

SHOW ME THE MONEY

What Happens If Markets Get Really Ugly

YAWN YAWN! Fundamental Analysis?

Golden Girls & Golden Years

IMF Sales Bearsish or Bullish?

TIME TO “SHOW ME THE MONEY”!

Company Profile

Hinde Gold Fund's primary aim is to provide our investors exposure to the precious metals market through a highly liquid, actively managed fund with low leverage levels. The turbulence of rapid globalisation, in our view, requires a significant allocation of resources to tangible assets like gold, which, over time should provide capital protection and appreciation. Hinde Gold Fund was created to meet the needs of investors as we head into a volatile monetary landscape in forthcoming years.

I enclose this synopsis of Hinde Gold Fund, our *raison d'être* is to ultimately “provide capital protection and appreciation”. We endeavour everyday to abide by this maxim. To date whilst almost every asset class has substantially depreciated in value, whether it be housing, equities- domestic and emerging markets, corporate bonds, fixed income (negative real rates), the commodity sector has accelerated higher. The Precious Metals sector has provided both capital protection and to some extent capital appreciation. But in many respects the Precious metals sector has been disappointing in its relative returns versus the agris and energy complex (see Hinde Monthly Chart Pack, March.)

Indeed one element of the PM sector in particular has substantially underperformed. This has been the miners relative to the appreciation in the gold price. They have not provided the leverage that usually occurs in a market of rising bullion prices. We expect this sector to provide us, the investors, with true “capital appreciation” as mandated in our offering memorandum.

“Those Who Know it Best, Love it Least, because they've been disappointed most”

Since 2004-06 there has been a relative poor performance by the PM miners as management of these miners have failed to make good the investors return on equity. However far from flagrating the miners we perhaps should have some sympathy for them. How could it be that in a rising market the miners have lagged so poorly in recent years?

Donald Coxe's (BMO Nesbitt) phrase above, really captures the sentiment of mining management, analysts and investors alike. In fact never could a phrase be more

apt to describe the general sentiment toward the miners' “loss of belief”. Cost issues, environmental and social permitting risks are the often repeated reasons cited by investors as why not to own them. I really think one has to look further back to get a true explanation. David Galland of Casey Research provides probably the best insight:

The managements of the gold producers have only recently escaped the state of fear they operated under during gold's 20 year bear market. Consider: as recently as the year 2002, gold was still trading near \$280. Against that number was a cash cost of around \$250 per ounce for a typical company. That cost figure is about as low as the number could go, and it was the response of an industry beaten down and huddling in a trench.

Caution lingers after the reason for it has gone. As gold began its upward move in 2002, it did so against the backdrop of an industry still in mothballs and still run by managers whose primary skills were cost cutting and frugality. This is important on a number of fronts.

1. *Having been trained in the acid bath of razor-thin margins, management was intensely sceptical about gold's rally. They suspected it might be just another bear market trap, ready to punish unwary optimists who parted with cash to ramp up production.*

2. *In the hunkered-down years, miners focused on the higher-grade, easy-to-mine material that gave them the best shot at turning a profit, however small that might be. And being in survival mode, they were extremely cautious about buying new equipment or maintaining a large workforce. Employee rosters were reduced to the bare minimum.*

3. *Because staying in business was such an urgent goal, they were willing, even eager, to sell future production at a set price - a perfectly rational strategy in a bear market, because it at least assured they would receive a price that covered the known costs.*

With all these factors taken together, it's easy to understand why the industry was slow to respond when gold started rising. In fact, it was only in February 2003, with gold trending over \$350, that Barrick Gold Corp., the world's largest gold miner, began the expensive process of unwinding its hedges. And it wasn't until November of that year that the company announced it would stop forward

selling altogether and would eliminate its entire hedge book.

Once the turning point came – when management finally realized the bull market was for real - the industry began to scramble to catch up. Which, in a choo-choo industry like mining, means hiring and training lots of people, buying or refurbishing the equipment needed to reestablish production on second-tier deposits, upgrading facilities, building expensive new mills, etc., etc. And, of course, dealing with the challenge and expense of unwinding hundreds of millions of dollars worth of forward hedge contracts.

