



COMMENT – Buy PAN, SLR & TTY

(Keith Goode : 11 September 2008)

Info on : **Silver Lake (SLR), Norton Goldfields (NGF) & Independence (IGO) (based on visits at Diggers)**

Overview

Post Diggers last year we wrote “*This Comment started out based on the visits we (ERA) took during the Diggers n Dealers Aug 2007 Conference. However, it has been extended following the recent decimation in share prices due to trading on money that did not exist, and requests for our nickel & gold favourites*”. That comment applies just as easily for 2008 too, except that this time around the “money that did not exist” has mainly been in different forms of sophisticated shorting.

It is often commented that the market likes a story and hates reality, that’s why the old model of the share price rising when a company starts production has gone out of the window. Now companies rise before production and fall when they go into production as reality hits, unless they are still in “story” mode. Our current Australian based and operated favourites are all appear to be debt free, generating cash with cash in the bank, and significant upside potential being for nickel : **Panoramic (PAN @ \$1.45); in gold : Silver Lake (SLR @ \$0.16) and in other (iron ore) : Territory (TTY @ \$0.52)**. – And all of them have PERs in the 2 to 4 x area. (**PAN** : 194m x \$1.45 = \$281m, less \$130m cash = \$151m/\$73m = 2.1 x; **SLR** : 153m x \$0.16 = \$24m less ~\$3m = \$21m/\$12m = 1.8 x; **TTY** : 265m x \$0.52 = \$138m less \$1m (check financials when reported) = \$137m/\$45m = 3.0 x)

Our (ERA) current favourites are :

- 1. Panoramic** : Recent August 2008 report, and stacks of upside both at Lanfranchi (due to Deacon) and at Kimberley Nickel due to Savannah. PAN recently reported some more of those thick high grade (double current grade) intersections, indicating further upside potential. Our report had a life of 10 to 15 years at ~15,000tpa - 20,000tpaNi (whereas it could be 15 to 20 years at up to 25,000tpa [which more resembles a portfolio stock]). The NPAT is about \$70m per year at prices of A\$9.47/lb Ni (US\$9/lb and an 0.95US\$ exchange rate, currently the nickel price at US\$8.3/lb and a 0.81US\$ exchange rate equates to 10.25A\$/lbNi)
- 2. Silver Lake** : We accept that the share price has fallen to as low as 15c, but how many gold mines are debt-free, treat at ~14g/t (July 2008), encounter 10m @ 6kg/t (6,000g/t in a development drive), have a development face averaging 57g/t, have the capability to double their mill size and could exceed our forecasts of 70,000ozpa by possibly up to 50% more in their first year, potentially generating profits of \$1m to \$2m per month.
- 3. Territory** : Yes we accept that it lost heaps ~\$50m or more last year investing in Monarch etc etc. But at Diggers it was selling its lump at ~A\$110/t, fines at A\$90/t, say A\$100/t on a 50/50 basis. Costs are A\$70/t falling to A\$60/t (and targeted to go lower), say a margin of A\$35/t, which at 2mtpa = \$70m less tax = ~\$50m NPAT less exploration etc = \$40m (and revenues may be US\$/t and not A\$/t, so the figures could be higher).

At Diggers, we also visited Norton Goldfields (NGF) and Independence (IGOs) operations, viz :

- 4. Norton Goldfields** : Being overlooked because of the Paddington history by Pancon. We were surprised by the upside potential seen on the visit (ahead of Diggers) with the old Padd I & II pits to be used as tailings storage (20 years at ~3.5mtpa).
- 5. Independence Group** : Remains a favourite, despite its share price collapse to under A\$3/share. Long-Victor and Tropicana could continue as low cost operations until the “cows come home”.

Reflecting on last year’s post DnD comment, where we recommended holding on to Consmin (CSM) for \$5/share, which happened. If shareholders had not sold, with a current Mn price of US\$16/pmu, CSM is now worth ~\$22.70/share (based on our 2006 model), with possible annual NPAT profits of ~A\$600mpa. And apparently Beta-Hunt has come right with a stronger hangingwall.

