

MAEDEL'S

EQUITY MARKET ANALYST

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Uncompromising analysis
exclusive advice beginning 1987.

An end to the never ending story Crystallex finally looks set to develop Las Cristinas

Risk On: Buy stocks - sell bonds

Finally in what looks like an end to the gold sector's longest running soap opera Crystallex International (CRY-T \$0.45) partnered with China Railway Engineering Corp. to develop the giant Las Cristinas gold deposit. Having a heavy weight and highly capable partner is essential in what is one of the mining industry's most dodgy environments. Crystallex finally has "what it takes" to succeed and after more than 10 years of intense scepticism I think its finally a buy. \$0.39.

Last June Crystallex International (KRY-T) announced it had formed a strategic partnership with China Railway Resources Group a subsidiary of China Railway Engineering Corporation, the world's largest contracting and engineering company, to develop the Las Cristinas gold project in Bolivar state, Venezuela. Under the agreement, which, critically, has the support of the Venezuelan government, Crystallex will retain a one third carried interest and CRRG, which will develop the mine, will have the remaining two thirds.

Las Cristinas is one of the largest deposits of its kind in the world. The open pit mine as currently designed would be over three kilometers long, one kilometer wide and half a kilometer deep and at a produc-

tion rate of 40,000 tons per day it would take 32 years to exhaust. Proven and probable reserves are 16.8 million ounces of gold based on a US \$550 gold price. Total measured and indicated resources, with an 0.5 gram gold per ton cut off, is 20.7 million ounces of gold, 9.7 million ounces of silver and 706 million kilos of copper. Resources in the inferred category add a further 6.2 million ounces of gold 2.2 million ounces of silver and 158.7 million kilos of copper.

My first introduction to Las Cristinas occurred in 1997 when researching the ongoing slugfest over who actually had rights to the deposit, that was between Placer Dome and Crystallex International. Placer Dome Inc. had been developing the project since 1991 and by the

time it gave up wrangling with the Venezuelan government a decade later, it had already done most of the Exploration and development work.

My 1997 inquiry took me to Venezuela, to an at the time

Venezuela's bright spot

The first question any explorationist or investor must ask when assessing a project's potential is what is the overall environment: Is it too dangerous or expensive and can we or they operate effectively? In Indonesia's case, the answer had been no in my estimation, consequently we completely avoided companies whose principal projects were there. Two weeks ago I returned to Venezuela to assess its political and business environment and Tombstone Exploration's Valle Hondo project, which is around 60 miles north of the controversial Las Cristinas gold deposit.

My last trip occurred several years previously -- only weeks prior to the country's infamous banking crisis during which almost half of its commercial banks collapsed under the weight of fraudulent loans. They were subsequently bailed out at an estimated cost of around \$7 billion. During that period a state of emergency existed; soldiers patrolled the streets to prevent rioting and looting. How much had things changed?

As I arrived, a controversy raged as to the rightful owners of a giant gold deposit called the Las Cristinas. To get a feel for what stands for a rule of law in Venezuela -- an essential aspect for any company without Freeport McMoRan-sized clout -- I took a close look at the dispute. The last time Maedel's examined a major claim battle we correctly poured cold water on Mansfield Minerals' claim to an Argentinian copper porphyry property called the Cerro Samenta. No small service to those that heeded it, Mansfield's shares traded at \$9 when the contest began and \$2.00 when it effectively ended (for the latest twist in this story see page 16). The short of it in this latest property dispute is that our bet is with Placer Dome.

From Maedel's April 28th 1997



famous gold belt called Kilometer 88 and into the offices of government officials and various Venezuelan mining industry experts.

My objective was to talk to the people originally involved in the claims. And for me, the deciding opinion for my subsequent report was voiced by Ms. Concepcion Suarez who, in 1989, was Venezuela's Director of Mines when the claims central to the dispute, the Cristinas 4 and 5 had expired and two others 6 and 7 were revoked by the ministry.