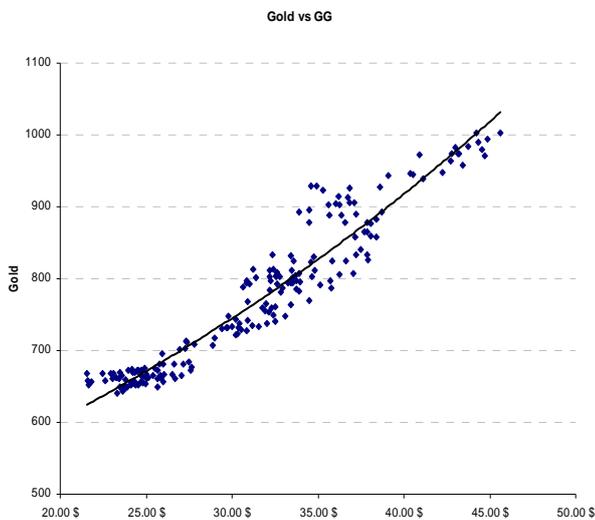
The rebuilding of the gold mining industry, in short, really only began in earnest over the past few years.

The cost of rebuilding the industry went right to the bottom line, understandably investment criteria didn't look attractive for long term plays. The slide in the dollar (many mines run on local cost structure), rising inflation and a shift away from higher grade to lower grade ore processing escalated production costs. (Low grade processing involves bulk tonnage movement –so more digging, hoisting, hauling and processing.)

By contrast, as Don Coxe observes in his February piece “Music of the Metals Market” the base metal miners had bottomed in 1998 and had emerged from their malaise earlier than the PM miners thanks to surging demand from the BRICs. By the time prices started soaring from 2004 the base metal miners had the infrastructure in place to meet production demands and now are experiencing mega-mergers of billions of dollars and are experiencing much higher share prices.

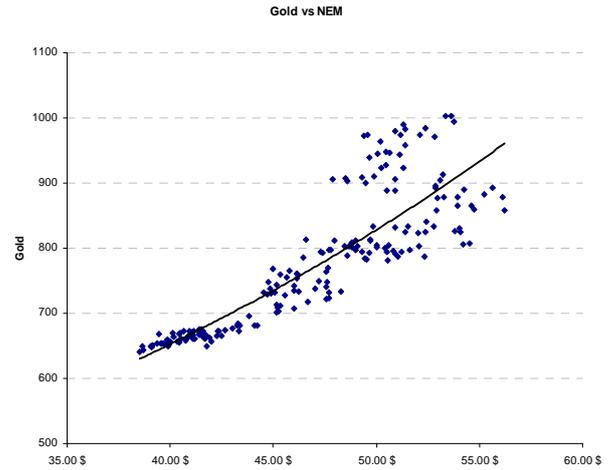
Most gold stocks, and this is particularly true of large caps, are highly correlated to the price of gold. Without knowing anything about the underlying mines, the ability of the companies to get it out of the ground, or the change in cash costs, you would still be able to guess where the shares should trade by just knowing where the price of gold was on any given day.

A good example is Goldcorp, which has a 96% correlation to the price of gold.



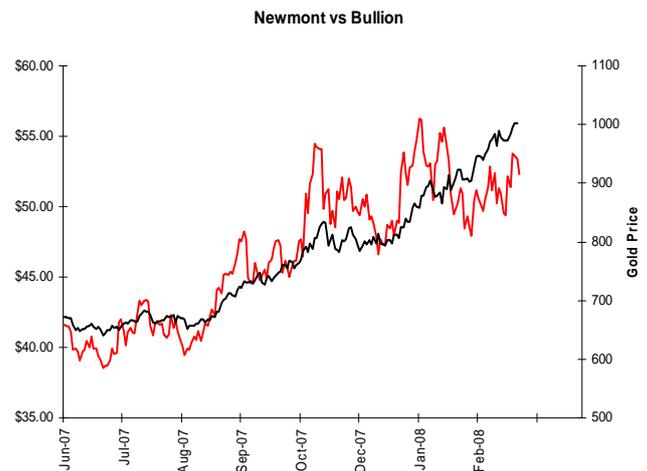
Source: Hinde Capital 2008

Newmont is slightly less correlated, but the correlation is still very high at 87%.



Source: Hinde Capital 2008

Here is another chart showing how closely Newmont trades relative to the physical gold, sometimes overshooting and sometimes undershooting the trend lines.



