



HALLGARTEN & COMPANY

Portfolio Strategy

Christopher Ecclestone
cecclestone@hallgartenco.com

Model Mining Portfolio: Where is the Love?

Performance Review - June 2011

Model Mining Portfolio

Where is the Love?

- + The base metals prices (Zinc in particular) are holding up well considering the gloom and doom talk on the Western economies and Chinese slowdown
- + Gold has held up well with the Greek crisis giving sustaining support
- + Rare Earths were subject to another *frisson* when China further tightened the supply spigot and seemed to prioritise stockpiling
- ✗ Peru was added to the list of dubious nations in which to do business in the wake of the Humalla Presidential win. This may yet prove to be a false alarm
- ✗ Financing has well-nigh shut down in the mining space at anything above the merely token
- ✗ Across the board mining stocks have lost ground as liquidity tightens
- ✗ The day grows nearer in which some of the hedge fund world's 800lb gorillas tire of gold's lethargy

The Month That Was – Fear and Loathing in Financing

The price of metals may not have retreated much but the prices of equities in the mining space have been brutalised over the last six weeks. It is clear to us from this that what we have long suspected has taken place. We sustain that there was never all that much new long term interest in mining equities (particularly precious metals) and that most of the momentum was coming from the rising liquidity tide engendered by QE2. The real long-term money was bedding down in physical gold (and the ETFs thereof) or in industrial metals. The financing surge in the last six months drained the blood from the equities market as many companies that did not need money grasped at overlarge offerings from their friendly local investment banker and stuffed their treasuries. This exercise only served to kill the goose that laid the Golden Egg.

Now the vast bulk of companies we meet seem to have decent cash balances (some indeed indecently large) and yet there is a feeling of poverty in the air. The suspicion that the financing drought might drag on for the rest of the year has many battening down the hatches with even IR firms reporting to us that companies are cutting back. Well they might as the indigestion from the recent could be longer lasting than even the most pessimistic miners might imagine. It's not just that there is no new interest (i.e. more money) in the mining space it's that there is the potential for some of the cash to be removed from the table and not necessarily willingly. Gold miners in particular can thank their lucky stars that the Greek crisis drags on for without it we suspect that gold would be closer to \$1350 than \$1500 at the moment. As Bernanke tells the dollars to "return to papa" some of the bigger hedge funds that have dabbled in gold (with headline effect) will be obliged to ditch positions. No one has yet to explain to us how a flat gold price gels with the need of funds like Paulson's to constantly produce performance for its investors. In light of some of the other extraordinary losses that big hedge funds are being hit with, the logic of them burying gold in the back garden like your average gold bug would counsel, is not going to hold much water.

Thus there is a long haul across the desert in front of the mining community.. like the camel one has to

drink up while one can and not expend too much energy doing anything until the next oasis is in sight.. Beware mirages though..

To QP or not to QP.. that is the Question?

As everyone knows (or thinks they know) the TSX had a massive housecleaning post-Bre-X in the late 1990s and overhauled its reporting for mining companies so this would “never happen again”. The fact that mining scams continue apace seems to have escaped them. The post Bre-X “clean-up” was based on the premise that “evil financial guys” had caused the scandal and that “virtuous” professionals are the solution. So the Exchange and regulators introduced the NI 43-101 concept for Technical Reporting and introduced the concept of the QP (Qualified Person) as the figleaf to cover its vulnerable parts from accusations that “evil” financial types might be feeding the market wrong technical information.