Ms. Suarez explained to me that at the time, under Venezuelan law (decree 2039) any rights or leases attached to a concession such as those in dispute as its term expires or it is cancelled, at the discretion of the state. Contrary

to the market hype at the time, some of the Cristinas leases had already been cancelled with the agreement of the leaseholders and then transferred to Placer Dome's partner in the project, state owned Corporacion Venezolana de Guayana.

This not only made Crystallex's chances of success, regarding its claim to the Las Cristinas remote but it also in the sights of a financial short selling gunslinger, activist and author, Manuel Asensio. Asensio sold short companies' shares if he thought their share price was based on untrue claims. At one time he boasted that of 26 companies he had recommended shorting the average decline in value was around 86 percent, translating to a loss of \$30 billion dollars in market value. In retrospect Crystallex ended



up as another notch on Asensio's gun barrel as the company's ultimate collapse easily exceeded his 86% average.

A second legal hurdle for Crystallex was that the original claims covered only the alluvial gold which made the company's claim to what is not an alluvial deposit, irrelevant.

Our advice to readers (see first page left) was

that Placer would win and that Crystallex shares should be sold. A few months later Crystallex's case was thrown out of court and its share price collapsed from \$12 to just above \$1.00.

Placer's wins the battle but lose's the war

But placer's victory lap was cut short as Crystallex's plummeting share price was soon joined by gold. Gold bullion had been trading between \$350 and \$400 for the previous several years but as Placer continued approached the final stages of the deposit's US \$576 million development, the yellow metal had fallen to \$252 an ounce. Placer attempted to sell its share to its partner in the project state owned Corporacion Venezolana de Guayana and then finally leaving it to be re-nationalized.

Crystallex gets Las Cristinas

In 2002 Crystallex got back in the game when it paid the Venezuelan government US \$15 million and



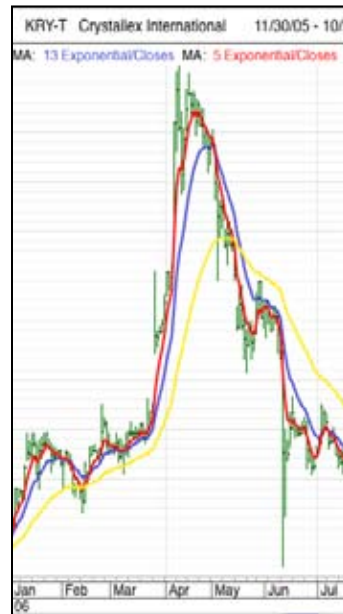
agreed to a 6% royalty on production for the right to develop the deposit. But Venezuela is not America or Mexico. For me travelling around Caracas always felt like a combat operation. The Economist Magazine recently reported the 2009 Caracas murder rate was at an "astounding 220 per 100,000.

Crystallex's April 2006 \$7.11 share price high occurred just after its positive feasibility study was approved by the Venezuela's Ministry of Mines. The numbers that matter most to us are the 19.91 million ounces of gold the deposit contains (16.8 million ounces proven probable) using a \$650 per ounce gold price, the projected production rate of 252,000 Ounces per year and the cash cost per ounce of \$252 per ounce – a number which is likely to have risen significantly, but then so has the price of gold. From there however began the company's long march into the arms of Chavez's waiting Chinese partners. The global financial crisis only added to their share price woes while drastically increasing the dilution from subsequent financings. Thus at the time of writing Crystallex now has approximately 375 million shares outstanding (Fully Diluted: 462 million).

After all the drama long term investors can hardly be happy about the outcome. But considering

that investors had been nerves had been badly rattled such as in 2006 when the country's President Hugo Chavez hinted Crystallex might lose the project and a third of something is a lot better than all of nothing.

But what did they expect? Christallex's flock of principally American investors seemed to believe that an American sense of law and justice would prevail when the reality was that in Chavista-land, instead of American jurisprudence, they would be dealing with the law of the jungle. All things are political in Venezuela. And it seems laughable that President Chavez would allow a bunch of American-Canadian capitalist gringos to just walk away with one of the world's and Venezuela's biggest gold mine. A sweet deal that cut in a



Things were looking good then they were not...

