

HALLGARTEN & COMPANY

Portfolio Strategy

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Model Mining Portfolio: Markets Quake

Performance Review - March 2011

Model Mining Portfolio

Markets Quake

- + Gold (and particularly silver) have rebounded in recent days on Mid-East tensions. Gold had initially dithered in its response to the Japanese earthquake and its aftermaths
- + Rare Earth stock prices gained a tailwind from further Chinese tightening after a brief moment of questioning in response to Japanese earthquake damage
- + Zinc and Lead are gaining favour amongst heavyweight investors which is tending to manifest itself in strength in the related equities more than in the physical markets
- ✗ Despite fears that Chinese copper stockpiles were starting to weigh on the potential for upside in that metal, the copper price remained resilient, but this may reflect excess cash sloshing around in markets leaving copper vulnerable to the downside in either Chinese or Fed monetary tightening
- ✗ Uranium and the stocks in that space were badly battered by the Japanese power plant situation and various moratoria announced around the world. Stocks rebounded smartly but this may be unjustified for the companies that are not near to production as funding could be much tighter in coming years
- ✗ Silver is in seriously overpriced territory and vulnerable to a pullback, possibly triggered by any reversal in the QE2 policies of the Fed

The Month That Was – Equal and opposite forces

The metals markets were briefly sidetracked by the Japanese earthquake situation that was an ill-wave that brought no-one any good (except Gaddafi by distracting attention from his campaign of dissident suppression). Gold did not know whether to go up or down in response to the damage wrought in Japan and the financial measures the Japanese government took. Was it inflationary?? Or was it the straw that broke the camel's back of global recovery? Would the Japanese government bringing back financial resources to the Motherland drain liquidity around the globe? Moreover would the rebuilding effort add fuel to the commodities super-cycle? The answers to most of these questions will only be answered by events but on the last issue we can see virtually no reason to justify the commodity/metals bulls. As can clearly be seen from the news reports several wooden villages inhabited by several tens of thousands of residents have been wiped out. If there is any demand of substance it will be for wood and cement in the rebuilding certainly nothing to move the needle on any of the major base metals. China probably uses more copper in a day than goes into all of the destroyed Japanese structures. The effect of the earthquake is not only minor for metals, it is also fleeting. That said, the collateral damage has largely been the uranium sector, which had scarcely gotten off its back only to be knocked down again. This will shall discuss anon.

The oil price's reaction to the Libyan crisis is a more interesting impetus, for better or worse, for metals at this time with the mixed signals that higher prices threaten growth (and thus base metal demand) while also potentially inciting inflation and giving comfort to precious metal fans. Then lower growth mitigates inflationary trends making for various conflicting imponderables.

Price Moves in the Model Portfolio

This was a negative month for the portfolio with a retreat of over \$300k. The notable features were:

- Our two new additions declined in value almost immediately
- UCore powered upwards with the Rare Earth space and we are now up over 150% on that position
- Shorts continued to move against us except for the Eldorado Gold position, which curiously continued to weaken despite the firm gold price.
- Our Uranium ETF position (UPC) declined but not as much as uranium stocks did showing the wisdom of avoiding the mining companies and sticking with the physical ETF
- Nyrstar continues to recover after its recent scrips offering to fund its Farallon purchase. We included our rights in the Model Portfolio. We have increased the target price to Euros 13.
- Reed Resources returned to positive territory as it moves towards imminent production of Lithium in Western Australia

The Model Mining Portfolio had a valuation of \$6.874mn on the 28th of February 2011 and now stands at USD\$6.596 mn of which some USD\$3.223 mn is the net cash position. The cash position was down around \$40K due to the netting of asset sales/purchases with the cost of exercising our Nyrstar subscription rights.

