Thursday, September 12, 2013

HALLGARTEN & COMPANY

Corporate Action

Christopher Ecclestone
cecclestone@hallgartenco.com

Donner Metals (DON.V)

Strategy: Long

Trampled by an Elephant

Key Metrics			
Price (CAD)	$ 0.005		
12-Month Target Price (CAD)	$ 0.03		
Upside to Target	500%		
12mth hi-low CAD	$0.005 - 0.205		
Market Cap (CAD mn)	$ 1.6		
Shares Outstanding (mns)	311.8		
Fully Diluted (mns)	401.9		
	FY12e	**FY13e**	**FY14e**
Consensus EPS		n.a	n.a
Hallgarten EPS		n.a	n.a
Actual EPS	($0.020)		
P/E	n/a	n/a	n/a

Donner Metals

Trampled by an Elephant

- + Donner still has cash, an NSR, the rump of its Matagami exploration projects and a holding in Sandstorm shares
- ✘ A failure to make a payment under the partners' agreement resulted in a default that caused Donner to lose its 35% stake in the new Bracemac McLoead mine
- ✘ It was forced into a restructuring of the holding which left it with scant consolation prizes
- ✘ Investors who participated in a financing on the eve of the default have suffered large losses
- ✘ Donner remains enmeshed with Glencore-Xstrata as a partner in the other exploration properties in the Matagami district
- ✘ The market effectively regards the company as "over", though that is not necessarily true

Another One Bites the Dust

In our hunt for "fresh meat" in the zinc and lead space, a lot of effort is expended for the discovery of precious few pearls. In itself this is a sign that there is a much more severe supply shortage coming down the pike in these two metals than in copper.

One of the names we came across in 2011 and adopted as a favorite was Donner Metals, a Toronto Venture Exchange-listed development and exploration company focused on base and precious metal projects in Abitibi region of central Québec. Its flagship project was a partnership with Xstrata's Canadian subsidiary in the Matagami Mining Camp encompassing both the current development of a new mine and on-going exploration activities. The project was supported by Xstrata's existing mine infrastructure, a highly experienced workforce and an operating 2,950-tonne per day mill. As well, the area was serviced by highway, power, airport, railroad and town site infrastructure. What could go wrong? From the outside it's not entirely clear but what was a benign regime at Xstrata turned into a decidedly more predatory crew after the merger with Glencore. Using a technical default by Donner in the current tough financing environment Glencore-Xstrata moved in for the kill and stripped Donner of its prime asset.

What went awry…

In the first days of September 2013, Donner announced to the markets that, as a result of an uncured default under the Metal Purchase Agreement dated July 12, 2011, entered into by Donner, Sandstorm Metals & Energy Ltd., Sandstorm Metals & Energy (Canada) Ltd. and Sandstorm Gold Ltd., Donner had forfeited its interest in the Bracemac-McLeod mine. This was a brutal blow that sent Donner's shares as low as they could go and sent shareholders reeling. What stunned us was the mercenary attitude of the partners of Donner that should stand as an object lesson to all and sundry in the mining market. In these days of beggars can't be choosers some may still be tempted to deal with these parties on their terms but it's definitely a case of *caveat emptor* when taking money from these parties. This note shall attempt to look at the recent history and muse upon whatever residual value Donner might have and how it can take its distance from its unfortunate bedmates.

Consolation Prizes?

In summary, Donner, Sandstorm Metals and Sandstorm Gold and Glencore agreed:

- Glencore would issue a 3% NSR royalty to Sandstorm Metals on 100% of production from Bracemac-McLeod, in consideration for the interest in Bracemac-McLeod acquired by Sandstorm Metals from Donner and for an option to acquire certain Donner shares and warrants they held

- Sandstorm Metals and Sandstorm Gold would relinquish their copper stream and their gold stream respectively.

- Sandstorm Metals will issue 1.33 million shares of Sandstorm Metals to Donner and Donner has provided each of Glencore and Sandstorm Metals with an irrevocable and unconditional release and discharge of any claim by Donner against Glencore or Sandstorm Metals and Donner agreed to an orderly execution of the agreement.

- Donner will receive a 1% NSR from Sandstorm Metals and Sandstorm Gold from any proceeds from the 3% NSR that exceed CDN$49 million.

The Missing Part – Financing

On July 18, 2013, Donner announced that it had completed a portion of its previously-announced brokered private placement for gross proceeds of CAD$2,787,010. The offering was completed on a best-effort agency basis through Secutor Capital Management Corp. and Marquest Capital Markets.

Donner issued via this transaction:

- 35,100,000 units (one share and one full warrant at of C$0.10 until July 17, 2018) at a price of C$0.05 per unit, for gross proceeds of $1,755,000

- 17,200,166 "flow-through" units at a price of C$0.06 per FT Unit, for gross proceeds of $1,032,009.96

The flowthrough units consist of one Common Share designated as a "flow-through share" and one Warrant. Each Warrant entitles the holder thereof to acquire one Common Share at a price. Should the closing price of the common shares on the TSX Venture Exchange be equal to, or above C$0.15, on 20 consecutive tradings days, the term of the Warrants will be reduced to 30 days from the 20th day.

Donner elected to pay a portion of the commission to the agents through the issuance of an aggregate of 3,813,814 Units and also granted to the agents an aggregate of 4,707,015 compensation options. Each such option entitles the agents to acquire one Common Share at a price of C$0.05 until July 17, 2016.

It was also revealed that there was the participation of two significant subscribers in the private placement: Sandstorm Metals & Energy (Canada) Ltd. and Marquest Capital Markets. As a result of Sandstorm subscribing for 26,500,000 Units it ended up holding 40,360,330 Common Shares, or 12.94% of the currently outstanding common shares. Sandstorm was also issued 26,500,000 Warrants as part of the Units, the full exercise of which would result in Sandstorm holding 19.76% based on Donner's outstanding common shares at that time.

Marquest, whose subscription for 8,000,000 Units and 8,333,333 FT Units (together with 3,051,051 Units issued as commission) resulted in Marquest holding 19,384,384 Common Shares, or 6.22% of the outstanding common shares. Marquest was also issued 19,384,384 Warrants as part of the Units and FT Units received and issued 3,765,612 compensation options, the full exercise of which would result in Marquest holding 12.70% based on the Donner's outstanding common shares.

In addition to this financing, Donner issued an additional 400,000 Units on a non-brokered private placement basis for gross proceeds of CAD$20,000.

A few weeks later the company had managed to scrabble together some more funds and announced on the 8th of August that it had closed a second tranche of its previously-announced brokered private placement for gross proceeds of C$232,240 to Donner.