Chavez-cronie or made geopolitical sense to Chavez was the most likely outcome. The principal hope was that Crystallex would not be entirely left in the cold.

The deal that mattered occurred last June and in reality the Chinese partners are being quite fair under the circumstances.

For Maedel's readers the Crystallex share price (\$0.39) is a far more interesting than the \$10 it once traded at, most critically because after more than a decade all the necessary players and ingredients are finally in place.

The entrance of China Railway Resources Group, a Chinese state sponsored champion, (which is the largest construction company in the world and is currently building a \$7.5 billion railway system for Venezuela) is the 800 pound guerrilla needed to drive the project forward.

Using just half the mining industry's going rate for proven probable gold re-

serves of \$100 per ounce and Crystallex's P&P reserves of 16.8 million ounces of gold makes the company's carried third is worth at least \$554 million or \$1.20 (fully diluted) per share. Clearly as the project advances its valuation should increase. If it gets to the \$210 per ounce many gold producers proven-probable reserves are valued, we will looking at a very profitable \$2.40 share price. Added to this is further upside as Crystallex reserves are likely to be increased. I am adding Crystellex which trades on both the Amex (KRY \$0.39) and (TSX KRY-T) to my portfolio at \$0.39.

Special Situations Continued...

Last July I highlighted three companies which I thought were bound to do better no matter how tough the market got. The first was **Lynas corp.** (OTC: LYSCF or AU:LYC). Like Crystallex I have been following the company for years and also similar it has a breathtaking amount (1.6 billion) of





shares outstanding. (It almost become even more similar but for the Australian Foreign Investment Review board's last minute veto of Chinese state sponsored champion China Non Ferrous Mining's bid to take over Lynas in 2009.) Lynas performance has defied naysayers who looked at its gigantic float and commented that for expecting its shares to go up was like waiting for a whale to fly. Yet up they have gone and in the midst of an appalling market.

Since May when I noted their refusal to sink with the rest of the market they have doubled in price from a flash crash A\$0.38 (more realistically \$0.45) to \$1.04. Originally added to the Maedel's portfolio December 2009 at \$0.51, the rare earth metal mine developer's shares did not really catch fire until last July 9th.

The excitement was sparked when The Ministry of Commerce of the People's Republic of China reduced the total export quota for 2010 by

40% from the year previous. Even more worrying for cost conscious REO consumers, which include everything from light bulb and cell phone makers to magnet manufacturers, the export quota for the second half of 2010 was slashed 72%.

Lynas is next in line to begin producing REO's (next year) putting it in an ideal position to take advantage of REO markets developing shortages. But as good as its future looks, at its recent A \$1.02 puts them nearly at its previous highs - a point where considerable supply could be forthcoming. In this market I think it is prudent to take some money off the table and thus I am taking profit on half of my position at \$1.02.

My second special situation **Ivanhoe Mines** NYSE: IVN(added at \$16.43) A recent study by **Standard Chartered Bank** does a great job of outlining why we should expect a bull market in metals over the next several years.

This combined with the

fact that Ivanhoe Mine's giant Oyu Tolgoi copper-gold project makes the company an obvious take over target is why I pegged it in July as bound to outperform even in the most dismal market conditions.

Given the current outlook for copper (which I had also noted has broken out to the upside), the longer potential suitors such as partner Rio Tinto wait, the more expensive and profitable for Ivanhoe shareholders it is likely to get. Below are the highlights of the Standard Chartered report which illustrate why I am so bullish:

"We have analysed more than 800 copper, iron ore, coking and thermal coal projects that exist today and fewer than 25% of them are likely to see production in the next five years. In this report, we introduce a supply forward curve, illustrating how the production plans of the industry have changed dramatically since early 2008 (pre-crisis). Large chunks of supply that were to come onstream in 2010/11 have now been pushed out to 2013/14 at the earliest. We believe this