Portfolio Changes

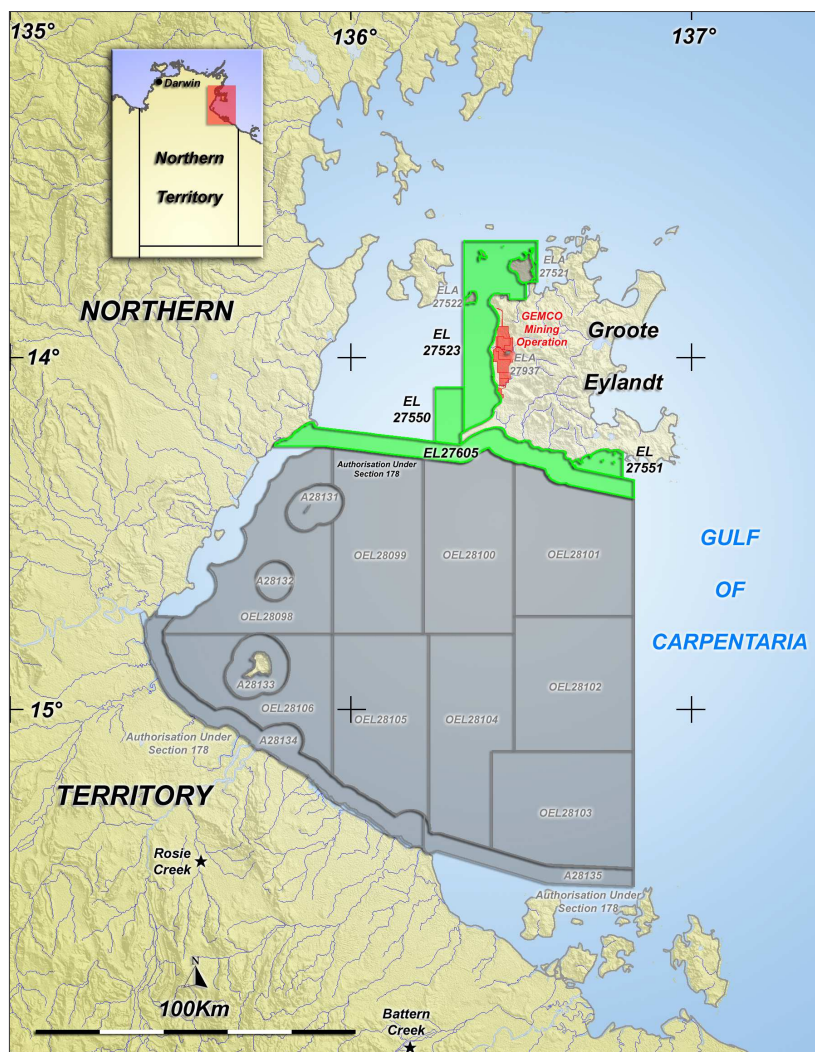
Our transactions this month were best described as like-for-like swaps:

- Opened a Long position in Norton Gold (NGF.ax). Purchased 1,000,000 shares of NGF.ax at AUD 18 cts on the 13 March 2011
- Closed a Long position in Troy Resources (TRY.ax). Sold 79,405 shares in TRY.ax at AUD\$3.44 on the 13 March 2011
- Closed a Long position in Aurora Minerals (ARM.ax). Sold 130,000 shares in ARM.ax at AUD 28 cts on the 28 February 2011
- Added a Long position in Groote Resources (GOT.ax). Purchased 200,000 shares in GOT.ax at AUD 43 cts on the 28 February 2011.

We exited our loss-making Aurora Minerals position in the Australian manganese space and added Groote Resources to maintain exposure to that metal. We also exited our highly-profitable Troy Resources position (up 120% since “purchase”) to replace it with another Australian gold miner in the form of Norton Goldfields.

Groote Resources (GOT.ax)

This is a company that came to our attention late last year as we have long been enthused by the prospects of middle and small-sized players breaking into the big boy cartel in the Manganese space. Manganese is an essential alloy used in steel production as a strengthening component and has no known substitute. Consumption is around 50mn TPA, with China accounting for nearly 50% of global demand. Groote Resources holds exploration rights for six tenements covering 1,723 km² of shallow marine terrain and two islands near Groote Eylandt in the Northern Territory of Australia. These tenements are located immediately adjacent to and contain the interpreted extensions of the world-class manganese deposits at Groote Eylandt currently being mined by Groote Eylandt Mining Company Pty Ltd (which is 60% owned by BHP-Billiton and 40% by Anglo-American). This is one of the world's largest Manganese mines.