In recent weeks we have engaged in a rather one-sided debate with the TSX. Out of this has appeared a realisation that the TSX does not particularly care who a QP is or what he knows but rather that he can be claimed to be a QP. This claim does not accrue though from any checking the TSX may have done of his geological *bona fides* but rather from the fact that he can claim a certain level of membership in a professional association. Interestingly the TSX does not seem to verify the relevance of the previous criteria for said QP having been admitted to the association that lends him its glory. This came to our notice when we wondered how a certain person who had been a serial disaster at four mining companies can have been so geologically incompetent and moreover how the TSX can have regarded him a QP. All was revealed (or rather not revealed) when we came upon a copy of his CV. Knock us down with a feather but didn't it look to these untrained eyes like said QP was a Mechanical Engineer. But hadn't everyone told us he was a Mining Engineer? Ah, but he belongs as a Fellow to two associations which makes him a QP. But who says that Mechanical Engineers spend as much as one minute in the course of all the years of their studies learning up on matters geological? After all what does an individual who designs elevator systems or hydroelectric turbine houses or petrochemical plants need to know about gold vein structures? Seemingly nothing in the mind of the TSX. Then how can one be a QP on matters geological without having studied on the subject? Maybe by joining as a Fellow a recognised association in a country that one has worked in (as a mechanical engineer mind you... not as a mining engineer) for less than one year in a forty-year career. And moreover an association not in the two countries from which one's professional qualifications were earned. We had our “lightbulb” moment from divining how a CV had been correctly massaged to show how a geological incompetent could wash and repeat so many times by gaming the QP system whereby the TSX outsources the filtering of technical “competence” to associations that do not necessarily have the same interests as the TSX, let alone the investors who are relying upon the QP's “qualified expertise”.

Over and above the issue of whether a QP has studied geology in their distant past, well may we ask why the concept for “horses for courses” does not apply. No brain surgeon would glean credibility for an academic paper on kidney disease so why is the TSX so unsophisticated as to think that that all QPs are born alike. If the system was working correctly only metallurgist QPs would be allowed to comment on metallurgy, geologist QPs on geology and mining engineer QPs on mine design. Even within the geologist space many geologists can't tell Rare Earths from a bar of soap. We noted with bemusement a NI 43-101 from one of the most respected Canadian consultancy firms where Thorium was counted into the TREO percentage. Seemingly this analyst was the first one to spot it. But what we would know, as we don't even faintly qualify as a QP? Indeed we are one of those “evil” financial types they warn you

about.

The irony of all this though is that the Bre-X scandal is remembered in popular memory for its most colourful event, namely the swan dive that a geologist took from a helicopter into the Indonesian jungle never to be seen again. Ironically if said geologist was still with us today he would be signing off on some mining company's releases as a QP. Feel safer?!

News on the Model Portfolio

The portfolio continued a downtrend as the negative sentiment weighed on the mining space. The notable features were:

- Yukon Nevada replaced its COO which was a most welcome measure in our estimation
- Capstone Mining closed its acquisition of Far West Mining
- ECU Silver announced a reverse takeover deal whereby Golden Minerals will takeover ECU.
- US Gold announced a merger with Minera Andes, another McEwen group company

The Model Mining Portfolio had a valuation of \$6.259mn on the 27th of May 2011 and now stands at USD\$5.849mn of which some USD\$3.538 mn is the net cash position.

Portfolio Changes

Our transactions this month picked up the pace as we purged some lagging names (and one undersized position) and added three new names we had met in recent weeks:

- Added a Short position in Golden Minerals . Shorted 5,000 shares of AUMN at US\$19.42 on the 27th of June
- Added a Long Position in Northern Minerals. Purchased 150,000 shares in NTU.ax at AUD\$0.73 on the 9th of June.
- Adding a Short Position in St Elias Mines to the Model Mining Portfolio. Sold 60,000 shares in SLI.v at CAD\$1.79 on the 9th of June

Our additions:

Golden Minerals is farther on in this note but St Elias Mines is a story we have been itching to short since we first met them. To put it most politely the company has a very large market capitalisation and virtually no resource. This stock gives us the feeling that a nasty surprise could send it to being virtually worthless.

Northern Minerals is the Australian Xenotime play in the Rare Earth space. We met with them recently and in line with our view of the potential of Yttrium Phosphate (Xenotime) as the up and coming REE mineral to pursue, we added them to the portfolio.

