



# BEACON ROCK RESEARCH

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## 2008 EMERGING PRODUCERS VALUE INVESTOR - SPECIAL REPORT

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Disclosures 1,2,3,4

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### Emerging Producers Attractive to Value Investors

There appears to be an enhanced investment opportunity for long-term value investors in emerging producers selling near cost of investment or book value. We see the mining sector becoming of interest beyond the mining sector as value investors screen for companies selling at 52-week lows, below book value, and with potential to expand margins and earnings. We sense that redemptions in the near-term, along with tax loss selling in both the U.S. and Canada, may create opportunities for value investors looking to acquire companies with real assets with potential for increasing production.

Key to our investment thesis is profitable operations and viability, given metal prices in the current economic environment. As a result of reduced global lending and investment, a shortage of liquidity has resulted in a deflationary environment unfavorable to commodities, including precious and base metal prices.

Recent actions by governments and central banks are largely inflationary, which should lead to higher gold and silver prices as banks begin to lend and invest. A reduction in credit risk should spur a resumption of global growth, increasing demand for commodities and leading to higher base metal prices. While this cycle appears inevitable to long-term investors, this scenario may be delayed by credit markets or anti-growth policies including protectionism, higher taxes, and increased regulation.

It follows that deflation in the near term should be favorable for companies that have cash or the ability to operate profitably at current metal prices. Clearly, the inflationary environment in the mining industry in 2007 has reversed and costs of labor, materials and supplies are moderating or declining. Recent declines in the price of fuel lifts a burden on both operating profits and a barrier to resumption of economic growth. As this situation persists, should metal prices rebound, margins will also expand, leading to potentially significant appreciation for emerging producers above current levels.

China continues to be important for sustained economic growth through wealth accumulation and investment in infrastructure. Despite concerns over declining rates of growth, China still maintains near double-digit annual growth rates. The ongoing demand for precious metals as a store of value, and base metals for the production of goods and infrastructure, remains immense. China's 1.3 billion people consumed \$1.2 trillion last year, while America's 300 million consumed \$9.7 trillion. While China is criticized for lack of domestic markets, this situation may be reversed as financed by its central bank's reserves, largely composed of U.S. treasuries.

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## **NovaGold's Market Cap Significantly Less Than Book value of its Three Projects**

NovaGold Resources Inc.'s (AMEX: NG) market cap is currently about \$270 million. This is roughly equivalent to the book value of only its recently started Rock Creek mine including property, plant, and equipment, plus development costs. This would imply that the market is currently attributing no value for NovaGold's share of its 50% ownership in its two world class projects, the partnership with Barrick Gold Corporation (NYSE: ABX) on the Donlin Creek gold project and with Teck Cominco Ltd. (NYSE: TCK) on the Galore Creek copper-gold project. NovaGold's share of the total investment in property, plant, and equipment plus development costs at Donlin Creek is \$238 million, with \$360 million on the Galore Creek project, for a total of \$868 million on these three main assets.

NovaGold's market capitalization is now less than one third of its share of the capitalized investment in these projects. NovaGold maintains these figures on its balance sheet, indicating its confidence that these projects will reach production (otherwise they would be written off). This is one valid indicator that NovaGold and its auditors consider that their current economic models justify economic value for these projects at book value using long term metal prices. It would follow that NovaGold's market capitalization and share price are significantly undervalued relative to one of the most conservative valuation metrics of a company's value and economic potential.

We understand that Barrick Gold is working toward completion of a Feasibility Study on Donlin Creek by 1Q09. This would mean that a majority of NovaGold's 50% ownership of this gold resource of 31.7 million Measured and Indicated ounces should move into the reserve category and allow for the start of the permit process. In addition, Teck Cominco is anticipated to provide an update on the Galore Creek project before the end of 2008, on a modified project layout that could potentially expand overall throughput and has focused on areas to reduce the construction schedule and risks associated with construction execution and operations. The selection of a new design plan is an important milestone for the project, and would be the basis for an updated Feasibility Study and initiation of permitting. Continued development by Barrick and Teck Cominco should assure markets, leading to NovaGold's market cap appreciating back toward at least the book value of these projects. Supporting this are reports from the senior producers that recent reductions in key mining inputs such as oil and steel are indications that operating and capital cost pressures may be moderating.