Source: Hinde Capital 2008

Does the high degree of correlation between gold and gold stocks, and the implicit ability to forecast gold stock prices, mean that fundamental company analysis and valuations are worthless? The answer, of course, is no. The value of gold companies should not be purely driven by the day to day change in gold prices.

The high correlation between gold and gold stocks is in fact misleading. Gold companies that have not hedged out their gold exposure are leveraged to the price of gold. By leveraged, it is meant that when gold prices rise, gold stocks should rise even more.

Gold mining companies have many separate mines. Because of very different geological situations at the different mines or even within the same mine, some gold is harder, and hence more expensive, to extract than other gold. As the gold price runs higher, gold mines can begin mining higher-cost ore.

In gold stocks, leverage multiplies earnings, which is the main driver of stock prices. As the price of gold rises, more and more of each dollar of gold sold drops to the bottom line due to fixed costs. There are limits to gold leverage.

This is because, the higher gold goes, the smaller fixed costs are relative to revenue. For example, gold stock leverage is massive when the price of gold is moving higher from a low base, e.g. \$250 to \$500, and decreases as the gold price runs higher, e.g. \$1,000 to \$1,250.

What can explain the divergence between the gold price and the theoretical value of the company? The increase in the gold price has not been translated into higher valuations as analysts have slowly been increasing their long term assumptions about gold prices. Many Wall St analysts still are pricing in \$600-700 as the long term price of gold and are pricing in very high ongoing mining cost increases.

A similar pattern can be seen by looking at Freeport McMoran, a large copper mining company. When copper skyrocketed in 2006, it took the stock another twelve months to catch up to the move in the physical, as analysts were late in upgrading their price forecasts and correctly analyzing cost increases.



Source: Bloomberg, Chart Hinde Capital

Many gold stocks are arguably cheap on a fundamental basis. One of our favourites is Newmont. Newmont doesn't promise tremendous production growth, but the stock is undervalued relative to other large cap gold stocks.

Newmont is one of the biggest gold producers in the world. It controls about 95 million ounces of gold reserves. Newmont has mines in Indonesia (Batu Hijau), Nevada, Peru (Yanacocha and Minas Conga), West Africa (Ahafo and Akyem) and Australia. Currently, it has six development projects: Ahafo, Phoenix, Minas Conga, Akyem, Boddington, Hope Bay. Newmont is unhedged, but it has some exposure to copper in its Indonesian mine which reduces its leverage to spot gold price. Newmont guidance for 2008 is of 5.2-5.4 million ounces at US\$400-430/oz cash costs.

Currently NEM trades at \$51, even though a discounted cash flow (DCF) valuation using spot and forward pricing indicates that it should be worth around \$91.

Most analysts are reluctant to revise up their long-term gold assumptions. We don't get it- how could they be so blind? Simple they had been disappointed and jaded by years of false promises before, just as the management had. **This is when a sector has most chance of success.**

“What Happens If Markets Get Real Ugly”?

This was the research title of a respected Investment Bank department from their Precious Metals equity analysts on why PM stocks could do really well in financial meltdown. [there are exceptions to the rule]Something we adhere to. Indeed this was the first analysis that struck the right cord.

For months in our portfolio we have held an increasing holding in the PM equity like many of the long only managers (who can often do nothing but). As always in a climate of fear and uncertainty no matter what equity holding you have if the overall indices start gyrating downwards in large flailing motions the good bad and the ugly get taken with it. Well on many days the PM equity fell at 2.5x the overall indices rate even if gold was up and god forbid if gold was down this would be more like 4x. Specific moments like in January spring to mind when some of the big cap miners like Barrick (ABX) and Goldcorp (GG) were undertaking 15-20 per cent daily swings from high to low. Well for a fund that is trying to lower downside volatility and still maintain the investor with the upside return potential this is a challenge. At times a “stomach churning” one.

We asked ourselves was it really worth the aggravation of taking such exposure. Most of you will understand that in theory the miners provide greater leverage than the gold price in a rising bullion market, (more of this later). Over the last year this has averaged out probably more like 1 for 1 instead of the average of 4.5 times over the course of this whole bull market. Clearly this is no compensation for the risk premia associated not only with generalised equities but as well as those factors associated with the miners such as economic, political, geological and social risks. (I hasten to add that it is almost churlish to speak of aggravation and risk, as those men and women who work the mines often do so under extreme duress and hazardous conditions.) Likewise if the miners fall at 2.4x to 4x rate of gold fall clearly its not good risk reward!