ZincOx (LON:ZOX) – Dust to Dust

This stock was added some months back to the Model Mining Portfolio due to our desire to increase exposure to Zinc stories. Our motivation was to add to the mining exposure but collaterally ZincOx also gave us access to an interesting subspace of the Zinc world which is the recovery of the metal from furnace slag in the steel industry. There are three players in this area that we know of, Horsehead (NASDAQ:ZINC), Silvermet (SYI.v) and ZincOx. There are bigger participants but they are not such unique exposure to the Zinc price dynamic. Horsehead, is purely a US story and has a market capitalisation of over US\$500mn. Silvermet, in contrast, is a low cap Toronto-listed story that has a processing plant in Turkey (and Korea Zinc as a minority shareholder). ZincOx is the only one that combines this recycling activity with efforts in mining (though there is no synergy between the two activities).

Ironically, in light of Silvermet having Koreans as meaningful shareholders the industrial activities of ZincOx Resources are in Korea where the company has committed US\$76 million to a zinc recycling project. This plant is designed to treat 400,000 tons per annum of dust from electric arc furnaces – which are widely used in steelmaking. Korea currently generates around 380,000 tons of electric arc furnace dust but this is estimated to rise to 400,000 tons during the next few years. Interestingly, funding is coming from Korea Zinc, who agreed a US\$50 million loan package at the end of April. Meanwhile, the first draw-down of this line, amounting to US\$12 million, has already been made.

Sampling projects during the past four years have found that the weighted average grade of this dust is 23% Zinc and 26% iron. The ZincOx facility is intended to produce more than 90,000 tons per annum of zinc in concentrate when it hits full production. This represents the same capacity as a medium-to-large zinc mine. Commissioning is expected for the first quarter of 2012.

In a recent statement ZincOx said that progress at the site is proceeding “very satisfactorily”. It stated that the civil works and foundations for the plant are 85% complete, while the installation of equipment is scheduled to commence before the end of June. A rotary hearth furnace is being refurbished in the US and is being shipped to Korea in three batches. The first batch has already arrived and erection is scheduled to begin in July. The construction of non-process buildings is nearing completion, while the building of the plant’s process buildings is well underway.

The ubiquity of Korea Zinc in these transactions indicates an interesting outreach to try and secure zinc supplies from non-conventional sources at a time when Nyrstar, Vedanta and Glencore are engaged in a scramble for zinc mining assets around the globe.

Old Wine in Newer Bottles

It is no secret that we are less than overwhelmed by ECU Silver, which has long been a Short position in our Model Mining Portfolio. The stock is usually more renowned for its disappointing earnings results than corporate actions but in the last week it has managed to pull-off a deal. Like everything to do with this name we take its statements with a shovelful of salt. In this case, the company claims to be undertaking a Reverse Takeover (RTO) of Golden Minerals (NYSE:AUMN). The latter is the reincarnation of Apex Silver, of unfond memory, the NYSE-listed Bolivian silver mining play where investors lost more

than their shirts several years back.

In its News Release, ECU says that the RTO values ECU at C\$0.97 per share (CAD\$302.5mn) in cash and stock, which was at a discount of 7% pct to ECU's close prior to the announcement. The deal has the support of Golden's largest shareholder, the Sentient hedge fund group (with a 19% stake). This fund is better known in our coverage for their purchase of the Rincon Lithium near-producing saline lake in Argentina. The company's May presentation shows the NY money manager, Gilder Gagnon as the largest shareholder (rather than Sentient) with a 20.2% stake. This leaves us wondering whether GG will be as content as Sentient to be lumbered with an over-priced and underperforming ECU. We would not be surprised if Sprott, with a 5.6% stake also head towards the escape hatch.

The one consolation in all this is that the new company to be led by Golden Minerals' CEO, Jeffrey Clevenger, and distance shall be made from the old ECU crew.

