HALLGARTEN & COMPANY

Latin Mining Viewpoint

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THE NEW *CONQUISTADORES* OF MINING

A Gentler Invasion

Ever since the days of the Spanish *Conquistadores*, Latin America has been closely associated with the production of metals. With prices for both precious and base metals currently in the fourth year of a strong sector bull market, the benefits that this has brought to Latin America need little preamble from us. Well-established large-scale metals producers have turned into veritable licences to print money. Be it copper from Chile, gold from Peru, iron from Brazil or silver from Mexico, the profits have rolled in. The well-established players have become darlings of Wall Street, and there is an embarrassment of triple digit stock price growth stories to choose from as examples.

The rise in revenues from established metals mining in the Latin America region has been exponential. Codelco, the world's biggest copper miner and owned by the Chilean state, is an excellent benchmark to show how money has flowed into the region via base metals. In 2002 they produced 1.62MT copper and received revenues of U$3.49Bn. In 2006, production had upped a little to stand at 1.78MT copper, but revenues were up an impressive fivefold to stand at U$17.1Bn. On the precious metals front, South America's biggest gold operation Yanacocha, owned by Newmont (NEM) (51.5%), Buenaventura (BVN) (43.5%) and the IFC branch of the World Bank (5%) had revenues in 2002 of $540m. In 2006, revenues had climbed to a whopping U$1561m even though production volumes had again stayed basically flat.

Dusting off old plans

However it is the opening of a new wave of mines up and down the continent that catches the attention. The rise in profits from late 2003 brought with it at that time an exponential increase in cash available for regional exploration and pre-production work. Many projects that were economically non-viable in the dog days of the late 90s were quickly re-examined and found to be worthy of investment. Prospects left dormant for decades were suddenly snapped up by those companies wishing to boost reserve assets. Geologists started combing for the next big orebody. And today some of the savvier early birds' actions have begun to come to fruition. From the largest of the large to the smaller independent miners, projects and early stage pre-production explorations dating back to the start of the boom are now on the verge of becoming living, breathing real mines, with production, revenue, free cash flow and all the other things that mining executives dream about.

We have chosen four examples of new projects currently bearing or about to bear their first fruits. While admittedly a mere scratch on the surface of the new projects now coming to life up and down the region, they do give an idea of the wide cross-section of metals, countries and project sizes on the rise across the length and breadth of Latin America.

Brazil: Copper

In the last four years, CVRD (ticker: RIO) has ballooned into the number one iron ore producer in the world and has expanded via aggressive acquisition of several other mining companies, the latest being last year's takeover of Inco. However the company has also been growing organically, and has diversified into copper production via its now producing Sossego pit close to its main iron ore production centre in the Amazon basin. Currently at 80% capacity and ramping steadily to its projected capacity of 140,000T copper per annum, it will soon be joined by the close-by Salobo and Alemão projects that have an estimated copper content of 10 million tonnes of pure red metal. The gross metal value of that copper is $77Bn at today's spot rates, which although rather a trite calculation does highlight the size of the projects RIO is currently undertaking. The close proximity to the RIO iron ore pits will add plenty of cost-cutting synergies to the new copper arm.

We feel that the days of labeling RIO "an iron play" are numbered, as the RIO of tomorrow looks set to fight BHP Billiton (BHP) for the coveted top spot in world miners on equal product terms.

Bolivia: Silver

Apex Silver (SIL) is currently in the last phase of pre-production at their mammoth silver project at San Cristobal, Bolivia. It is 65% owned by SIL and 35% by Sumitomo of Japan, production is due to start in September 2007. The reserve is calculated to hold 467m oz silver at 63g/t as well as 8 billion lb zinc and 3 billion lb lead. Once full rhythm is reached, San Cristobal will be one of the world's biggest silver miners, projected to process 40,000T ore per day and produce a touch under 17m oz silver per annum at under U$2/oz cash cost.

Although the project lies in the apparently politically unstable Bolivia of Evo Morales, there is much to like about the macro situation as regards SIL. Firstly, it is situated in the politically clam region of South Western Bolivia, well away from the Santa Cruz hotspot. Secondly, it has the active support of a government that still wants to attract foreign investment. Thirdly, and our view most importantly, the minority shareholder is Sumitomo. The Japanese conglomerate has the finest of reputations in Bolivia. Respected by all sides of the political and economic spectrum in Bolivia, Sumitomo has a long history of social and community works and honourable conduct in Bolivia. With Sumitomo as the sleeping partner, the future stability of San Cristobal is virtually guaranteed. SIL could not have made a finer choice of partner.