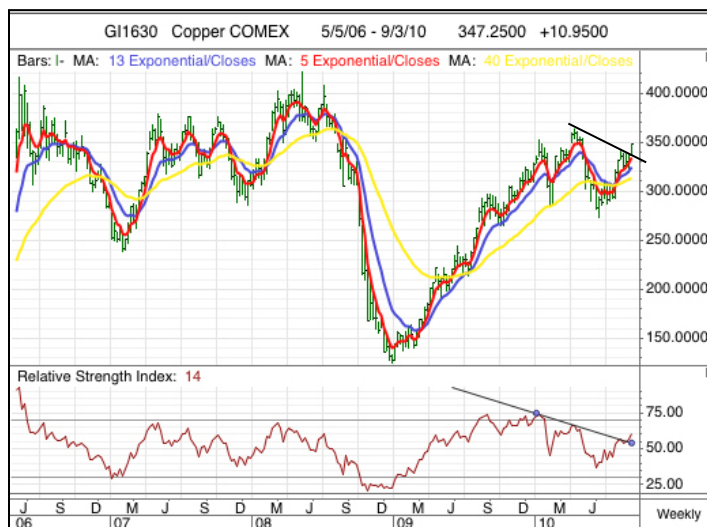
will be very bullish for near-term prices.

We think copper has the potential to spike to \$12,000/tonne in the next two years. We also think the supply forward curve could flatten and rally on the long end as we believe not one of the seven largest copper producers will be undertaking any new copper production in 2011 or 2012.

- 3.5mt or 18% of copper capacity delayed till 2014. Consumers destocked in a tight market."

The bottom line is that the Bank's analysts see the potential for a copper price spike to \$6 a pound (\$12,000/tonne) in the next two years. This can't hurt the value of Ivanhoe's Oyu Tolgoi project where the first decade of production is expected to average 1.2 billion pounds of copper and 650 000 ounces of gold annually. Cost of copper production (after gold credits) is estimated to be \$0.45 per pound of copper.

My third choice for bear-proof investing remains Australia Stock exchange listed **Independence**





Group NL an nickel producer and gold explorer with a crack management team a great JV partner (AngloGold Ashanti Ltd-operated Tropicana gold project, in Western Australia.)

IGO's share price has begun to break out as it's revenues from nickel production have taken off. Net profit for the 12 months to June 30 was \$28.74 million, up 78 per cent, while revenue totalled \$116.67 million, up 17 per cent.

"The major factor contributing to the above increases was that spot nickel prices during the 2010 period were significantly higher (by approximately \$A4,164/tonne) than in the previous corresponding period," Independence Group said in a statement on Friday. Not mentioned was that actual production ended up about 5% higher than guidance and the grade was somewhat higher.

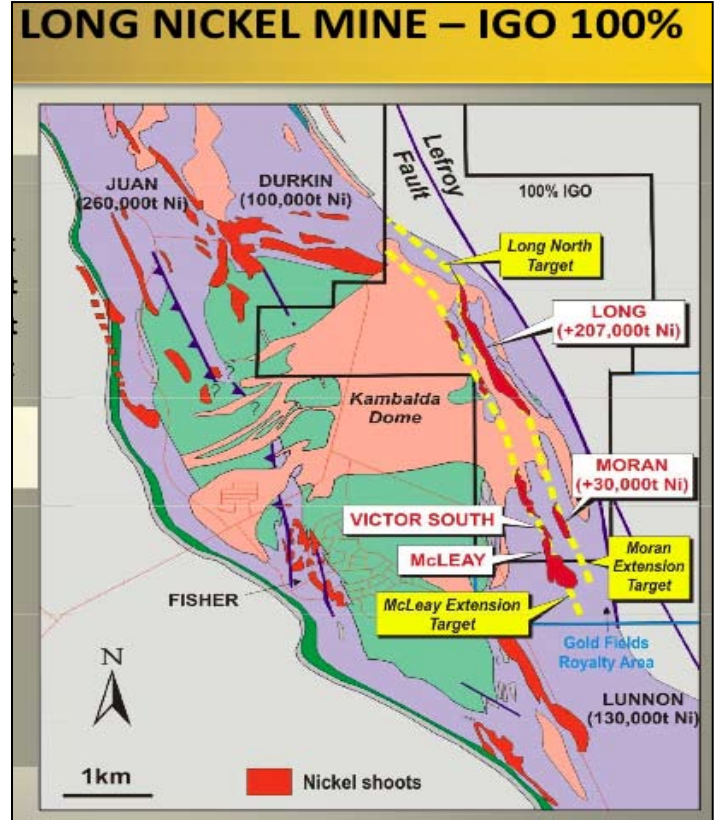
Considering that nickel prices spiked to \$52,000 per ton in April 2007 the

