Pensive calm…

Continued bad news out of the western banking system is holding markets in a fearful grip. Concern can be summarized as wondering whether some of the early attempts to bail-out the bad mortgages barge have simply shifted the bilge water to ships that were holding their own in the storm. Certainly these are causing the likes of Citigroup and Bank of America to list. This is the season for bad news in a bad market, but few are yet willing to assume Q1 reporting will be better.

Continued weakening of retail sales numbers in the US is adding to this. The 2.7% decline in December was larger than consensus guesstimates, and large enough to mark an overall decline of 0.1% for the full year. US inventories also continue to decline, by 0.7% in November, which adds the falling industrial outputs. Selling down of current inventories is coupled with negotiating lower costs on future orders, which is slowly bringing down the US cost of living and allowing gains to its savings rate.

The 0.5% drop by the ECB indicates (finally) that it sees little reason to worry about inflation, near term. Europe will be increasingly viewed as a collection of economies. The British government pouring more Pounds into its banks confirms this is the worst off of large European economies. The President of France suggests regulating commodity prices, but we doubt oil and metal subsidies would be as easy to arrange as those to French farmers have been. Germany with its high savings rate and Italy that largely missed the credit debacle should be watched for signs of thaw.

The fundamentals of the **gold** mining continue to auger concern of supply disruption. London based Gold Field Mineral Services indicates gold mining costs gained 22% through the first three quarters of 2008. Cash costs averaged US $472 per oz and total costs averaged $591 per oz through that period. The run up in the yellow metal's price would have had its miners moving to repair "higher-grading" of deposits that kept operations open prior to September '07 when the gold subsector struggled to compete with a mining sector that was otherwise very healthy.

GFMS indicates jewelry fabrication dropped 11% through 2008, to its lowest level since 1989. This isn't surprising given how quickly fabrication everything fell off a cliff in the latter part of 2008. GFMS expects further jewelry decline through the first half this year, partly because of higher prices outside of the US (and Japan). The protestations of those who think gold should zoom during a banking crisis aside, the yellow metal has settled into a trading range that accords with its being eschewed as a luxury during a general consumer slump offsetting gains from crisis buying. Mine supply fundamentals point to the need for price gains if current gold demand levels are going to be met. We continue to expect the greenback to roll over, and so still expect a healthy lift for gold's price, in US$ terms.

With the US about to inaugurate a history making President for whom expectations are very high, the balance of this month should be filled with enthusiasm for change and renewal. We hope this speeds a shift in US sentiment. We equally hope, and believe, the new administration will be pragmatic enough to talk down its Dollar in order to enhance its export picture. That would be the right mix of hope and reality for this market. Ω

Trip report...

As if in reflection the economy, my quick trip to visit **Premier Gold (PG-T; $1.62)** at its main gold project in Ontario greeted me with -20^{O} temperatures in Toronto and, according to the Geralton airport, a wind chill equivalent of -40^{O} on site. In this northern Ontario town were the last lumber mill shut down in November, hope of reviving the gold industry that created the town is largely pinned on the program PG has just resumed there. The project, dubbed Hardrock, has that potential.

Geralton is home to the past producing Little Long Lac gold mine that was the namesake operation of Lac Minerals into the 1960s, when it became one of a number of northern Ontario gold camps that couldn't survive the fixed gold price regime. When the gold price began rise in the 70s Lac was focused elsewhere, and was eventually taken over by Barrick Gold in 1994. While exploration in the camp has never stopped, the core areas held by Barrick have seen limited work since its Lac takeover. Premier entered the camp through a joint venture with Roxmark Mines (RMK-V) begun in September '07, which was expanded in December with purchase of core Lac holdings from Barrick (net of a 3% NSR). PG should complete earn-in requirements with RMK to hold 51%, after which it has the option of increasing its interest to 70% by carrying Roxmark to a production decision.

Gold camps were the development backbone of northern Ontario and northwestern Quebec, and are tied to power and transport infrastructure because of this. They slowly began to fade on the back of a fixed $43 per oz gold price (the Canadian government paid an $8/oz premium in order to maintain its peg), typically because companies could not justify the capital requirement to chase systems to depth rather than because they were mined out. Gold price gains in the 70s breathed new life into camps like Red Lake by allowing them to move to depth, but also by allowing development of low grade surface ore in camps like Timmins. Gold has been recovered at depths of 8,000 feet (2,500 metres) in this region, and there are several smaller camps in which bulk tonnage evaluations are on-going and may generate multi-100,000 oz per annum producers. This and the limited recent exploration set the stage for market interest in Hardrock.