NovaGold is in the process of commissioning its Rock Creek gold mine in Nome, Alaska, and has recently completed its first gold pour. NovaGold is scheduled to produce 100,000 ounces annually, generating an estimated \$25-\$35 million in 2009, at an average cash cost of \$500 per ounce. NovaGold is working to increase the resource to extend the mine life to ten years. Management estimates that production from the Rock Creek mine, plus cash on hand and proceeds of other non-core assets, should provide funds for planned activities for the next twelve months. In uncertain times NovaGold remains a viable company with significantly undervalued and unrecognized assets.

**Figure 2 - Ore Pile, Rock Creek Mine, Nome, Alaska  
Source: NovaGold**



**Figure 1 - Gold Pour, Rock Creek Mine, Nome, Alaska  
Source: NovaGold**



### **Etruscan's Market Cap Less Than Half Book Value of Youga Gold Mine And Does Not Include Development Potential of Projects in West Africa**

Etruscan Resources Inc.'s (TSX: EET) market cap is currently about \$42 million. This is less than half of Etruscan's investment in property, plant, and equipment, plus development costs for the Youga Gold project of about \$109 million. This is also less than the revised construction budget for the Youga Gold Mine of \$59 million, which included a back-up generator and spare drive train.

The Youga Gold Mine produced 6,572 ounces of gold in September, 98% of its estimated average monthly production, and with further optimization should be in position to build its treasury to fund further development. Cash cost should improve through project stabilization to an estimated \$450 per ounce for the life of the mine. The project includes a program to limit price exposure of the gold price on the downside to \$629 per ounce.

At the current market cap, the market does not fully value the cost of the Youga Gold Mine or Etruscan's other assets. Etruscan may have the largest land position of any mining company in West Africa, acquired at a time which allowed a preferential position of prospective properties. Investors familiar with the Etruscan story may be familiar with numerous targets in Mali or in Côte d'Ivoire.

We are looking for additional reports on their Bitou project about 35 kilometers from the Youga Gold Mine and new discoveries in southwest Ghana. We are also quite keen on further developments on its recently announced rare earth deposit in Namibia. As the market cap of the company is now less than the construction cost or book value of the Youga Gold Mine, value investors have the upside to increasing gold prices, as well as exploration in West Africa, Namibia, and its diamond assets in South Africa.



**Figure 3 - Youga Gold Mine, Burkina Faso**  
**Source: Etruscan**

### **Minefinders' Market Cap Less Than Book Value And Half Base Case at Long-Term Metal Price Assumptions**

Minefinders Corporation Ltd. (AMEX: MFN) has a market cap of about \$200 million. This is slightly less than the book value of its Dolores gold-silver mine in Chihuahua, Mexico. Current book value of the Dolores mine, including property, plant, and equipment plus development costs, totaled \$203 million as of the end of June 2008. The total budget for the project is \$191 million, which includes about \$10 million for contingency, with available cash and credit to complete construction. Incidentally, Minefinders recently negotiated an additional \$10 million in credit for additional working capital.

Minefinders recently began leaching ore, a major milestone, and anticipates its first gold and silver production in the next few weeks. Previously they had targeted producing 10,000 ounces of gold and 350,000 ounces of silver in the remainder of 2008. This may be a challenge, but they do report crushing at a rate of 15,000 tpd, close to the design capacity of 18,000 tpd. Estimated operating cost for gold equivalent during ramp up may range from \$400 to \$450 per gold equivalent ounce, declining to \$297 per gold equivalent ounce over the average life of the mine, scheduled for 15 years.



**Figure - 4 - Stackers Place Ore on Leach Pad**  
**Source: Minefinders**

The Dolores open pit mine currently has 99.3 million tonnes of Proven and Probable reserves containing 2.44 million ounces gold and 126.6 million ounces of silver. The most recent economic study estimated an NPV at a discount rate of 3% to be \$563 million (metal assumptions of \$675 gold and \$13 silver). The study did not include the potential benefit of adding a 3,000 tpd flotation circuit to increase recoveries of gold and silver in the pit or located in a high-grade gold-silver resource below and parallel to the identified reserve. As Minefinder's market capitalization is less than the book value of its investment, and less than one third of its base case economic study at current metal prices, we also consider the company to be significantly undervalued and of interest to value investors.