This latter financing was completed on a best-effort agency basis again through Secutor and Marquest and involved:

- Placing 3,200,000 units at a price of CAD$0.05 per Unit, for gross proceeds of CAD$160,000
- Placing 1,204,000 "flow-through" units at a price of CAD$0.06 per FT Unit, for gross proceeds of C$72,240

Each unit is the same as those in the first tranche. Each FT Unit was the same as the first tranche except that the warrants entitle the holder to acquire one common share at a price of CAD$0.10 until August 7, 2018. Should the closing price of Donner's common shares on the TSX Venture Exchange be equal to, or above CAD$0.15, on 20 consecutive trading days, the term of the warrants will be reduced to 30 days from the 20th day. Thus the company had now raised **a total of CAD$3,039,250** in connection with this private placement(s).

Donner paid a commission on this later deal of CAD$16,256.80 and also granted to the agents an aggregate of 396,360 compensation options in the second closing. Each such option entitles the agents to acquire one common share at a price of C$0.05 until August 7, 2016.

Marquest acquired 3,000,000 units in this second closing (so the bulk of the issue) and therefore owns directly (i) 22,384,384 Common Shares representing approximately 7.08% of the Company's issued and outstanding Common Shares and (ii) common share purchase warrants or compensation options of Donner exercisable into 26,467,084 common shares. Should the warrants and compensation options be fully exercised, its holdings would represent approximately 14.26% of the Donner's issued and outstanding common shares on a partially diluted basis assuming the exercise of the warrants and compensation options only.

The Legal Shemozzle

Scarcely was the ink dry on the second tranche of the private placing but the wheels started to fall off. The participants must have been left with a very sour taste indeed because we are hard pressed to recall an example where participants in a deal lose 90% of their money within two weeks. But that is what transpired for on the 13th of August, 2013, Donner reported to the market that it failed to make a cash call in the amount of $4.3 million under the Development and Operating Agreement (dating from July 2011) by and between Glencore Xstrata plc, formerly Xstrata Canada Corporation and Donner. Here we have revealed the nub of the problem, Glencore.

Donner noted that if it failed to remedy this situation within thirty days, it would be in default under the Development Agreement (unless it remedies such failure within a twenty-day curative period following the receipt of a notice to that effect from Glencore). Failure to meet its obligations would result in Glencore having the right to recoup any shortfall from Donner's portion of the proceeds of mine production. Should Donner's portion of the proceeds of mine production be insufficient to do so, Glencore might elect to buy the Donner's interest at fair market value or to forgive the amount owing and convert the company's interest in the Bracemac-McLeod mine to a 2% NSR royalty, of which a 1% NSR royalty can be purchased by Glencore for $1 million. So effectively the total compensation was valued at around $2mn.

By letter dated August 30, 2013, Sandstorm Metals advised Donner that, as of August 15, 2013, Donner was in default of the Metal Purchase Agreement. Then, as required by the Intercreditor Agreement Sandstorm Metals delivered to Glencore a notice of Donner's default under Metal Purchase Agreement.

The Intercreditor Agreement required each of Glencore and Sandstorm Metals to deliver to the other a default notice in the event of the occurrence or existence of an event of default pursuant to their respective agreements. Under the Intercreditor Agreement, Donner and Sandstorm Metals had granted Glencore an irrevocable right and option to acquire Donner's interest in the Bracemac-McLeod mine and project and all rights or title related thereto each time Glencore receives a copy of a default notice.

Sandstorm though could also exercise a right to acquire at the earlier of: (i) Sandstorm Metals becoming aware that Glencore will not exercise its option, and (ii) the expiry of the period during which Glencore has the right to exercise its option (i.e., on the 15th day after the receipt of a default notice), Sandstorm Metals also had the right to cure any event of default of Donner under the Development Agreement. So they could have bailed out Donner in its hour of need.

The Intercreditor Agreement includes a form of assignment and assumption agreement to be executed and delivered by Donner, Glencore and the assignee of Donner's interest in Bracemac-McLeod and all rights or title related thereto if, among other things, Glencore does not exercise its option and Sandstorm Metals chooses to purchase Donner's interest in Bracemac-McLeod.The way things transpired though it looks like Glencore grabbed the asset ahead of Sandstorm.

Clearly it seems that Donner was a babe in the woods when it came to the welter of documentation that the original Sandstorm deals required. As a result of the interplay between the Metal Purchase Agreement, the Development Agreement and the Intercreditor Agreement, a default or an occurrence of an event of default by Donner might result in the forfeiture of Donner's interest in Bracemac-McLeod and all rights or title related thereto to either Glencore or Sandstorm for no or little consideration.

The Endgame

On August 30, 2013, Donner and Sandstorm Metals entered into a settlement agreement which provided, among other things, for the manner in which Sandstorm Metals would exercise its rights pursuant to the Metal Purchase Agreement, the irrevocable and unconditional mutual release and discharge by Donner, Glencore and Sandstorm Metals of each other from any claim, Donner's covenant not to commence any action or proceeding or to make any claims whatsoever against Sandstorm Metals or Sandstorm Metals Parent with respect to what was Donner's interest in Bracemac-McLeod and all rights or title related thereto and the consideration that would be delivered by Sandstorm Metals to Donner in exchange therefor.

Immediately after the execution and delivery of the Settlement Agreement, Sandstorm Metals sold to Glencore what had been Donner's interest in Bracemac-McLeod and all rights or title related thereto pursuant to an agreement of purchase and sale executed by Sandstorm Metals, Glencore and Donner. The distribution of the spoils resulting from this were described earlier. Donner also covenanted and agreed not to commence any action or proceeding or to make any claims whatsoever against Sandstorm Metals or Sandstorm Metals Parent with respect to the affected assets or the participating interest.

Donner was left with its residual interests (detailed further on) in the remaining five Matagami joint ventures, where exploration continues. Donner stated that it was committed to manage its obligations to the Quebec lenders. We discuss the loan further on.

The New NSR Deal

Sandstorm Metals agreed, that from and after the date upon which Sandstorm Metals has received an aggregate of the net sum of CAD$49 million from the Sandstorm Metals' New Royalty under the Royalty Agreement, Sandstorm Metals shall pay to Donner, a 1% NSR royalty on sales of ore produced from the mining leases of Bracemac-McLeod that is subject to the Sandstorm Metals' New Royalty under the Royalty Agreement.

As they say the devil is in the details and thus there are some further twists that potentially leave Donner or indeed Donner's creditors with little to nothing. Clearly Sandstorm (despite Donner's promise to not sure either them or Glencore) is concerned that some sort of legal action might come out of left-field (Donner shareholders?). Therefore in the event that: (i) any action shall be commenced against Sandstorm Metals with respect to the transaction contemplated by the Settlement Agreement for which a final and unappealable judgment is obtained that is adverse to the interests of Sandstorm Metals; or (ii) Donner shall become subject to an insolvency event, regardless of whether or not the payments from Sandstorm Metals have commenced, then in each or either of such instances, the obligation of Sandstorm Metals to pay to Donner the agreed royalty shall terminate and be extinguished.