The new shorting is occurring both in commodities and shares : During the past 6 months, we (ERA) have seen a number of new mega commodity hedge funds form by the big broking/banking houses and apply a long/short strategy of shorting base & precious metals. Selling on a 1 month to 3 month time-frame, rolling forward positions, collectively backed by \$xbn driving metal prices lower, which has resulted in platinum falling by about US\$1,000/oz to ~US\$1,150/oz, and nickel reaching US\$8/lb before the nickel laterite producers started closing and it recovered to between US\$8 and US\$9/lb.

Why are they selling ? Because it is a market like anything else and it would appear that somehow or other, the sub-prime losses have to be recovered/created by any means possible. These new “players” can operate together on market perceptions (possibly even “fanning the flames” of rumours themselves) of the impact of the collapsing US, slowing demand, and the world (including China) grinding to a halt.

In the first month of its operation (May or June), one of the new funds stated that it was up by 20% due to shorting base metals. It can best be described as **analogous** to the gold forward selling/hedging that destroyed the gold price for so many years.

This commodity short selling thrives on perceptions which could result in its ultimate periodical downfall, since for nickel the view appears to be that nickel companies can still produce at \$4/lb Ni and one of the major stockbrokers has predicted that the nickel price is heading to US\$6/lb. There are a few nickel sulphide orebodies that have all-in cash costs of ~A\$4/lbNi due to higher grades or by-product credits such as IGO’s Long-Victor, PAN’s Savannah and Albidon’s Munali.

When Minara and the new Ravensthorpe stated that they were not viable at US\$8/lb, Falcondo closed and Vale’s new nickel laterite 2012 project was shelved, the market recovered, since it is all very well to short base metals assuming that they can be bought when required, but if operations close....then the shorts may not be able to cover.

Should nickel head to US\$6/lb (as some forecasters firmly believe) then Kambalda would largely shut down which would result in BHPB closing the bulk of its nickel division (it needs the high Fe:MgO Kambalda ore to blend with its low Fe ores at Mt Keith etc) for a loss of 90,000tpa Ni to the market. From what we have read despite all the arm-waving, stainless steel demand continues to rise in China, being up 10.2% y-o-y for the first half of 2008 at 3.86mt (and is expected to be at least 8% up y-o-y by the end of 2008, which is still above the annual trend rate).

Nickel pig-iron (despite its environmental shortcomings) has continued to fill the supply/demand gap, increasing to 54,000t in the first half of 2008, compared to ~38,000t in the first half of 2007. However, full year usage is still expected to be in the 85,000t to 100,000t region, depending on just what nickel price level it is viable.

Assuming that the ni-lat projects come on-stream as planned and meet demand as expected and ni-pig iron is uneconomic below US\$10/lbNi, RTM [Resources & Technology Marketing Services] have forecast that the nickel price should remain in the range of **US\$8/lb to US\$13/lbNi between 2008 and 2012**, with the average appearing to be in the US\$9/lb to US\$10.50/lb vicinity and volatility occurring between the expected US\$13/lb high and US\$8/lb low. We (ERA) are using US\$9/lbNi for our long-term forecasting, and consider US\$10/lbNi to be more realistic.

As for the nickel laterites, at Diggers, the audience had a shock when Xstrata stated that the expected capex for **Koniambo was now US\$3.85bn**. That kind of investment needs a much higher nickel price to produce any form of viable return, and casts a big question over the future of nickel laterite projects.

The rising costs of labour are certainly beginning to hurt (most mining wages have doubled in Australia in the past year, driven by the demands from the iron ore industry), with Newmont flagging possible closure of the Super Pit because its cash costs are ~A\$860/oz (due to rising costs and lower than expected grades, although that may solve a large chunk of the labour shortage issues).

As for the share prices, which have been decimated across the board, the reason for the share price falls is partly due to **sophisticated covered short selling**. The process was described in the SDIA Conference (partly sponsored by the ASX) in May 2008, and as one speaker commented “how do you think your super fund gets its extra 0.5% to 1% annual performance ?”.