Though it has been working on adjacent ground for a year, Premier is still early in its data compilation for the newly acquired Lac holdings. Mining took place in them to about 3000 feet (900 metres) depth in this area. The data from this period predates the digital age and is being converted into computer files. There is sufficient detail on the cross sections and plans I went through to indicate that ore grade material was left in place, and that the system is open to depth. The potential is for either, or both, narrow high-grade mining or moderate grade bulk underground methods to a larger plant.

There are also a number of surface zones of mineralized porphyry that did get tested after the underground operations closed down which might be mineable from open pits. Getting to that potential would require outlining sufficient material to capitalize a larger plant, and probably from a series of surface zones in this case. There is also some higher grade material within these porphyry zones that might be included in an underground resource, and a potential to add to surface resources with more linear zones where the high-grade zones surface.

At this point the evaluation of geological and metallurgical details is as important as testing for grade-thickness blocks, and this is work that is just getting underway. Historic gold extraction was done by cyanide leach, which typically means relatively fine gold that was not encapsulated in pyrite or other material. That said, there can be significant variations of ore type within different settings in a gold camp and it is too soon to assume working hypotheses for what “viable” would be in this case. It is however quite possible to follow the main trends and create this detail as the older data is being recompiled and assessed. Premier will have four drills doing that through the balance of the year.

Typically the first hurdle achieved in a camp reassessment program of this sort is to outline sufficient high-grade material to justify a small plant build. Smaller plants are less costly, easier to come by, and can be used to test ideas for a larger scale concept. This is the old-school way of doing things, which is well worth keeping in mind in this market environment. At this point the bigger potential appears to be outlining a bulk underground deposit and adding to it with surface material. That testing focus may, and in this setting probably would, locate more high-grade material. Outlining sufficient resource to justify dewatering the old workings would be an initial objective, and is achievable with this year’s program.

On the whole I expect the drill program will generate a combination of high-grade and broader bulk tonnage level gold intersections to demonstrate both good cost and scale potential. Added to this is the speculative appeal of the 100% PQ ground adjacent to the Musslewhite mine that will see a drill start next month plus the well established appeal of being in the Red Lake camp. PG has turned over 6.7 million shares at an average $1.57 since announcing its $1.80 flow-through placement in late October, so is well positioned to gain as an accumulation of good results at Hardrock, or strong initial results at PQ, come to market.

As a final note on Hardrock, some will be wondering if partner Roxmark is worth a punt. Roxmark is a long time northern Ontario explorer that has struggled to make a market, and has 175 million shares out after raising $1.35 million in a 7 cent flow-through placement lat last year, earmarked for expanding the small 10 g/t gold resource it has established in the Beardmore camp which is about 60 km along the Trans-Canada Highway to the west of Geralton. Though we don’t plan to add it to the HRA list, we may accumulate a bit while waiting to see if on-going results can pick up its volume. Premier is more than the one project, but certainly Roxmark could do better on strong results from Hardrock.

Those holding PG as a Wolfden spinout should continue to do so, and as one of the few juniors with multiple large scale programs laid out for this year our outlook would be to accumulate it on gold price weakness.
http://www.premiergoldmines.com/

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Updates…

The pace of junior mergers in the gold sector continues to quicken (at least on our list), so the question of whether each of these is actually accretive rather than dilutive will take up some time going forward. A merger and a take-over attempt have been announced by Dispatch level companies since mid December, which will speak to the interest of working in the tropical bits of Latin America going forward.

Linear Gold (LRR-T; $1.11) and Central Sun Mining (CSM-T, SMC-Amex, GGX-Frankfurt) is one with an interesting appeal. We have played the waiting game on the work Kinross Gold has been doing at Linear’s Ixhuatán project in southern México. While that wait continues, LRR has decided to tuck its spare cash into a turn-around deal we have had our eye on for a while now. Central Sun operates the Limon gold mine in Nicaragua, and was able to push its bottom line out of the red with it in Q3 after having had significant write-downs over the previous year. One issue CSM has had is with its Orosi gold deposit in the same country where an attempt to heap leach generated poor gold recoveries of about 38%. CSM plans to convert Orosi to a conventional milling operation that should up the gold recovery to the +90% level, after a capital cost of US$20 million. We took a look at this plan after Central Sun announced a debt financing to move it forward and decided it made sense, but the credit crunch squeezed that financing plan out of contention. More recent good news from Central Sun has been testing at its Limon mine indicating it has some higher-grade extensions.