At the left can be seen a map of the very sizeable acreage that Groote holds. Before the question is asked “Isn’t that underwater?” we would respond that while a small part of the tenements are onshore at the island the rest are in water that is only a couple of metres deep.

On Groote Eylandt manganese ore occurs over an area exceeding 150 km², mainly on the western side of the island. The ore beds in the mining area are typically between 2 to 20m in thickness, averaging 3m in thickness. Sand/clay overburden ranges up to 15m thick, but averages 3m. The sedimentary and tabular nature of the manganese deposits at Groote Eylandt and their interpreted shallow dips towards the west and to the south suggest that beneath the shallow sea floor within the tenements that manganese mineralization may occur.

Thus the below-sea Manganese would be mined by dredges with minimal land disturbance, no overburden and no atmospheric contamination (i.e. dust).

The company has set an initial exploration target of 50 mn tonnes of high grade Direct Shipping Ore (DSO). A debut resource of this size matches one year’s worth of global consumption. The company

claims to be on target with an exploration program to delineate an initial JORC resource by mid 2011. We have added a **Long** position to the Model Mining Portfolio with a 12-month target price of \$1.20.

Norton Goldfields

Troy Resources, the ASX-listed gold miner with operations in Australian, Brazil and Argentina seemed to have run out of puff lately and sat there, very handsomely up from the level at which we added it in the very first iteration of the Model Mining Portfolio in May 2009, but static all the same. In line with our policy of taking profits off the table particularly when valuation are as crazy as they have been lately we had been pondering its demise. However, where to find something that was a producer that was bargain priced?

Norton Gold Fields is likewise listed on the ASX and is one of those curious breed of gold miners that still haven't made it back to their highs of previous years despite the soaring gold price.

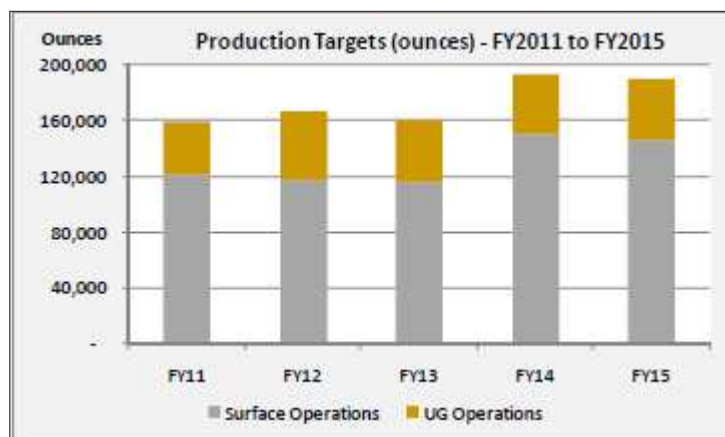
In FY10 the company produced a little over 140,000 oz of gold from its open cut and underground operations, which are located 35km north west of Kalgoorlie, Western Australia. All of the ore is processed through the massive 3.3mn tpa Paddington mill.

The map to the right shows the mill *vis-a-vis* the other mines that the company has scattered across this district. At the moment the production comes from the three mines shown in brown. The current mine life of these is in excess of 10 years. The company intends to bring the other prospective properties (most of which have been mined historically in some fashion) into production in the next few years to maximize utilization of the Paddington's mill excess capacity (as well as provided tolling for other gold producers in the area).



Aside from the wide spread of Kalgoorlie assets the company also holds the Mount Morgan Mine Project in northern Queensland. This project has been approved for development (subject to funding) and will increase gold production by 30,000 to 35,000 oz pa and diversify production. The project has all the requisite regulatory approvals and can potentially be in production within 12 months.

For the time being though the company is working with just production targets based upon the Paddington complex. These are shown in the bar graph on the following page. We find it very difficult to think of any gold company with this level of gold production that is selling at the type of multiple and market capitalization (AUD\$110mn) that Norton Goldfield's currently endures.