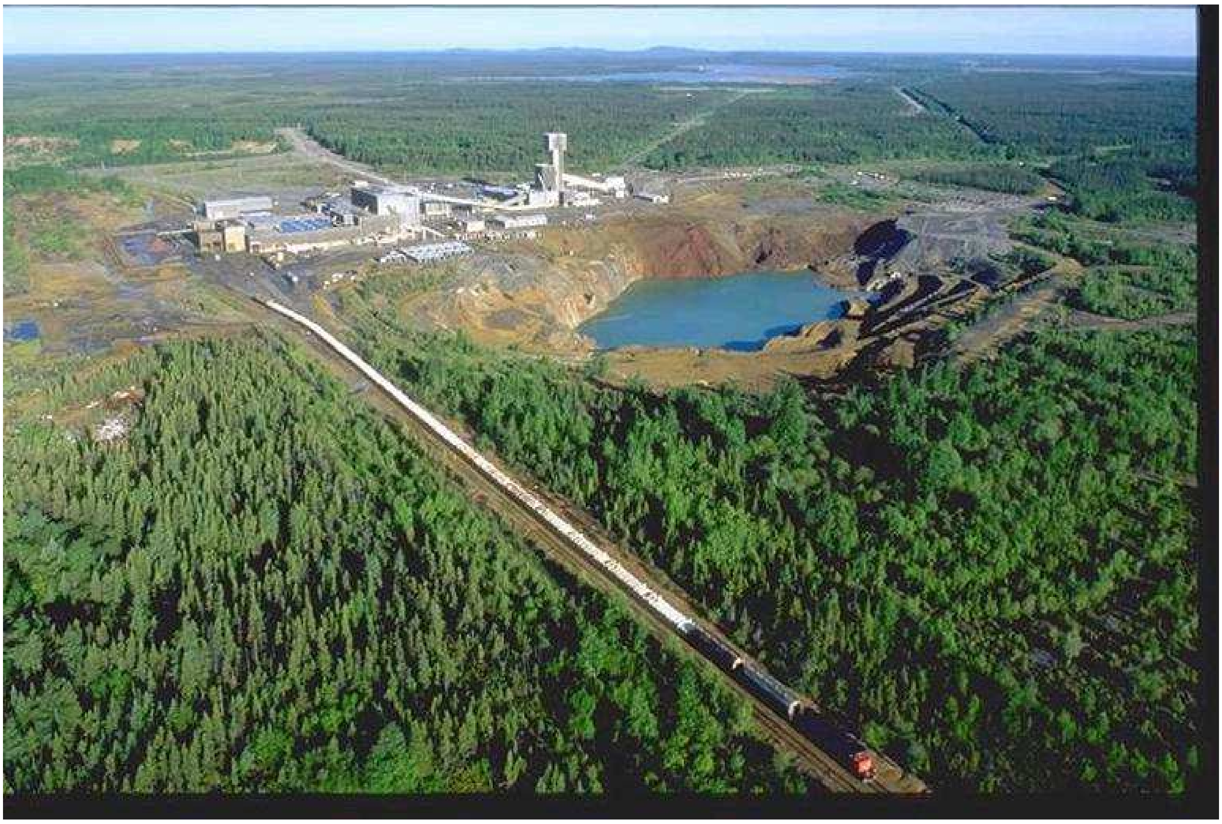
Glencore Gets to Scoop Sandstorm's Holding

In a further perverse twist, Glencore managed to extract a deal whereby it ended up with the bulk of Sandstorm's shares in Donner. Thus, in connection with Glencore's issuance of a 3% NSR to Sandstorm

Metals, Glencore acquired from Sandstorm Metals an option to acquire 40,360,330 Donner common shares and 26,500,000 warrants exercisable for the same number of Donner common shares. The option is exercisable for $2 million and the warrants are exercisable for $0.10 per share. Assuming Glencore's exercise in full of its option and the warrants, Glencore would own approximately 19.5% of Donner's outstanding shares calculated on a partially diluted basis.

The Matagami Project(s)

The Matagami Mining Camp is a mining district which hosts 18 known VMS deposits, including ten past producing mines of varying sizes. One of these was the sizable Matagami Lake deposit (25.64 million tonnes of 8.2% Zn, 0.56% Cu, 20.91 g/t Ag and 0.41g/t Au) discovered in 1957 and mined from 1963 to 1988. The first discovery at Matagami was made in 1957 and continued exploration has yielded timely new discoveries. The Perseverance deposit, wholly owned by Xstrata, was producing until early in 2013. Mineral concentrates produced in Matagami are processed and refined at Xstrata's facilities in Rouyn - Noranda and Montreal.



The Matagami Project is an almost district-sized complex and has an area of mutual interest of 4,737 square kilometres that is governed by the Matagami Joint Venture Agreement signed in 2006 between Donner Metals Ltd and Falconbridge Limited, now Xstrata Canada Corporation.

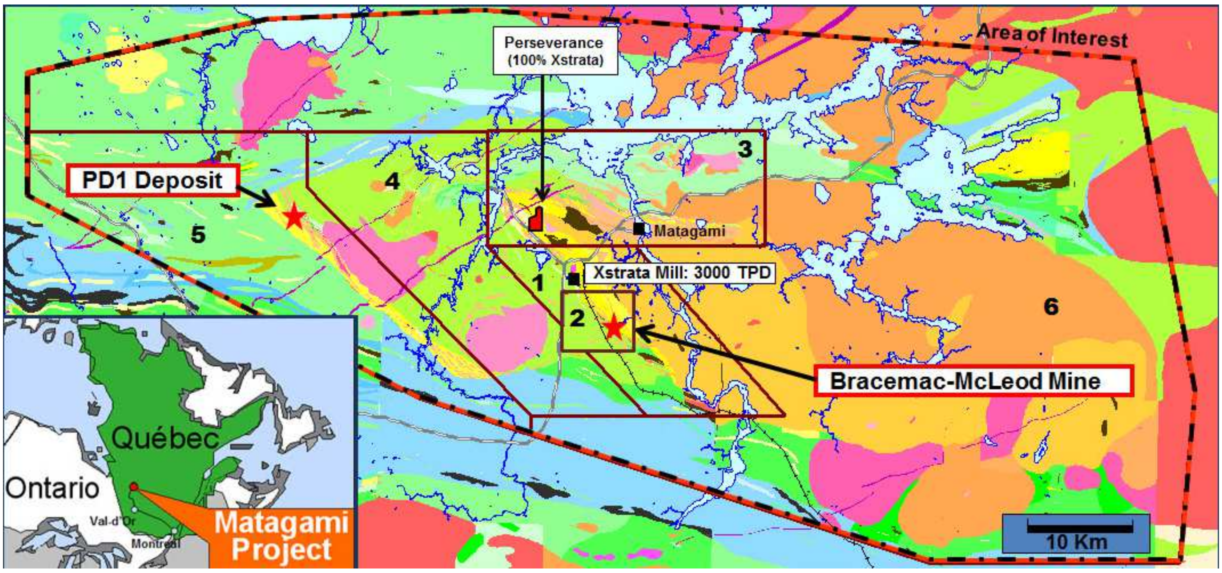
The area of mutual interest is divided into five separate joint ventures areas that cover claims in which