The reality is the single biggest drivers of PM equity prices over the long run are the bullion prices, and no amount of beta from the stock market will deflect this. Sure from time to time asset allocations and risk aversion will see the correlation to overall indices increase. Indeed the financial turmoil, we have now, and in the main the concept for the Fund's inception, has produced what we call the “daily global margin calls”. Institutions and investors hurting from losses in one asset have to raise cash from performing ones like the PM equities or gold just to meet their margin payments elsewhere. So no sooner do they appear to be re-rating than they sell-off.

The reality is we are talking about two different aspects. One is the value of a company based on the price of a rising asset, the other is investor sentiment. We should not let other fear drive us from our investments when the reality is the appreciation of a companies assets will lead to better performance of the share price in the long run. We all know the old adage “Market's remain irrational longer than you or I can remain solvent.....”. So we have to devise means of being invested, but should we be invested? Clearly when it has GOT UGLY it has not been worth it. But it will be. To understand why, we need to **YAWN a little.**



Source: Zeal Intell. SPX sell off vs HUI performance

YAWN, YAWN! Fundamental Analysis?

Some of our investors have asked for a brief outline of how PM equities are analysed.

So apologies but we have to interlude here with what for most of us would be considered a cure for insomnia, a precis of how to value mining stocks. By establishing the criteria for valuation we can help outline to you our investors why we believe there to be great potential in the miners going forward.

Fundamental Analysis of companies invariably revolves around an array of PE, EBITDA and cashflow ratios. For example, on examining a manufacturing company producing "widgets" one would compare the company's price to earnings, price to cashflow, operating margin, net margin, to list but a few examples, to other manufacturing companies to help assemble a picture of relative value. Is the stock rich or cheap compared to its peers. Likewise absolute value could be ascertained by assessing dividend rates and return on equity to prevailing interest rates, allowing for risk premia in the sector, or just by analysing book value per share.

Embedded in such analysis is the implicit assumption that earnings and cashflow are for all intents and purposes infinite. In such companies it is appropriate to use such analysis, but with mining it is just not the case, WHY?

Mineral deposits contain a certain amount of ore and when that ore is fully mined out the deposit is exhausted. Mining is a FINITE business. Take a hypothetical mining company, with only one asset, i.e. one mine and it produces for a LOM (LIFE of MINE) of 5 years, at which point the ore body is depleted. The mining company is trading at a P/E ratio of 10. If we observe our widget company we find it also to be trading at a 10 multiple how do we differentiate between the two? We note that the yield on 10yr bonds offers 5 per cent.

The Widget company earns the shareholder 10 cents (10%) of earnings for each dollar of stock owned. Your analysis suggests this is ongoing for next few decades all things equal. So you earn twice as much than 10yr bond, granted there is much more risk, but hey it's a widget factory, a boring and safe annuity stream is expected. Looking to our mining stock we see it too has P/E ratio of 10, and should pay 10% per year on ownership. Wrong, the LOM is 5 years so you will earn only 50 cents per share, half what you paid for the stock, and then in 5 years the mine is depleted and your earnings have stopped and you have only recouped half your investment and no earnings in effect.

Using this basic comparison it is fair to say that valuing mining companies on a traditional fundamental analysis basis is useless. Even comparing mining company to mining company under such evaluation is not helpful as mines have different mine lives in their operations.

Valuation Methodology

A reasonable way to evaluate mining companies is to look at the net present value calculations. This is the preferred industry standard. Contrary to the previous paragraph the large scale miners can likewise be observed using more traditional fundamental analysis as they seek to secure long-lasting resources, i.e. they cease to be quite so finite. Nonetheless such miners have miner assets from around the world that aggregate too provide future cashflows over differing temporal horizons.

Discounted Cashflow Models (DCF/NPV Models)

The simple discounted cash flow method of calculating the net present value from future cash flows is often a reasonable starting point. The value of a mining stock's after tax earnings over the life of the reserve base is calculated with forecasts of revenue from production less the full estimated cost of that production. It is then discounted back using an appropriate interest rate, say 10%. This rate will represent the geological, political, social and financial risks. Whatever the rate used, the discounted results, in today's money are then aggregated to give a final net present value per share of the group's earning potential which can be compared against the current share price. It is perfect for valuing mining projects in that it allows for differing life span of mines, the variety of metals, the differing metallurgical complexities (that is the metal recoveries) as well as the infrastructural differences of projects. (Some projects are in remote locations, some are close to existing infrastructure.)