### **Mercator's Market Cap Less Than Book Value And Profitable at Significantly Lower Long-Term Metal Prices**

Mercator Minerals Ltd.'s (TSX: ML) market cap is currently about \$150 million. As of June 30, 2008 the book value of its Mineral Park mine near Kingman, Arizona, including property, plant, and equipment and development costs were over \$141 million. The original budget for both phases of the 50,000 tpd facility (\$128 million for stage one and \$62 million for stage two) has increased to about \$200 million. As Mercator is completing commissioning, is anticipating production in the near term, and has completed and paid for about 40% of stage two, it is very likely that their market cap is less than the book value of the Mineral Park mine.

The first stage of the Mineral Park mine was financed by debt. The balance of the second phase will be paid out of cash flow from the first phase, remaining cathode copper production, and cash from the sale of its silver stream to Silver Wheaton Corp. (AMEX: SLW). The mine has an estimated mine life of 25 years, and with a strip ratio of only 0.18, the project has good economics. Cost of production, assuming a 50-50 split for production of copper and molybdenum (net silver credits from Silver Wheaton), is estimated at \$1.28 per pound and \$6.49 per pound, respectively.

Their pre-feasibility study, assuming metal prices of \$1.53 copper, \$10.16 molybdenum, and \$7.50 silver (prior to the sale to Silver Wheaton), estimated an after-tax IRR of 51% and NPV of \$426 million with 1.8 year payback of capital. As Mercator's market capitalization is about one third of its base case pre-feasibility study, and is likely less than the book value of the Mineral Park mine, the company should be of interest to risk averse value investors.



**Figure 5 - Mineral Park Mine, Kingman, Arizona**  
Source: Mercator

### **Acadian's Market Cap Less Than Scotia Mine Book Value And Replacement Value Despite Significant Gold Assets**

Acadian Mining Corporation's (TSX: ADA) market cap is about \$13 million. This is less than one half book value of their Scotia Mine operation in Nova Scotia, including property, plant, and equipment plus development costs of approximately \$30 million. This includes the cost to acquire the mothballed Scotia Mine and bring it into production. Management estimates the replacement cost of the Scotia Mine to be about \$100 million.

Acadian brought the operation into production in 2007 on time but faced challenges in early 2008 due to difficult weather conditions. This was followed by declining zinc and lead prices. Management estimates an operating breakeven rate of \$0.55 per pound zinc-lead, and overall company breakeven of \$0.59 per pound zinc-lead. This was prior to the decline in the Canadian Dollar to the U.S. Dollar, which benefited Acadian, as their costs are in Canadian Dollars. Prior to declining metal prices, management implemented an aggressive cost reduction program, with plans to resume development of its gold assets in 2009.



**Figure 6 - Scotia Mine, Nova Scotia**  
Source: Analyst

Acadian has a gold resource in Nova Scotia of about 1.6 million ounces. When Acadian acquired the Scotia Mine it was expected to centrally process gold resources. Record zinc and lead prices accommodated restart of the mine as previously designed. Should base metals stabilize at lower levels, we expect management to revisit the original concept of processing gold ore. We estimate this could be accomplished in six to eight months at a cost of \$5 to \$10 million.

We remain bullish on base metal prices in the mid to long-term. Many mine operations are unsustainable at current metal prices. We perceive good potential to return to long-term metal prices for zinc and lead of at least \$0.60 to \$0.70 per pound in the near to mid-term with reduction of production and declining inventories or increased economic growth.

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This report has been written in accordance with current SEC regulations and the Standards of Practice developed by the Chartered Financial Analyst Institute (CFAI). Our research has been conducted by employing analytical practices generally accepted as standard within the analytical industry. In this instance, a comparison of financial strength, a bottom-up earnings projection based on a recovery in the U.S. economy, and relative multiples, were employed. Target prices are calculated on comparative EPS, sales and book value multiples, and our knowledge of small-cap markets when enjoying both a sector and a cyclical rebound. Our conclusions are, by the very nature of forecasting, speculative, but are also reasonable, supportable and consistent.

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