Thus some background is needed. The only negative that lingers around the company is the memory of its relationship with Lehman Brothers. The company had a gold loan in place with the failed investment bank and in the generalized confusion after the bank's demise the company started accumulating the monies that would otherwise have been going to the bank. Eventually after some rancorous interchanges with the trustees of the

Lehman Estate the debt was restructured in July 2010 with the Estate taking a sizeable haircut (\$33mn) and Norton having had use of the cash, it would otherwise have paid over, for several years. The company paid \$10mn upfront with the remaining \$97mn to be paid over the next four years. In fact the company just sold some coal leases for \$30mn and shall use the first installment of the payment for this to reduce the debt to around \$84mn. The market only sees and obsesses about the high debt/market capitalization ratio in an industry in which debt burdens are generally light. With an interest rate of 12% and an extra 4% in Payment in Kind, the company has every incentive to replace this debt (over which it has right of first refusal) with either a more acceptable and cheaper piece of paper (a convertible with a high strike?) or a mix of debt and equity. Obviously the equity component is unattractive while the stock is so lowly valued.

Clearly changing the nature of this debt would likely trigger a virtuous circle in the company's share price valuation and thus its debt/market cap ratio. Even without this scenario the company has given guidance of expected pre-tax profits in the first half (period ending Dec 10) of AUD\$12.6mn. It would not surprise us to see the company make over AUD\$28mn in the full year (to June 2011) without factoring in the sizeable extraordinary gain that will be booked for the sale of the coal tenements.

We have added a **Long** position in Norton Goldfields to the Model Mining Portfolio with a twelve-month target price of AUD 60 cts.

Meltdown

The Japanese nuclear crisis has resulted in yellowcake taking a well-deserved beating. We remain bullish on uranium for the long term and gave no credence to the Chinese "construction freeze" or whatever it was. China and India need nuclear power plants to deal with their carbon emissions problems and construction will continue apace. The only factor that is added to the mix is that old real estate adage "location, location, location".

The most immediate effect is that those survivors of the last uranium meltdown (2008, not Three Mile Island) that were pondering returning to the bubbly uranium space will probably switch back to shell status which they deserve to have. We had already noted that some who were surplus to requirements

were fancying that they had another chance in the space. However, the U space needs to be much smaller and the contraction will go on. The lucky ones are those that were financed in the past few months for we see the financing door slammed shut for a good while now. The survivors will be the producers, the near producers and a very select band of explorers with exceptional properties in terms of location (amenable jurisdictions being a great help), grade or size. Some of the near producers were heavily overvalued before the tsunami hit their stock prices and they will be lucky to see those levels again for quite a while, if ever. We shall be watching the space to see whether the rally off the lows provides some shorting opportunities if it comes to be seen as a dead-cat bounce.

Conclusion

Gold seems to be getting more support these days from political risk considerations than monetary fears. Gold bugs drew comfort from the fact that Libya seemingly believes with them and is long \$6bn worth of gold but they forgot the obverse that the embattled leader has such a stash expressly so he can liquidate it on a rainy day (and it is not water that is raining down on him these days...). Dictators can buy gold but they can also liquidate it. In any case it's an ill-wind that blows gold buyers some good... even more so for the silver buyers who have found themselves in their heyday. Nary the thought crosses their mind that they may be being set up for a "Wiley Coyote" moment. Our advice "Don't look down"...

That having been said it seems that institutions are finally starting to get chary. The Financial Times on the 23rd of March reported that a survey of around 100 European institutional investors discovered that gold was not only NOT at the top of investors' picks for upward movement in 2011 but it was second from the bottom with only NatGas faring worse. This goes part of the way towards explaining why the AUM of the gold ETFs has been in steep descent. The Chinese retail crowd may be buying, but the big money (though we are cautious in calling them the "smart money") is taking bets off the table.