While the combined company would have the cash in hand to move Orosi forward, there was still fine tuning to do as regards an existing $8 million bridge loan against the project and the closing out of a mine in El Salvador that CSM has on its books. Central Sun (formerly Glencairn Gold Corp before a 1 for 7 roll back in late 2007) has a history of focusing on small scale developments with low up front costs.

These types of project can look fine on paper, but are problematic if they force a company with limited capital resources into a do-or-die situation. Small developments leave limited room for the revamping that simply is sometimes a part of mine development after even the best laid plans. In the case of Orosi, however, the plan to add a grinding circuit that will allow better recoveries looks sound. Since it comes on top of existing development expenditures, it means a relatively small additional cost for the envisioned +50,000 oz per year output.

The bridge loan issue has been answered by extension of its repayment to June, plus an announcement that Linear has arranged a $15 million bought-deal financing at $1.15. That is a marked gain from the 70 cent level LRR was trading at prior to announcing the merger, though in keeping with a number of its peers' climb from the bottom. This placement should leave the combined company debt free and with a comfortable working capital cushion after paying for the balance of the Orosi make-over.

Orosi's planned output added to the Limon production gives the combined company a potential to generate upwards of C$100 million of revenue within a vehicle that can do well at that level. This should at a minimum make it a decent gold price hedge, once the deal has closed and it is moving to redevelopment status. It is hard to say how being in Nicaragua would impact its cash flow multiples, but even though the country's current President is in the region's socialist club we do think his past stint in the job has made him more of a pragmatist than others in that group. The country badly needs infrastructure spending away from its Pacific coastal strip, and even if having these mines move to profitable development meant only some of the major potholes in the access highway were repaired it would be a worthwhile endeavor for the country. For the moment it makes sense to wait out the placement, or accumulate further if gold weakens substantially, after which we will have further follow up on Linear.
http://www.lineargoldcorp.com/
http://www.centralsun.ca/

Rusoro (RML-T, *$0.67*) also announced a take-over bid before Christmas, for **Gold Reserve (GRZ-T, N-Alt; *$1.20 on T*)** on the basis of 3 RML shares for each 1 GRZ share. Gold Reserve has responded to this with some degree of rancor, based in part on the relative ease with which RML is able to operate in a country that has otherwise killed off most other foreign investment in resources. While we sympathize with a GRZ management group that has, a far as we can see, not put a foot wrong. However a partner that can operate in a difficult environment is usually considered a good thing, and we also think that in balance the offer is a fair one.

On the whole, the question for Gold Reserve shareholders has to be whether waiting out the twists and turns of Chavez style politics would make more sense than taking this deal. Even if there was a change of government in Venezuela tomorrow it would still be several years before the various issues were resolved and the Gold Reserve's Brisas gold project moved through development, which now include trying to finance a high-risk venture during a credit squeeze. Protesting statements by Chavez about developing this resource in a JV with Rusoro in a 50-50 joint venture may miss several pertinent points. One is that since that is the basis for Rusoro's two operating mines, expectation of a similar deal may be all one sided. But more to the point, the current Venezuelan government apparently feels it should hold 50% of the project, and it makes little sense to assume that changes soon regardless of current tenure.

Venezuela's potential to become a major source of the yellow metal is questioned by none, on a geological basis. If Venezuela's country risk ranking were to improve it is quite likely that senior companies would be taking a hard look at the assets in its main gold district. That is a future event for which timing can not be assigned, and there is no assurance that GRZ shareholders would find themselves better off after a further long wait-and-see period. Rusoro has been able to both move its own projects along expeditiously, and to acquire operating and turn-around assets from others as they decamped from the district.

After some pause to see how GRZ would react to this deal, the market has apparently taken a harder look at Rusoro and decided it likes what is seeing. Gold Reserve is trading at heavy 60% discount to the offer, which really indicates that few are willing to wade into this on any basis. We are in RML at a low cost by having been in its first acquisition, and have since played the waiting the game in a gold district that will, some day, be an important source for the metal. We can not see playing long ball in Venezuela with any other company. Despite the understandable disappointment they may feel, we expect the GRZ shareholders to come to that conclusion as well in a market that is been disappointing for everyone - if the two management groups stop squabbling. The market distain for this deal makes an arbitrage risky, but for the moment that is its best opportunity.
http://www.rusoro.com/
http://www.goldreserveinc.com/

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Regards for now, David Coffin and Eric Coffin

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