Donner holds an interest with Xstrata. Under the joint venture agreement, Xstrata Canada Corporation - Xstrata Zinc Canada Division is the project operator for the Matagami Project and its relative joint ventures.

This almost district-sized complex consist of five properties in the sway of Donner or which one is fully backed in by Donner and the other four have potential for Xstrata to increase its stake through further work. The state of ownership of these concessions currently is:

- South Flank JV (Xstrata 65% - Donner 35%) - No further Back-in
- North Flank JV (Xstrata 50% - Donner 50%) - Xstrata Back-in option (15%)
- Central Area JV (Xstrata 50% - Donner 50%) - Xstrata Back-in option (15%)
- West Camp JV (Xstrata 50% - Donner 50%) - Xstrata Back-in option (15%) – Xstrata has elected to back-in
- East JV (Xstrata 50% - Donner 50%) - Xstrata Back-in option (15%)

The five concession areas are shown on the map below.



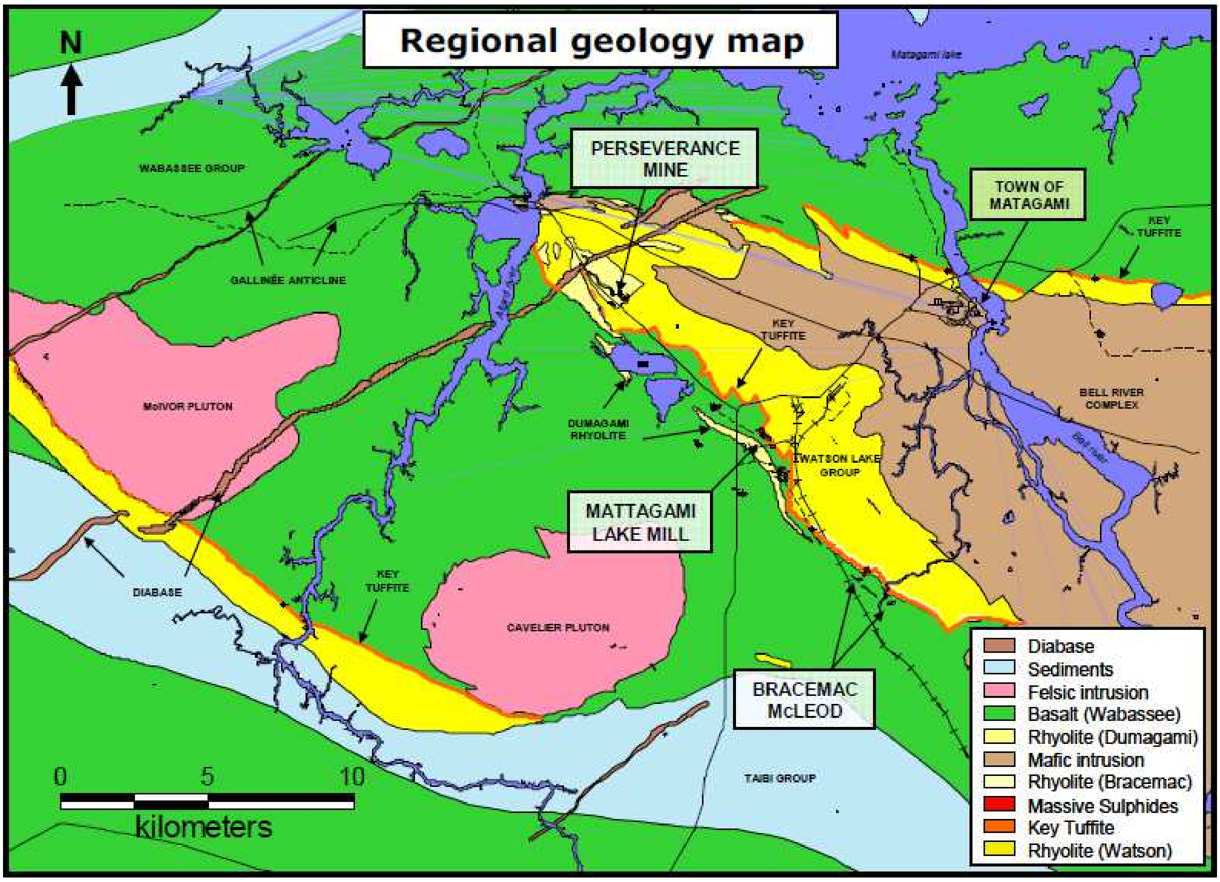
The objective is to explore for, and discover zinc-copper-silver-gold deposits in the Matagami Camp in order to supply the Matagami Mill over the long term. Production from Xstrata's Perseverance mine is being at least partially replaced by production from the Bracemac-McLeod mine. New discoveries will leverage the general infrastructure and existing processing facilities within a known and well-established cost structure for developing deposits.

Geology

The Matagami VMS Camp is located in western Quebec in the Abitibi Greenstone Belt of the Superior Province. The district's deposits are classic examples of Archean volcanogenic massive sulfide deposits that have been generated by syngenetic processes on the seafloor (in this case the primeval Watson Lake) and subsequently subjected to a regional metamorphism of greenschist-facies grade. There is an excellent animation of how the deposit evolved on the company's website.

The Matagami camp is typified by extensive volcanic rocks that pass upward from felsic rocks (Watson Lake Group) to volumetrically more abundant mafic rocks (Wabassee Group). The transition between these two groups occurs in three belts, the South Flank belt, North Flank belt and West Camp belt. The volcanic successions were synvolcanically intruded by the large Bell River layered complex (which drove hydrothermal processes), gabbro sills and dykes and lesser intermediate to felsic dykes and sills. Stratigraphy in the Matagami region is relatively layer-cake and typically progresses from a lower sequence of felsic volcanic rocks (rhyolite/dacite – Watson Lake Group) to a very thick upper sequence of mafic volcanic rocks (andesite/basalt – Wabassee Group). The map below shows the regional geology.