The following purely hypothetical transaction that takes place is that a large broker (apparently often with international connections) approaches an insto (possibly an index fund, Insto A) that has a sizeable holding in a company (Company A) that it does not intend to sell, and offers it the ability to earn 0.5% to 1%pa on its holding by making it “available” should it be required. The broker then offers a facility, say 0.5m shares in Company A to another insto (Insto B) should it require it.

Insto B then sells say 2m shares in Company A when the market opens on Day 1, and only manages to buy back 1.7m shares during the day, so it is 0.3m shares “short”. The broker notifies Insto A that it needs to borrow 0.3m Company A shares overnight and from an ASX viewpoint, the buys and the sells match.

The sale in Company A by Insto B was not reported as a short sale, because it has effectively been a covered sale. The next day (Day 2), the 0.3m balance can be purchased and the borrowed shares returned. By completing the transaction within 3 days, no change in ownership appears to have occurred. However, it should be recognised that Insto B could sell another 2m shares on Day 2.

It is very difficult to regulate this practice as it is unofficial/ unrecognisable short selling because the buying and selling is “matched” from an ASX viewpoint by the end of the day. To put it into perspective, in one day in May 2008, 30.5million trades occurred on the ASX or about 1,400 per second for 6 hours. On the LSE, trades average ~4,200 per sec. Basically computers are trading with each other with the mega and large trades now broken up to a maximum size of 20,000 per trade which has been determined by quants as resulting in the most representative traded price.

So how to stop it, possibly through buy-backs as we have already seen by cashed up companies like Independence (IGO), buying back stock and cancelling it. Players short a company unless they think there is a risk of not being able to cover the short position, in which case they move on to another stock.

As for China stopping. We were last in China (in Sichuan and Guizhou) in June 2008 and saw more steady growth than “flat-out” growth. Still significant as in Chengdu (pop ~ 12m or 16m) putting in a new underground/metro system from scratch, and new sky-scrappers on corners. We can recall a previous “sabre rattle” occurring in March 2004, before it was shown to be unfounded & rallied.

So as for the commodity boom ending, yes China is slowing, its growth rate in July was 10.1% compared to 10.6% in June, although its copper imports actually rose from 174,000t in June to 186,000t in July, and it reported power restrictions due to a shortage of coal. China has a reputed US\$5trn “war-chest” to drive its economy independent of the rest of the world. Even if the US does completely “fall-over” it may only reduce China to a more normal 7% to 8%pa growth, which is still significant.

Silver Lake (SLR)

– Making steady progress to increase production. Rated : Spec Buy (A\$0.155)

When we revisited the mine on Thursday 7 August (after Diggers), we saw the 10m @ 6kg/t (6,000g/t) encountered in the development drive’s sidewall as shown in Figure 1a.

Figure 1. Sidewall of 6kg/t underground, Old PEM Development 20 Lev, New SLR Development 21Lev
 a. Sidewall of 6kg/t underground b. Old PEM development 20Lev c. New SLR development 21Lev



SLR’s Daisy Milano mine continues to suffer from the fact that Perilya (PEM) operated the mine unsuccessfully. Aside from the fact that PEM did not have their own mill and were trucking to Coolgardie for toll treatment, the differences in the stoping and development methods are clearly shown in Figure 1b, where PEM was mining its development on 20 Level at 5.5m x 5.5m, compared to SLR’s 3m high x 2m wide drive in the same position on 21 Level as shown in Figure 1c.