Golden Minerals, which is based in Colorado, has assets in Mexico and South America and its key project is the El Quevar project in Argentina. ECU Silver owns the Velardeña properties in Durango in Mexico which has been one of the most anemic and unprofitable silver "mining" operations in Mexico.

Through the RTO, ECU shareholders will get 0.05 common shares of Golden Minerals and about CAD\$0.000385726 in cash for each share they hold, giving them ownership of more than 50% of the new entity. Both companies agreed to not solicit alternative proposals, but granted the other party a right to match any competing proposal. The break-up fee is C\$10 million for both parties. The directors and officers of both companies also agreed to vote in favor of the deal, which is expected to close between late August and early September.



Additionally ECU Silver said it will issue about CAD\$15 million in convertible notes to Golden Minerals, with a conversion price of CAD\$0.97 per share and a maturity date of June 30, 2012. This is clearly to

plug the financial hole at ECU that would have necessitated another damaging financing if this current deal had not been cooked.

We see no reason to change our view of the merged company from that we held on the prime component. This sounds more like a rescue of the flailing ECU. If bulking up is the goal for Golden then there are plenty of worthier candidates than ECU. We are even more stunned to see that Golden is bringing \$109mn in cash and short term investments to the table and that a chunk of this is going almost straight away to fund ECU's convertible. We cannot see why non-Sentient shareholders (and even Sentient for that matter) haven't looked through the ECU financials and run for the hills. Makes us think that there might be even something worse afoot at Golden. Good reason enough to put a short position in Golden Minerals into the Model Mining Portfolio, which we duly did.

Conclusion

With Greece in the balance the gold bugs are frothing for action but alas the gold price seems almost static which doesn't conform to their version of the hymn book. With the long death agonies of the country dragging on this has given more than enough time for exposed parties to work out what they are going to do and to reduce their exposure, unwind derivatives etc. Thus comparisons to the sudden onset Lehman debacle are well off the mark. Greece is a death well foretold. The mourners are already dressed and the coffin hammered into shape.

Thus is Greece cannot get the gold pulse racing then what can? Inflation may be breaking out in some emerging markets but some of these, namely Brazil, are QE2 junkies and maybe heading for a wakeup once the dripfeed is turned off. This will damp inflationary tendencies in a big way, but in any case why buy gold to hedge Brazilian inflationary risk unless you are Brazilian? The West is barely registering a pulse economically so inflation on the broader scale is not going to be a gold price motivator.

The best we can hope is that industrial metals hold up as precious metals lose ground.