Interlayered with the volcanic rocks are tuffite beds, some of which can be laterally extensive and act as stratigraphic marker horizons. The sequence is intruded in all areas by synvolcanic, gabbro sills and dykes. The impact of intrusion of the gabbro sills is to inflate the stratigraphic succession as much as 30-40%. Felsic intrusions, generally dykes, occur locally and tend to cluster around areas of VMS activity. Both of these intrusion sets clearly post-dated the hydrothermal activity responsible for sulphide deposition.



The Matagami Lake region has a mining history that dates back to the late 1800's when Robert Bell first conducted exploration in the area. The first discovery of zinc and copper-bearing massive sulphides was made in 1956 at what became the Mattagami Lake Mine. Production began in 1963.

Additional discoveries (Iles Dieu and Norita East - 1985, Bell Allard – 1992) supported continuous production until October 2004 when the last ore was drawn from the Bell Allard Mine and operations ceased due to depleted resources. The Perseverance Deposit was discovered in 2000 and put into production in 2008.

The table below details production at the various mines, grades and depths.

Past Producers in the Matagami Camp

Deposit	Production	Mt	%Zn	%Cu	Ag g/t	Au g/t	Depth
South Flank							
Matagami Lake	1963-1988	25.64	8.2	0.56	20.91	0.41	30-228
Orchan	1963-1982	4.51	9.84	1.02	37.03	0.51	31-366
Isle Dieu	1989-1997	3.05	17.85	1.01	76.63	0.46	320-610
Bell Allard South	1968-1970	0.23	9.24	1.14	37.03	0.51	18-70
Bell Allard	1999-2004	3.59	13.67	1.25	40.55	0.69	950-1025
North Flank							
Norita	1976-1997	3.89	3.94	1.83	25.84	0.59	10-689
Norita East	1992-1996	1.08	10.21	0.8	41.42	0.74	600-900
New Hosco	1963-1970	1.83	1.73	1.73	10.29	0.34	09-305
Garon Lake	1968-1970	0.47	2.17	1.46	10.29	0.34	15-305
Radiore 2	1979-1980	0.14	1.34	1.57	8.57	0.31	Surface

Bracemac-Macleod – the Object of Contention

The Bracemac-McLeod deposit was discovered in 2007 and development began in April 2010 with production projected for early 2013, something that, surprisingly was achieved on time. Rather conveniently the Bracemac-McLeod deposit is located only six kilometres from Xstrata's Matagami mill complex, which became fully available for processing when the Perseverance deposit ran out earlier this year.

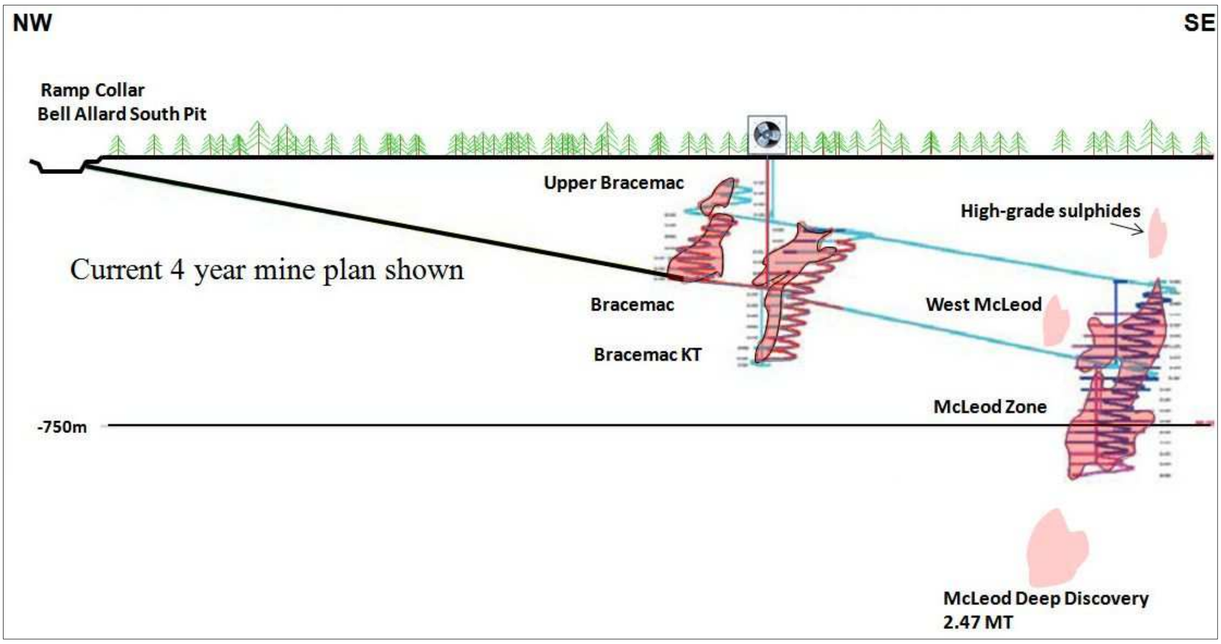
The Donner-Xstrata team discovered the Bracemac-McLeod deposit containing NI 43-101 compliant, proven and probable mining reserves of 3.73 million tonnes grading 9.60% zinc, 1.26% copper, 28.25g/t silver and 0.43g/t gold that support an initial 4 year mine plan. In close proximity to these reserves are inferred resources of 2.63 million tonnes grading 8.78% zinc, 1.31% copper, 38.83g/t silver and 1.06g/t gold.

Advancing to Production

Xstrata Zinc had a feasibility study prepared by GENIVAR (with Xstrata Zinc) in September 2010.

The orebody is comprised of four distinct ore zones: Bracemac Upper, Bracemac Main, Bracemac KT and McLeod. The cross-section on the following page shows the four year mine with the decline currently nearing the first part of the deposit. This access ramp will be 2.3km in total.

The feasibility study recommended using a longhole mining method with either a transverse or a longitudinal access to the orebody. For economic reasons and to maximize productivity, it was decided to utilize the transverse mining method where the orebody thickness is greater than 6 meters.



When the decline reaches Bracemac it was spiraled up as a ramp with the decline continuing towards the Bracemac KT deposit. Ramps spiral up and down in that deposit and an airshaft was sent up to the surface. Stope production began in the early 2013 and will end in December 2016. In total, 250 stopes will be mined between January 2013 and the end of 2016.

It was projected in the feasibility study that metal production will total 606 Mlbs of payable zinc, 83 Mlbs of payable copper, 1.5 Moz of payable silver and 13 koz of payable gold over the LOM.