volatile metal's current price (around \$20,000 a ton) looks a bargain unless compared to its October 1998 low of \$9,000.

The outlook for the metal is like the storm that hangs off the beach but never comes ashore. If all the mines in development are added a wave of supply looks set to send the metal price crashing. Except it never happens. Instead the added supply has come on incrementally.

Start up problems with a new complicated and hard to incorporate technology called high-pressure acid leaching (HPAL) is among the significant factors. For example the Vale owned (69%) \$4.3 billion Goro project in New Caledonia, should have added 60,000 tpy capacity but because of problems with its HPAL system it is not even saying when in the future the mine will begin production. As a result analysts like Societe Generale expect the metal to remain in deficit to 2014.

But IGO is less a play on nickel and more a play



on management execution and its development and growth potential. The company has several catalysts on the horizon. The first is the release of the 5 million ounce Tropicana (IGO 30%) Bankable feasibility study which should be released in the coming months. As we wait, the potential of serious reserve growth from an ongoing drill program at the high grade Moran ore body is definitely a looming catalyst. High impact drilling at Duketon Nickel Joint Venture (70% IGO) focus is prospective massive and disseminated nickel sulphide mineralisation approximately 80km north of the 1969 Windarra nickel discover. The most notable of the Two prospects that have been defined is the high-grade Rosie Prospect. Bets inter-

cepts include up to 3.3m (true width) @ 9.1% Ni, 1.1% Cu, 0.2% Co and 7.1 g/t PGEs (2.2 g/t Pt, 1.7 g/t Pd, 0.8 g/t Rh, 1.8 g/t Ru). This is the high impact high risk part of the speculation and certainly not why I own IGO. Fools depend on these types of exploration projects. But if you can get a free near riskless lift from it. Why not?

Risk On

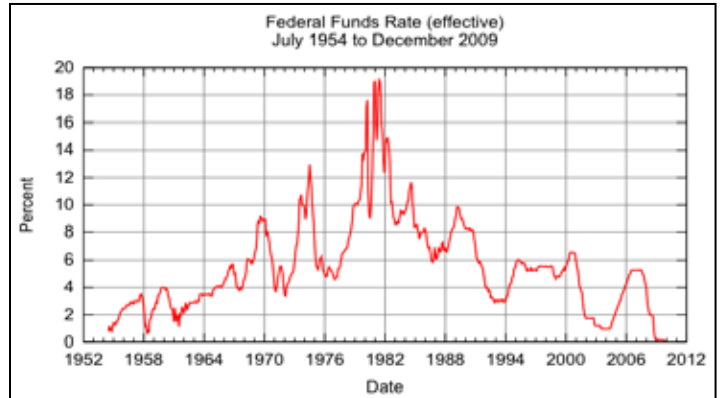
Buy stocks - sell bonds

The New York Times headline "**Small Investors Flee Stocks**" was a warning of the approaching tsunami of equity selling and fund redemptions. At the same time panicking investors scrambled to buy bonds which in turn drove yields to record lows. Maedels had already moved to 50% cash in preparation for the bargains I thought the bottom would bring (All Signs Point Down July 2010). As the lows were reached **The Consensus** survey of published opinions showed nearly 80% expected the bond bull market to continue - almost as many as when bonds last peaked in 2008. **The American Association of Individual Investors** said last week that bond allocations by individual investors had also reached 24%, a top-indicating, near-record high.