Mining Model Portfolio as at: 25-Mar-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	10.01	6.3%	30.2%	\$13.00
	Thompson Creek Metals (TC)	01/15/10	USD	15.20	12.56	4.0%	-17.4%	\$20.00
Corporate Actions	Platinum Group Metals (PLG)	02/11/10	USD	2.02	2.10	4.4%	4.0%	\$3.80
	UCore Rare Matels (UCU.v)	08/20/10	CAD	0.40	1.01	4.4%	152.5%	\$0.70
Mid-caps	Norton Goldfields (NGF.ax)	03/13/11	AUD	0.18	0.17	3.7%	-5.6%	\$3.00
	Uranium Participation Corp (U.to)	10/20/10	CAD	7.01	7.19	3.7%	2.6%	\$9.00
	Capstone Mining (CS.to)	05/29/09	CAD	2.32	4.63	4.7%	99.6%	\$5.00
	Labrador Iron Mines (LIM.to)	08/20/10	CAD	4.61	13.81	7.5%	199.6%	\$7.50
	Yukon Nevada Gold (YNG.to)	07/20/10	CAD	0.34	0.71	4.6%	110.8%	\$1.50
Gold Juniors	Zinc ETF (Zinc.L)	01/15/10	USD	7.04	8.99	1.9%	27.7%	\$11.00
	Dynasty Metals (DMM.to)	05/29/09	CAD	3.89	3.20	5.4%	-17.7%	\$5.50
	Cerro Resources (CJO.v)	05/01/09	CAD	0.08	0.25	6.4%	196.8%	\$0.30
	Goldgroup (GGA.to)	06/02/10	CAD	0.68	1.33	4.3%	95.6%	\$1.35
	Adamus Resources (ADU.ax)	10/22/09	AUD	0.44	0.77	4.2%	75.0%	\$1.20
	Golden Band Resources (GBN.v)	04/13/10	CAD	0.28	0.43	0.9%	53.6%	\$0.65
	Oromin (OLE.to)	05/29/09	CAD	0.74	1.30	1.6%	75.7%	\$1.25
	Timmins Gold (TMM.v)	01/25/11	CAD	2.23	2.57	3.3%	15.2%	\$3.00
	Oromining (OGR.v)	12/03/10	CAD	0.39	0.25	1.6%	-35.9%	\$1.32
	Atna Resources (ATN.to)	11/15/10	CAD	0.62	0.58	2.5%	-6.5%	\$1.00
Other Juniors	NWM Mining (NWM.v)	11/29/10	CAD	0.10	0.15	3.3%	50.0%	\$0.36
	Commerce Resources (CCE.v)	12/15/09	CAD	0.48	0.84	3.6%	75.0%	\$0.90
	Malaga (MLM.to)	12/15/09	CAD	0.14	0.28	1.2%	100.0%	\$0.60
	Groote Resources (GOT.ax)	02/28/11	AUD	0.43	0.36	1.6%	-16.3%	\$0.72
	Geovic (GMC.to)	11/23/09	CAD	0.61	0.59	2.6%	-3.3%	\$1.50
	Reed Resources (RDR.ax)	12/15/09	AUD	0.59	0.59	2.6%	0.9%	\$1.80
	Philippine Metals (PHI.v)	05/12/10	CAD	0.37	0.25	1.1%	-32.4%	\$1.50
	Revett Minerals (RVM.to)	11/15/10	CAD	3.15	4.98	4.3%	58.1%	\$5.00
ZincOx (ZOX.L)	10/26/10	CAD	39.25	51.44	2.6%	31.1%	\$68.00	
Eagle Star Minerals (EGE.v)	11/19/10	CAD	0.22	0.25	1.6%	13.6%	\$1.80	
NET CASH						3,223,568		
Short Equities								
Shorts	US Gold (UXG)	05/01/09	USD	2.34	8.54	27.0%	-265.0%	\$1.70
	Gold SPDR ETF (GLD)	11/15/10	USD	133.93	139.22	5.9%	-3.9%	\$115.00
	Silver ETF (SLV)	02/24/11	USD	31.09	36.12	3.8%	-16.2%	\$27.00
	ECU Silver (ECU.to)	09/10/09	CAD	0.60	1.01	4.4%	-68.3%	\$0.45
	Eldorado Gold (EGO)	05/12/10	USD	18.06	16.13	23.8%	10.7%	\$13.00

Current Cash Position	3,223,568
Current Liability on Shorts Not Covered	(1,353,607)
Net Cash	1,869,961
Current Value of Bonds	0
Current Value of Long Equities	4,726,478
TOTAL VALUE OF PORTFOLIO	6,596,439

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