Donner-Xstrata Matagami Agreement

Current Mine Plan - Proven and Probable Reserves

	Deposit	Production	(Mt)	% Zn	% Cu	Ag g/t	Au g/t	Depth (m)
South Flank	Bracemac-McLeod	Scheduled 2013 4 yr LOM	3.73	9.60	1.26	28.25	0.43	35-900

				Expansion				
	Deposit	Resource Classification	(Mt)	% Zn	% Cu	Ag g/t	Au g/t	Depth (m)
South	McLeod Deep	Inferred	2.47	9.20	1.22	40	1.10	600-1200
Flank	McLeod West	Inferred	0.16	2.20	2.60	24	0.20	400-600
	McLeod Copper zone	Indicated	0.24	0.96	1.25	7.80	0.19	600-700

In total, 250 stopes will be mined between the start of production in 2013 and the end of 2016.

Cemented rockfill will be poured in longitudinal stopes and in transverse primary stopes, while unconsolidated rockfill will be used in transverse secondary stopes. This approach fits with the relatively small tonnage of the deposits and the waste rock management program (development waste rock used as rockfill in underground stopes).

Average daily production rate has an initial run-rate of 2,300 tpd, for the first two years of production. Then, it will reach 2,800 tpd for the last two years of the LOM, for a LOM average daily production rate of 2,500-tpd. At this rate, the LOM of the Bracemac-McLeod Project will be 6.5 years: two and a half years of preproduction for developing the underground mine, and four years of production. The potential exists though for a slightly longer LOM by bringing in the inferred resource and considering that the Macleod Deep is open in various directions.

Capital costs for the Bracemac-McLeod Mine, including a 10% allowance for contingencies, were around $159 million. Average direct operating costs for the Bracemac-McLeod Mine were estimated back in 2011 at $72.27/t milled. This included mining, mineral processing, maintenance, administration and human resources. Below we present a summary breakdown of the operating costs estimate.

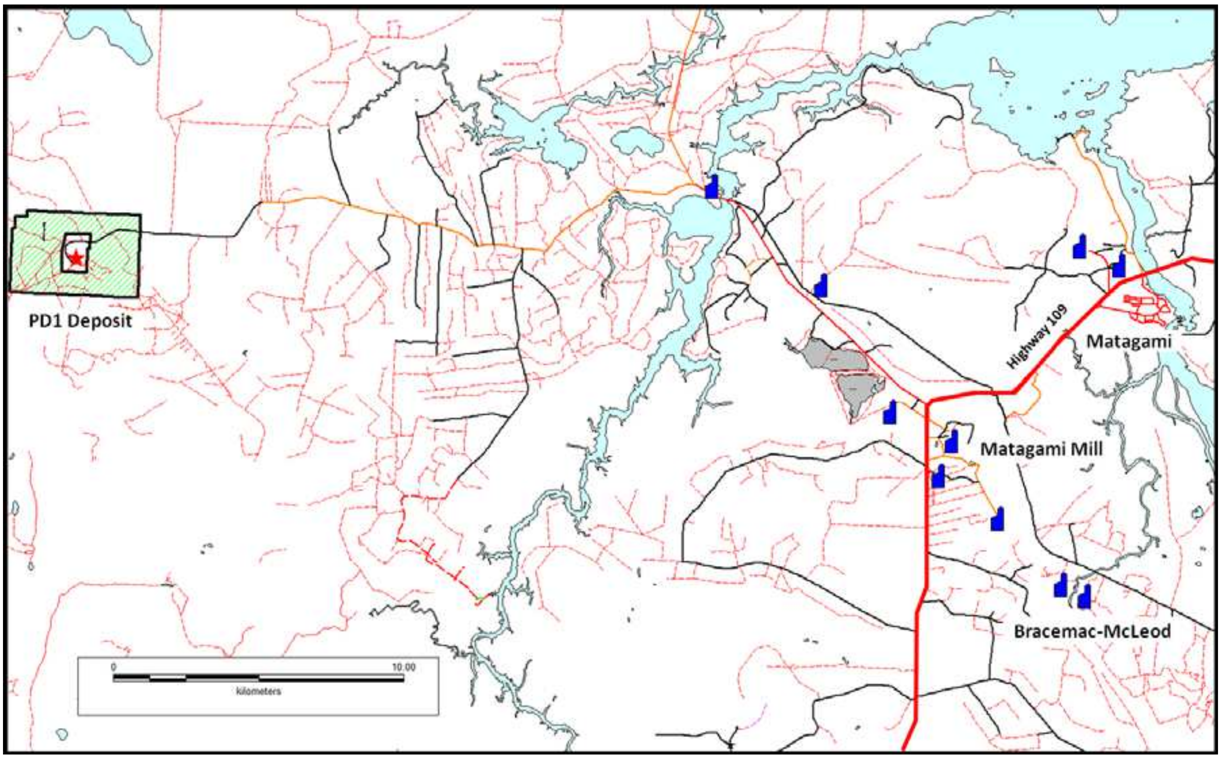
Operating Costs Summary

Mining	$37.51/t milled
Maintenance	$7.06/t milled
General & Administration	$9.70/t milled
Milling	$18.00/t milled
TOTAL	**$72.27/t milled**

Finally on May 16, 2013, Donner reported that production at the anticipated average rate of 3,000 tonnes per day had commenced on May 15 at Bracemac-McLeod and that processing copper and zinc ore from the new mine had begun.

PD1 – a lifesaver in a storm-tossed seas?

This nondescriptly named second project of Donner started to make sense when we plowed through the historical literature and found references to the "Phelps-Dodge" deposit. The PD1 deposit was discovered in 1974 by Phelps Dodge Corporation of Canada, which subsequently sold the property to Orchan Mines Limited in 1976. The property was included in the MLOJVA in 2007.



A total of 50 historical drillholes were drilled on the PD1deposit between 1974 and 1984. In 2010 Xstrata Zinc drilled 25 holes in the upper portion of the deposit above 100 metres vertical depth.

Donner earned in its stake of 50% on PD1 which will then be reduced to 35% by Xstrata producing a Feasibility study on the project. Phelps Dodge does have residual rights though. These include:

- ✓ Phelps Dodge holds a 15% *net carried interest* on the first 1.6 million tons mined from the 9 mineral claims. This will increase to a 25% net carried interest after 1.6 million tons are mined.
- ✓ Net carried interest in this case is defined as Net Proceeds less capital expenditures, working capital and carrying charges. (Net Proceeds being defined as gross revenue less operating costs and both transfer and processing charges).
- ✓ Phelps Dodge is entitled to $400,000 in cash payments, paid in annual installments of $100,000, during each of the first four years of production from the property.
- ✓ Following production of the first 1.9 million tons from the property, Phelps Dodge may elect, within one year, to participate at 40% in any further development of the property by foregoing its net carried interest from the point of election.