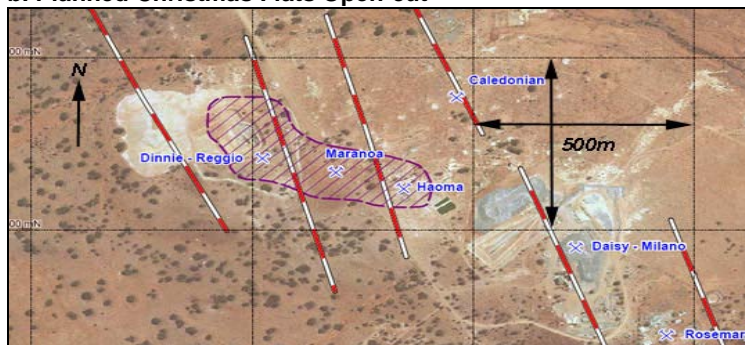
Daisy-Milano has a hangingwall and a footwall orebody separated by about 8m of waste, and PEM were taking “the lot” including the waste, from PEM’s main footwall drive. Whereas SLR have cross-cut across (to the right) of the picture (Figure 1b) in 3m high x 2m wide development to develop along the hangingwall orebody, and mine the two orebodies separately as 1m wide or 2m wide stopes (depending on how many lodes are present when each level has been developed as shown in Figure 2a of a 1m wide air-leg stope.

Figure 2. 1m wide Air-Leg Stope, Planned Christmas Flats Open-cut

a. 1m wide Air-leg Stope

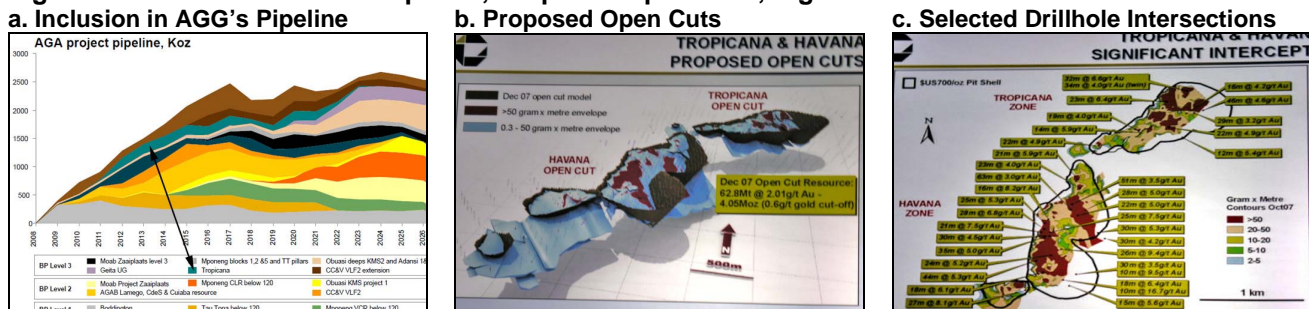


b. Planned Christmas Flats Open-cut



We visited some development at Victor South that illustrated just when you think the orebody may have finished it hasn't due to the fluidity of nickel sulphide as shown in the blasted face northwards (to confirm sterilisation) in Figure 4a that was grading ~18%Ni (which is now to be blended with lower grade ore to achieve the 3.6%Ni [or higher] target for this year to June 2009). IGO expected to develop a further 4 to 5 levels at Victor South, with potential still lying between Victor South & Victor. IGO's presentation showed further extensions to McLeay as shown in Figure 4b, and IGO have been experimenting with seismicity to locate Long South as shown in Figure 4c.

Figure 5. Inclusion in AGG's Pipeline, Proposed open Cuts, Significant Drillhole Intersections



IGO also provided some updated details of the progress of its Tropicana JV with AngloGold Ashanti (AGG or AGA). Located about 330km NE of Kalgoorlie, Tropicana had resources of 62mt @ ~2g/t (diluted) or ~4.05moz in Dec 2007 (using a 2g/t cut-off, the head grade could be ~3.5g/t). Since then the orebody has been infilled 25m x 25m (was 50 x 50) and there have been a number of intersections outside the resource (so it is probably heading for 5moz). The orebody lies under sand dunes at an average depth of 10m (ranges from 3m to 25m because of the dune heights), resulting in an SR of ~6.5:1. The likely production rate appears to be ~5.5mt to 6.0mtpa for 350,000oz to 400,000ozpa at a 91% recovery and capex of ~\$500m (including the road and everything).