But as sentiment peaked, so did treasuries. What happened: 2-year notes' yield's fell Aug. 24 to a record low of 0.4542 per-

cent. What didn't happen was 10-year yields failed to fall by a similar amount. This generating a bearish divergence that indicates a top may be in place. At the same time 10 year notes closed the week at 2.70, just five basis points away from generating a critical bearish trend reversal. The bottom line: the bond market has come a very long way. For perspective, in the 1980s interest rates reached nearly 20%. They have probably already discounted the worst. Chasing today's micro-yields in the hope that the bond bull market will go on forever, is a bit like picking up dimes in front of a steam roller.

But the flip side of ultra-low yields is ultra-cheap borrowing costs which has led to a rush of refinancings, and helped expand profit margins, while enabling US companies to raise cash in record amounts and as **MKM Partners** reports have made equities look



very cheap compared to bonds. They say that using the Bureau of Economic Analysis NIPA data, "the gap between equity earnings yields and Baa bond yields is the largest in nearly six decades".

Another positive that larger banks, once in intensive care, are now far healthier. According to Richard Bove, an analyst with Rochdale Securities: "The U.S. banking industry "has more capital as a percentage of assets right now than in any time since 1935,".

Inflation risks grow...

But as corporate america becomes more deflation resistant perhaps investors are preparing for the wrong war. More worrying for bond buyers is the continued rise in basic commodities such as copper, wheat and cotton. Cotton prices recently hit a 15-year high last Thursday, as not easily fixed supply problems put upward pressure on clothing prices for consumers.

Not only do the commodity price increases imply that the economy is expanding, but also that inflation pressures are growing. As the chart on the previous page shows, the CRB Index looks to be in the process of breaking out. I think it very significant that the CRB index did not break down over the past three months in spite of the relentless barrage of appalling economic statistics. That is a bullish divergence if there ever was one.

At the same time rising commodity prices have been accompanied by inflation virtually throughout the emerging markets. Higher costs for them will eventually translate to more expensive imports for us. It is a continued supply of cheap products from Asia that has been a major factor in keeping inflation low in America prior to the GFC.

Are we about to endure a period of 1970s stagflation? The potential that the emerging markets will one day begin to export their inflation to the US is not all that far fetched. Andy Xie former Chief Economist (Asia) for **Morgan Stanley** says that inflation exceeds 5% throughout Asia while according to the latest statistics inflation in India is 14%. He worries that is exactly what will occur. The risk is that a declining US dollar and increased Asian manufacturing costs, will combine with rising commodity prices to increase inflation.

At the same time America's bond yields are min-



iscule compared to yields in the fast-growing and cash-rich emerging market countries. Brazil's Central Bank Overnight Rate for example is 10.25%.

Capital goes where the returns are best. As it flows to the emerging markets the dollar decline will accelerate.

A telling sign as to where the dollar is headed may be found in speeches made by FED Chairman Ben Bernanke. In one speech made when he was a professor at Princeton University in 1999, Bernanke insists that one of the most effective actions to end the Great Depression that was taken by President Roosevelt was the "devaluation of the currency".

But if this the FED's objective it leads to a second question: what effect will a declining dollar have on equities and US inflation?

A lower dollar increases the cost of manufactured imports while bullish increasing exports and the value of foreign earnings of US based companies.

As Germany's robust export driven economy shows, booming emerging markets matter. According to **The Economist** Brazil's economy is growing at about 7% per year while in South East Asia GDP growth rates range from 6% (Indonesia) to 18.8% (Singapore) and here in Thailand 12%.

And so if the Emerging markets are growing and the US dollar continues to weaken many of America's companies' should see increased earnings and consequently as the dollar falls US equities should rise. Also bullish is that pessimism amongst stock investors is near record levels. Who is left to sell when according to **Investors Intelligence**, the number of investors bullish dropped to 29.4% last week - around the same level when the GFC stock market crash bottom was reached. I am adding **Direxion 3X30 year Bond shortETFs**(NYSEARCA:TMV) to the portfolio at \$36. The gold and biotech sectors remain among the strongest and I will continue to focus on them.