The deposit differs from the typical Matagami sulphide deposits on three fronts:

- ✓ The deposit is a body of dense massive pyrite within which two internal parallel layers are defined on the basis of minimum cut-off grade.

- ✓ The overall grade of the deposit and that of the above cut-off mineralization is lower than camp average for massive sulphides.
- ✓ The grain size is finer than camp average.

A NI 43-101 resource calculation, prepared in February 2011 by Zorayda Consulting, contained a resource that was interesting from the copper and zinc grade perspective but not sizable in terms of tonnage. However, PD1 provides a possibility of an extra source of material for the mill after Bracemac-Macleod peaks in its production. PD1 has the big advantage that the bulk of its resource is shallow suggesting to us, maybe an open pit, followed by a move underground. Xstrata is moving ahead with the feasibility study on the deposit.

PD1 Deposit – Resource

Category	Tonnes	Zinc %	Copper %	Silver g/t	Gold g/t	Vertical Depth metres
Measured	596,193	4.34	0.83	19.59	0.12	25 to 100
Indicated	262,387	4.26	0.91	19.95	NS	100 to 200
Indicated	528,925	4.25	1.59	21.13	NS	200 to 300
Indicated	272,211	5.48	1.41	20.27	NS	300 to 400
Indicated	71,895	6.32	0.77	12.44	NS	400 to 500
Indicated	5,762	2.64	0.19	8.14	NS	500 to 515
Total M&I Resource	1,737,373	4.55	1.16	19.88	-	25 to 515

The Sandstorm Deals

History of the Sandstorm relationship dates back to when Donner consummated a pair of deals to ameliorate the financing burden as it forged ahead on the way to production. In mid-July 2011 the company announced an agreement with Sandstorm Gold to:

- ✓ buy gold and gold equivalent equal to 17.5% of Bracemac McLeod's project output (thus half of Donner's 35% share of output)
- ✓ to pay Donner $5 mln in June of 2012

The deal with Sandstorm Gold committed Donner to sell gold to Sandstorm, with Sandstorm Gold paying the lesser of US$350 per ounce of gold (or gold equivalent) and the then prevailing market price of gold. However Donner had the option, for a period of 24 months, to repurchase up to 50% of the gold committed in the agreement by making a US$3.5 million payment to Sandstorm Gold whereupon the percentage of gold and gold equivalent that Sandstorm Gold is entitled to purchase would be decreased from 17.5% to 8.75%. Aside from the upfront deposit and per ounce payments, Sandstorm Gold was not required to contribute to any capital, exploration or operating expenditures in respect to the Bracemac-McLeod mine. Sandstorm Gold received a guarantee that it would receive minimum before tax cash flows of:

- ✓ US$0.8 million in 2013,
- ✓ US$1.4 million in 2014,
- ✓ US$1.4 million in 2015, and
- ✓ US$1.4 million in 2016,

This would have provided Sandstorm with a 100% return of capital within approximately five years.

Then in a separate deal later in July 2011, the sister company, Sandstorm Metals & Energy (TSX-V: SND) made a US$20 million payment to Donner in fulfillment of the copper purchase agreement announced on July 13, 2011. Like the gold agreement, Sandstorm Metals was entitled to purchase an amount equal to 17.5% of the life of mine copper produced from the Bracemac-McLeod mine at a per pound price equal to the lesser of US$0.80 and the then prevailing market price of copper unless the price of copper falls below US$2.75 per pound, in which case the per pound price would be equal to the lesser of US$0.55 and the then prevailing market price of copper.

Sandstorm Metal's payment to Donner consisted of US$17.75 million as an upfront payment and the remaining US$2.25 million coming from the purchase of 6,428,571 common shares of Donner at US$0.35 per share. Of course both of these off-takes are now cancelled in exchange for a rather small NSR.

Xstrata Zinc – the Big Bad Wolf

One of the eye-popping numbers that came to light in the IPO process of the major metals trader Glencore in early 2011 was that the company claimed to control a market share of around 60% of the openly traded zinc in the world. Since then of course Xstrata (in which Glencore owned a 34% stake) was merged with its erstwhile progenitor. This happened amidst a welter of complaints from end-users about concentration in the zinc market. One of the results was that Glencore was forced to divest supply contracts (with the likes of Nyrstar) and the Chinese insisted that Glencore sell off some (non-zinc) mines, which then saw the Chinese pop up as potential buyers.

Xstrata Zinc is headquartered at Madrid in Spain (ironically a country in which Rio Tinto also has its roots in zinc). Xstrata is one of the world's largest producers of zinc with zinc and lead operations and exploration projects located in Australia, Canada, Germany, Peru, Spain and the United Kingdom.

Xstrata Zinc's operations in Spain comprise the San Juan de Nieva zinc smelter and the Arnao zinc semis plant in Asturias, and the Hinojedo roasting plant in Cantabria.

In Australia, operations comprise: the Mount Isa, George Fisher underground, Handlebar Hill open cut and Black Star open cut zinc-lead mines, zinc-lead concentrator, lead smelter and Bowen Coke Works in north Queensland; the McArthur River open pit zinc-lead mine, processing and loading facility in the Northern Territory; and 75% of the Lady Loretta zinc lead deposit in north-west Queensland.

In Canada, operations and exploration projects include the Brunswick zinc-lead mine and lead smelter in New Brunswick; 25% of the CEZ zinc smelter near Montreal; and the Bracemac McLeod mine.

Xstrata Zinc also operates the Nordenham zinc smelter in northern Germany; the Northfleet lead refinery in the United Kingdom; and owns 33.75% of the Antamina mine in Peru.

As mentioned though, Glencore–Xstrata had timed Bracemac-McLeod coming on stream to match the end of life at the Perseverance Mine. So a 100% owned property was terminating to be replaced by a 65/35 owned mine with Donner as junior partner. To celebrate it anniversary of merging with Glencore, Xstrata now has "Junior" out of the way and the new mine is all Glencore's. Funny that…

Donner Balance Sheet		
As at 31 May 2013		
ASSETS		Notes
Current assets		
Cash	4.023	Would now include financing proceeds
Trade and other receivables	1.766	
Inventories	2.023	
Advances for exploration	0.241	
Prepaid expenses	0.026	
Total current assets	8.082	
Non-current assets		
Non-current portion of tax credits recoverable	4.916	Partially nets out liability?
Property, plant and equipment	56.323	To be heavily written down
Total non-current assets	61.239	
TOTAL ASSETS	69.322	
LIABILITIES AND EQUITY		
Current liabilities		
Trade and other payables	2.196	
Flow-through share premium	0.138	
Current portion of loan	0.601	
Total current liabilities	2.936	
Non-current liabilities		
Deferred revenue	30.642	Cancelled by Sandstorm deal
Loan	4.482	Not secured against Bracemac-McLeod
Asset retirement obligations	1.009	
Deferred tax liability	6.211	Nets out against tax credits?
Total non-current liabilities	42.345	
Total equity	24.039	
TOTAL LIABILITIES AND EQUITY	69.322	

Balance Sheet

Above can be seen the situation of Donner's assets and liabilities as at the end of May 2013. We have added notes to speculate on what it might look like currently. Cash would have gone down but the financing proceeds would be in there now so the amount might conceivable be something similar to what it was then.