Cash costs are A\$450/oz depending on the power costs. If diesel is used then at the high prices it is 35c/Kwh and probably higher than \$450/oz, whereas hybrid options are being considered such as solar energy. Apparently a hybrid solar energy plant is operating in Spain (and capable of storing energy overnight) has a cost on solar power of 10c/Kwh. Add gas-diesel and it becomes ~20c to 30c/Kwh. Due to the hybrid power possibilities and other considerations such as HPGR (high pressure grinding rolls that could reduce power costs by 30%), the PFS is taking longer. Now due March 2009, followed by a 6-month BFS with a production target ~2011. IGO were free-carried up to PFS completion, and are retaining their 30% by initially contributing to some of the exploration.

However, **AGG have already included Tropicana in their production pipeline** as shown in Figure 5a (from their Diggers n Dealers presentation), with the proposed open-cuts in Figure 5b and some of the intersections in Figure 5c.

Norton Goldfields (NGF)

– Rated as a Spec Buy (A\$0.16)

We (ERA) have not written a report for NGF, but visited Paddington on a pre-Diggers visit (Sun 2 August) out of interest as the last time we saw the Padd I and II pits was when Pancon was mining them (many years ago....in fact it was interesting to see the Chariots of Fire film was on Australian TV at the time of the Beijing Olympics – we can recall a video of the Pancon board running through the surf to that soundtrack in their last AGM).

When we saw NGF's JQ08 result of ~30,000oz at a grade of 1.36g/t and cash costs of A\$1048/oz, we thought they must still be mining the old Paddington pits which graded about 1.2g/t in one and 1.4g/t in the other, and were not sure whether they became refractory with depth. (It occurs in that region if the orebody passes through the Victorious Basalt as at Ora Banda).

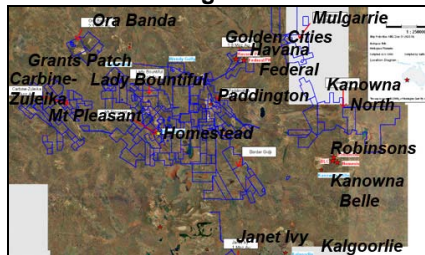
Well for starters, the Padd 1 & 2 pits are being used for tailings storage (3.3mtpa for 20 years) and NGF literally has the whole area as shown in Figure 6a, being Golden Cities, Kundana, Mt Pleasant, Grants Patch, Ora Banda, Racetrack etc etc, and the old plants (it intends to send the Kundana plant to Mt Morgans in QLD to treat the old tailings there at ~50,000ozpa). And after the Bellamel transaction tying in Binduli South (as shown in Figure 6b, which CRS [Croesus] had but apparently did not drill deep), NGF have a significant chunk of the regional area to feed the Paddington plant.

The high cash costs were due to an abnormal loss of about \$10.5m, the loss of 5,000oz costed at \$700/oz, \$3.2m for changing the mining fleet (the new one is faster and cheaper), and \$2m on fixing the 3.3mtpa Paddington plant (including a gravity circuit and bringing forward the planned maintenance due to the WA goldfields gas disruption), which would apparently have reduced costs to about A\$690/oz. NGF estimate that they should produce ~ 75,000oz to 80,000oz at a cash cost

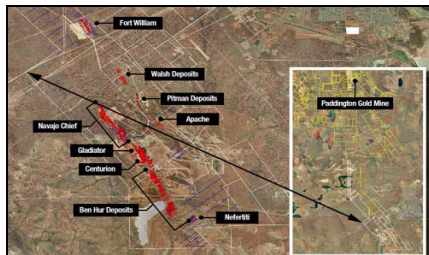
of A\$600/oz to A\$650/oz in DH08 (based on mining 60% from the 1.6g/t to 1.8g/t Havana pit (SR 8 to 1 due to the 25m pre-strip) and 40% from the softer Robinson's pit. The floor of the pit shown in Figure 6c is at an expected 2 to 1 SR based on 2 east-west striking veins that dip at ~60°S.

