	05/29/09	CAD	0.74	0.90	1.6%	21.6%	\$1.25
	Patagonia Gold (PGD.L)	05/29/09	GBP	12.00	15.64	4.2%	30.3%	£18.00
	Alexis Minerals (AMC.to)	04/13/10	CAD	0.35	0.15	1.4%	-57.1%	\$1.10
Other Juniors	Commerce Resources (CCE.v)	12/15/09	CAD	0.48	0.34	2.2%	-29.2%	\$0.90
	Malaga (MLM.to)	12/15/09	CAD	0.14	0.10	0.6%	-28.6%	\$0.60
	Callinan Mines (CAA.v)	10/22/09	CAD	0.90	1.60	5.2%	77.8%	\$3.00
	UCore Rare Metals (UCU.v)	08/20/10	CAD	0.40	0.41	2.6%	2.5%	\$0.70
	Aurora Minerals (ARM.ax)	12/15/09	AUD	0.75	0.32	1.2%	-57.3%	\$1.20
	Geovic (GMC.to)	11/23/09	CAD	0.61	0.61	3.9%	0.0%	\$1.50
	Amazon Mining (AMZ.v)	05/12/10	CAD	1.41	2.38	6.8%	68.8%	\$4.00
	Reed Resources (RDR.ax)	12/15/09	AUD	0.59	0.45	2.9%	-23.1%	\$1.80
	Philippine Metals (PHI.v)	05/12/10	CAD	0.37	0.34	2.2%	-8.1%	\$1.50
	Geologix (GIX.to)	06/02/10	CAD	0.19	0.24	3.1%	26.3%	\$0.65
NET CASH					2,602,787			
Short Equities								
Shorts	US Gold (UXG)	05/01/09	USD	2.34	4.82	18.7%	-106.0%	\$1.70
	International Minerals (IMZ.to)	09/10/09	CAD	4.44	4.35	6.9%	2.0%	\$3.30
	Capital Gold (CGC.to)	02/12/10	CAD	3.65	3.49	6.7%	4.4%	\$3.30
	ECU Silver (ECU.to)	09/10/09	CAD	0.60	0.61	3.9%	-1.7%	\$0.45
	Eldorado Gold (EGO)	05/12/10	USD	18.06	18.95	34.4%	-4.9%	\$13.00

Current Cash Position	2,602,787
Current Liability on Shorts Not Covered	(1,102,813)
Net Cash	1,499,974
Current Value of Bonds	0
Current Value of Long Equities	2,959,115
TOTAL VALUE OF PORTFOLIO	4,459,088

Important disclosures

I, Christopher Ecclestone, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

Hallgarten's Equity Research rating system consists of LONG, SHORT and NEUTRAL recommendations. LONG suggests capital appreciation to our target price during the next twelve months, while SHORT suggests capital depreciation to our target price during the next twelve months. NEUTRAL denotes a stock that is not likely to provide outstanding performance in either direction during the next twelve months, or it is a stock that we do not wish to place a rating on at the present time. Information contained herein is based on sources that we believe to be reliable, but we do not guarantee their accuracy. Prices and opinions concerning the composition of market sectors included in this report reflect the judgments of this date and are subject to change without notice. This report is for information purposes only and is not intended as an offer to sell or as a solicitation to buy securities.

Hallgarten & Company or persons associated do not own securities of the securities described herein and may not make purchases or sales within one month, before or after, the publication of this report. Hallgarten policy does not permit any analyst to own shares in any company that he/she covers. Additional information is available upon request.

© 2010 Hallgarten & Company, LLC. All rights reserved.

Reprints of Hallgarten reports are prohibited without permission.

Web access at:

Research: www.hallgartenco.com

444 Madison Ave, 40th Floor, New York, NY, 10010