The short term liabilities are easily met by the financing proceeds (in theory) as would be some of the maturing loan amortizations for 2014. The company is thus seemingly not in imminent danger but has a gun against its head to get a real business going with whatever it has to hand (Sandstorm shares etc).

Loan – the Damoclean Sword

Ostensibly Donner should be able to crawl out of the rubble, dust itself off and start back on the road to recovery. However the fly in the ointment is that back in mid-March, 2013, Donner closed a debt financing of CAD$6mn. The participants in the deal were:

- $5,000,000 by Ressources Québec Inc.
- $500,000 by the Société de développement de la Baie-James
- $300,000 by Capital croissance PME
- $200,000 by the Fonds régional de solidarité FTQ Nord-du-Québec

In connection with the loan, the company issued 5,625,000 common shares to the lenders in proportion to the respective amounts extended by each, equivalent to 15% of the total amount of the loan. Donner also incurred $244,142 in cash transaction costs. The net proceeds from the loan are being used for working capital in connection with the operations of the Bracemac-McLeod Mine.

The loan has a term of three years and bears interest at a rate of 14% per annum, computed daily on the balance of the loan at the end of each day until it is fully repaid. Interest is payable monthly. The principal of the loan is repayable to the lenders in thirty equal monthly installments starting as of the seventh month following the closing date. The initial face value of the loan is $4,855,858 after deducting the transaction costs. The loan is accounted for on an amortized cost basis using the effective interest rate method.

As collateral for the loan, Donner granted a hypothec in the amount of CAD$5mn on the universality of its property, except for property (i.e. Bracemac-McLeod) that was already covered by a conventional hypothec granted to Glencore-Xstrata and except for some of its assets that may not be hypothecated or given as collateral in accordance with the terms of agreements entered into previously by Donner. It is not clear to outsiders though to what extent the non-property assets of Donner (Sandstorm shares, cash, NSR etc) are included in this collateral. Additionally, the lenders do not look like a particularly predatory group. It also leaves us wondering whether the whole event will have left Glencore-Xstrata in the bad books of the Quebec government.

Risks

The ongoing risks we can envisage with Donner are:

- Action from participants in the last-gasp financings claimed they were duped or at least matters were not fully disclosed
- Ongoing rancorous relations with Glencore-Xstrata to which Donner is still joined at the hip on all its other exploration properties in the district
- A failure to enunciate a new direction (i.e. read new management, in all or part)

Conclusion

The tragedy of Donner reminds us of the old parable "For the want of a nail the war was lost…". While not apportioning blame we would say that anyone going into a partnership with Glencore had better count their fingers after shaking hands. It is interesting to muse whether the previous great relations with Xstrata deteriorated or whether the merger with Glencore brought in a group of new management who were less sensitive to the needs and stresses of small partners. In any case it is imperative now that small miners go into any relations with this group in particular with eyes wide open. Glencore cannot expect that juniors will be beating a path to its door when to any outsider this disaster is redolent of the fate that a praying mantis reserves for its mates. The amount of money that Donner was short was a mere bagatelle compared to the size of the project and the size of Glencore. That the larger partner did not allow a waiver was a dark blot on its copybook.

And it's not just the partners that juniors should be wary of, for the downfall of Donner was also in the terms of the cross-default conditions relating to not only Glencore-Xstrata but also Sandstorm. No amount of lawyers on the job can make up for a management that has a view that on the day it will be able to get finance. This has proven to be folly, over and over again and as far as zinc is concerned, was definitely on shaky ground since 2007. This was a calculated bet, that was badly calculated.

Then there are the participants in the financing on the death-knock. All seem to have lost their shirts, though Sandstorm at least managed to have Glencore take an option to buy its holding at some point out in the future. The other financiers and the small fry who participated in the issue have gone down the gurgler. With the due date for the cash-call being so close to the financing the funds raised should have been returnable in the event of the entire needed amount NOT being raised. The fact that Sandstorm also participated at that point would seem to indicate that people even in the inner circle did not reckon upon Glencore's behavior.

Fortunately Donner is left with a stake in a swathe of properties in the highly prospective Matagami district. Unfortunately it is stuck to the Tar Baby of Glencore, with Donner as the minority partner in these properties. Frankly who would want to put money and effort into any JV with such a sour taste in the mouth after so much past effort and money has been spent on Bracemac-McLeod for nought?

Out of the ashes of the deal the company has the small cash-pile form the financing, some shares in Sandstorm and a sliver of an NSR on Bracemac-McLeod.

The sole consolation we have out of all this is that the holding in the Model Mining Portfolio is theoretical rather than real. Other investors out there have lost real money and must be hunting for some sort of satisfaction. They certainly won't get it by taking on the 800lb gorilla of Glencore. Still the whole episode has maybe done Glencore more damage in the long-term as managements who jump into bed with the Swiss behemoth will be justifiably punished if they don't have armour-plated protection from encroachment.

We shall maintain the **Long** position in the Model Mining Portfolio with a 12-month price target of 3 cts. We maintain our bullish stance on zinc and maybe the NSR will someday yield some return for Donner. As for the rest of Matagami, Donner should let Glencore pay for everything and then wait to be bought out at some point. Revenge is a meal best eaten cold.


Historic Chart for Cdn:DON by Stockwatch.com 604.687.1500 - (c) 2013
Wed Sep 11 2013 Op=0.005 Hi=0.005 Lo=0.005 Cl=0.005 Vol=2,166,700 Year hi=0.205 lo=0.005
Cdn:DON Use
0.285
0.27
0.255
0.24
0.225
0.21
0.195
0.18
0.165
0.15
0.135
0.12
0.105
0.09
0.075
0.06
0.045
0.03
0.015
Volume
15.0 M
10.0 M
5.0 M
Sep
Oct
Nov
Dec
Jan
Feb
Mar
Apr
May
Jun
Jul
Aug
Sep
2012
2013

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60 Madison Ave, 6th Floor, New York, NY, 10010