Mining Model Portfolio as at: 28-Jun-2011

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Security		Date of original rec.	Currency	Price Avg. Current		Portfolio Weighting	Increase in Value	Target Price	
Long Equities									
Large Caps	Nyrstar (NYS:BT)	09/28/09	Euros	7.69	9.75	7.9%	26.8%	\$13.00	
	Thompson Creek Metals (TC)	01/15/10	USD	15.20	9.51	3.8%	-37.4%	\$20.00	
Corporate Actions	Platinum Group Metals (PLG)	02/11/10	USD	2.02	1.91	5.2%	-5.4%	\$3.80	
	UCore Rare Matels (UCU.v)	08/20/10	CAD	0.40	0.57	3.1%	42.5%	\$0.70	
Mid-caps	Norton Goldfields (NGF.ax)	03/13/11	AUD	0.18	0.14	4.0%	-22.2%	\$3.00	
	Uranium Participation Corp (U.to)	10/20/10	CAD	7.01	6.38	4.2%	-9.0%	\$9.00	
Gold Juniors	Capstone Mining (CS.to)	05/29/09	CAD	2.32	2.91	3.8%	25.4%	\$5.00	
	Labrador Iron Mines (LIM.to)	08/20/10	CAD	4.61	10.75	7.4%	133.2%	\$7.50	
	Yukon Nevada Gold (YNG.to)	07/20/10	CAD	0.34	0.40	3.3%	18.8%	\$1.50	
	Zinc ETF (Zinc.L)	01/15/10	USD	7.04	8.32	2.2%	18.2%	\$11.00	
	Industrial Minerals (IDM.ax)	04/14/11	AUD	0.29	0.27	2.6%	-6.5%	\$0.80	
	Cap-Ex Ventures (CEV.v)	05/13/11	CAD	0.92	0.52	1.7%	-43.5%	\$1.50	
	Cerro Resources (CJO.v)	05/01/09	CAD	0.08	0.22	7.2%	161.2%	\$0.30	
	Goldgroup (GGA.to)	06/02/10	CAD	0.68	1.10	4.5%	61.8%	\$1.35	
	Adamus Resources (ADU.ax)	10/22/09	AUD	0.44	0.55	3.9%	25.0%	\$1.20	
	Golden Band Resources (GBN.v)	04/13/10	CAD	0.28	0.32	0.9%	14.3%	\$0.65	
	Lion One (LIO.v)	05/13/11	CAD	1.20	1.02	2.8%	-15.0%	\$2.70	
	Timmins Gold (TMM.v)	01/25/11	CAD	2.23	2.25	3.7%	0.9%	\$3.00	
	Oromining (OGR.v)	12/03/10	CAD	0.39	0.30	2.5%	-23.1%	\$1.32	
	Tamerlane Ventures (TAM.v)	05/13/11	CAD	0.29	0.29	2.0%	0.0%	\$1.00	
	Other Juniors	NWM Mining (NWM.v)	11/29/10	CAD	0.10	0.11	3.0%	10.0%	\$0.36
		Malaga (MLM.to)	12/15/09	CAD	0.14	0.24	1.3%	71.4%	\$0.60
		Groote Resources (GOT.ax)	02/28/11	AUD	0.43	0.13	0.7%	-69.8%	\$0.72
		Geovic (GMC.to)	11/23/09	CAD	0.61	0.33	1.8%	-45.9%	\$1.50
		Reed Resources (RDR.ax)	12/15/09	AUD	0.59	0.52	2.9%	-11.1%	\$1.80
		Northern Minerals (NTU.v)	06/09/11	AUD	0.73	0.63	2.6%	-13.7%	\$1.50
Philippine Metals (PHI.v)		05/12/10	CAD	0.37	0.09	0.5%	-75.7%	\$1.50	
Revelt Minerals (RVM.to)		11/15/10	CAD	3.15	4.25	4.7%	34.9%	\$5.00	
ZincOx (ZOX.L)	10/26/10	CAD	39.25	64.00	4.1%	63.1%	£68.00		
Eagle Star Minerals (EGE.v)	11/19/10	CAD	0.22	0.22	1.8%	0.0%	\$1.80		
NET CASH						3,538,742			
Short Equities									
Shorts	US Gold (UXG)	05/01/09	USD	2.34	5.72	17.5%	-144.4%	\$1.70	
	Gold SPDR ETF (GLD)	11/15/10	USD	133.93	146.13	7.9%	-9.1%	\$115.00	
	St Elias Mines (SLI.v)	06/09/11	CAD	1.79	2.06	3.4%	-15.1%	\$0.80	
	Silver ETF (SLV)	02/24/11	USD	31.09	32.83	4.4%	-5.6%	\$27.00	
	ECU Silver (ECU.to)	09/10/09	CAD	0.60	0.92	5.0%	-53.3%	\$0.45	
	Golden Minerals (AUMN)	06/27/11	USD	19.42	18.83	2.5%	3.0%	\$15.00	
	Eldorado Gold (EGO)	05/12/10	USD	18.06	14.50	20.7%	19.7%	\$13.00	

Current Cash Position	3,538,742
Current Liability on Shorts Not Covered	(1,397,701)
Net Cash	2,141,041
Current Value of Bonds	0
Current Value of Long Equities	3,707,964
TOTAL VALUE OF PORTFOLIO	5,849,005

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60 Madison Ave, 6th Floor, New York, NY, 10010