We like SIL at its current price of $15 and see upside to the $25 range by the start of production. The current market cap of around U$900m is also the kind of size that will catch the eye of fund managers as it steams past the $1Bn barrier in the near future.

Peru: Tungsten

With a market cap of around U$63m Dynacor (DYN.to and available as US pinksheet MSDRF.pk) is a much smaller operation than the first two outlined, though that should not put investors off the idea of looking into the company as a long-term investment. DYN's main asset is the Pasto Bueno tungsten mine in Peru, around 500 miles north of the capital, Lima. Production has already started at Pasto Bueno, but due to the nature of the beast, full production tonnage at their number one mill of 250 tpd is only now being handled. The early production was also of a lower grade as stripping rates have been higher than the ratios fully expected when the mine is working at full tilt. The company plans to extend production to 750 tpd via its number two mill in the mid-term future and has already put down capex to upgrade the electricity supply system at the site.

Tungsten prices languished at around $50 per MTU (the industry standard 10kg quantity) in 2002. Even at the beginning of 2005, the price per MTU stood at less than $100. With tungsten currently fetching $260 per MTU and stable at this price range through 2006 and 2007 to date, there is plenty of profit in the metal. There is much demand for the high quality tungsten mined by DYN too, and the company has already signed up with end user Osram to supply the light bulb manufacturer with all production at spot prices. China supplies around 75% of the world's tungsten, and with the Asian giant using more itself and exporting less, supply squeezes on the world market which benefit DYN are logical for the mid-term future of the metal. We see plenty of upside in this stock currently selling at a discounted U$0.56.

Argentina: Gold

Minera Andes (MAI.to/MNEAF.ob) is another on the cusp of production. We have watched this stock since it was a valiant (and lone) pioneer in the mid-1990s. It has been our favored junior miner exposure to Argentina for quite some time. It will be quite an occasion in 3q07 when, if all goes to plan, production begins at their San Jose mine in Southern Argentina.

Much of the San Jose project has already been built. This includes a 28 kilometer all-weather access road, more than 7,000 meters of underground workings such as tunnels, drifts, ore passes and raises, two 45-degree incline shafts, and surface structures for vehicles, power, employees, equipment storage and drill core storage, among other uses. Construction of the mill and extraction plant is underway.

The current resource, as shown in the feasibility study, is 700,000oz of gold equivalent. Using a cutoff grade of 100g/t, the Huevos Verdes vein has an indicated resource of 1,058,000 tonnes with a silver grade of 266.8 g/t and gold grade of 3.1 g/t, for a total of 9,075,300oz silver and 106,000oz gold.

MAI were one of the first juniors to set up stall in Argentina, and have maintained their vanguard position all the way through the ramp-up process. They are teamed up with the veteran Hochschild Group from Peru in the upcoming mine. The management team has shown their worth throughout the pre-production phase, and has earned the praise of none other than Rob McEwen of US Gold (UXG), who bought a 23.5% slice of the company. Significantly, it is the only US Gold investment outside of the Nevada Cortez trend to date.

Beyond San Jose, the company has other prospects that could be brought into development with cashflows from the San Jose mine. One is Los Azules, for which Minera Andes has a letter of intent signed with Xstrata. The potential of this deposit is suggested by the results of the first one-third of the scoping study, completed early 2006. In that work, significant high-grade copper was discovered. An eleven-hole drilling program returned intervals including 1.62% copper over 221 meters and 1% copper over 173 meters.

If anything the biggest negative for Minera Andes was its listing situation. First it was Vancouver and Bulletin Board, now it has shifted to the main Toronto board and intends to get an AMEX listing when its price is over US$2 for a sustained period. Despite this the company has managed to be a very big name in Bulletin Board trading with volume well exceeding that of the Canadian listing on most days.

Conclusion

The New Conquistadores in the region are now ready to make their mark. Established players will continue to be extremely profitable, but we look to the dynamic producers and new regional players as the next wave of success stories in the dynamic and highly profitable LatAm mining sector. There are plenty of plays on the verge of production or even producing still priced as if they were junior exploration concerns. A little research will uncover many more promising investment opportunities than the handful outlined above.

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