Figure 6. Plans of Paddington and Bellamel Tenements, View South of Havana (Golden Cities) Pit

a. Plan of Paddington Tenements



b. Plan of Bellamel Tenements



c. View South of Havana Pit



During the coming year, NGF expected to start mining the 2.3g/t Federal pit, which with the underground approval for Homestead (series of vg in quartz veins, mining 60,000 to 70,000ozpa at 6.3 to 7.0g/t vs 12g/t in-situ), the production in the 09/10 year could increase to ~250,000ozpa at cash costs of A\$600/oz to A\$625/oz (costs remain high due to labour and consumables).

The concept behind NGF is that the directors are ex-Felix Resources, and are trying to do it again, namely generating a >\$1bn company from something less than \$50m in size. The Paddington operations assets having been bought from Barrick for \$39m.

Additional Information

As usual at Diggers, a wealth of information is shown and presented. Some of the notable highlights that affect some of the companies we have researched are :

BHPB comments about its nickel concentrator at Kambalda :

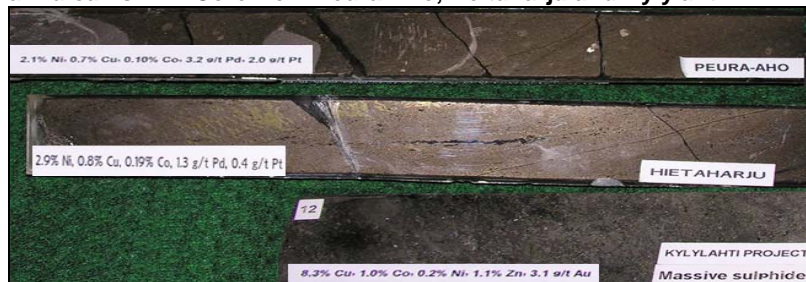
Either by the end of June 2008 or during the shutdown, BHPB had debottlenecked its nickel concentrator and raised the capacity from 1.7mtpa to 2.0mtpa, and were now considering various expansion options. BHPB appear to be intending to have their own (actually were WMC's) Kambalda operations again, having entered into a deep 3d seismic JV agreement with Mincor examining the old workings north of Otter Juan and Durkin. So PAN has received its increased allocation from BHPB to 455,000tpa to June 2009 for Lanfranchi and probably could go higher.

Vulcan's Nickel Drillcore

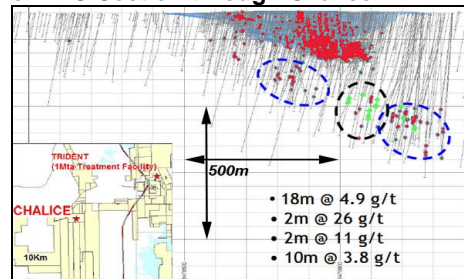
In the Vulcan booth were intersections from their new drilling at Peura-Aho and Heitaharju showing massive nickel in core in Figure 7a. Kylylahti continues to make progress and the decline was expected to intersect the orebody in early 2010.

Figure 7. Vulcan's drill core from Peura-Aho, Heitaharju and Kylylahti, AVO Section Through Chalice

a. Vulcan's Drill Core from Peura-Aho, Heitaharju and Kylylahti



c. AVO Section through Chalice



Avoca's new Musket discovery and Progress at Chalice

Avoca reported on their upcoming Musket discovery (which has since been announced) and that new mineralisation had been discovered in the "gap" at Chalice (shown in Figure 7b), so Chalice was to be dewatered & the decline re-opened, the same as at Trident, for AVO's second operation.

Disclosure:

Keith Goode, who is an Authorised Representative with Taylor Collison Ltd ACN 008 172 450, and is a consultant with Eagle Research Advisory Pty Ltd ACN 098 051 677 compiled this comment. At the date of this report Keith Goode and his associates held interests in the shares contained in this report.

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