A top quality mining company will have an excellent team of first rate geologists and mining engineers with secure long term financing and first class reserves on the site. Gold mines are located worldwide in countries where current instability and politics increase the risks. However the recent environmental issues in North America show that there can be risks even in countries perceived to be stable.

Net Asset Value per Share (NAVPS)

An outdated and simplistic methodology, but one still used by practitioners in the mining world. NAV (Current assets-liabilities) divided by market capitalisation of stock gives the NAVPS. Typically it is below the market price per share because the current value of the mines' assets is higher than the value appearing on the historical financial statements used. Gold producers trade at average premium of 60% above NAVPS. Junior (and emerging) gold producers are trading within a range of between 1.0 NAV to 1.6x NAV. Intermediates trade at an average of 1.7x NAV. These are Price/NAV multiples. (In reality the industry often uses the term NAV when in fact it is referring to NPV calculations.)

Metal value per Share

Metal value per share has been widely used in the last few years in the gold sector to try and calculate an overall value that can be used for sector comparisons for operating and developing gold mining companies.

There are difficulties with this approach as some gold groups have high cost resources and others have low cost reserves. If the exercise is conducted at a time of low gold

prices, and so a low gold price is used for valuation purposes, the result can give a false impression of the relative attractiveness of a company with high cost resources. The share price of the company will be low because the market will know its gold resources are uneconomic at the time. However unsuspecting investors will see that the underlying gold value per share of its assets looks very interesting when compared to its far more robust low cost peers. The answer is to apply a discount to the high cost resources, but the problem is how big a discount. Some would ignore such companies in those particular circumstances, but a rise in the relevant metal price could well put these companies right back into consideration.

In short, metal value per share could work quite well as a forward looking tool but anyone using it must be aware of the pitfalls. A rough and ready formula for the discount of 10 per cent of their contained metal can simply be applied to the value of the reserves and resources. The percentage discount figure can be varied and often made to tier between reserves and resources. Neither approach is scientific, or ever likely to be, but results do enable comparisons with other companies in the peer group.

As a variation on this many analysts and mining companies, particularly in the gold sector, draw up peer group comparisons by dividing a mines market capitalisation by either its annual production, its measured reserves or its indicated or inferred resources. This gives a current value per ounce of gold in the three categories and then peer group comparisons can be made. The problem with this approach is that the figures must be precise and exactly comparable or conclusions may be unsound.

Sector PE ratios

The price earnings ratio (forward or trailing estimates) where the earnings per share after tax are divided into the share price, is a universal tool for comparison of peer group stocks. This tool is industry standard for all stocks and is not redundant for mining stocks which in theory have finite mine lives. In practice majors and mid-tier producers replace their production so over the longer term the wasting nature of their assets, the mines, does not preclude the use of PE valuation.

Cash Flow per Share (CFPS)

Many analysts place more weight on cash flow per share than earnings per share. Because EPS is more easily manipulated, its reliability can at times be questionable. Cash, on the other hand, is difficult, if not impossible to fake. You either have cash or you don't. Therefore, cash flow per share is a useful measure for the strength of a firm and the sustainability of its business model.

Cash Flow Per Share (CFPS) = Operating Cash Flow (OCF) - Preferred Dividends / # Shares Outstanding
The cash generated from the operations of a mine is generally defined as revenues less all operating expenses, but calculated through a series of adjustments to net income. The OCF can be found on the statement of cash flows.

OCF is the cash that a mine generates through running its business. It's arguably a better measure of its profits than earnings because a mine can show positive net earnings (on the income statement) and still not be able to pay its debts. It's cash flow that pays the bills. You can also use OCF as a check on the quality of a mine's earnings. If a mine reports record earnings but negative cash, it may be using aggressive accounting techniques.

Gold Producers typically trade within a range of between 6x and 20x forward cash flows, depending on the quality of the asset based growth profile, exploration upside, acquisition potential and perceived risk.

P/CFPS i.e. Share price/CFPS indicates the multiples at which the mine share price is trading relative to its cash flows. On average producers are trading at roughly 11.9 times CFPS. Juniors currently trade below 9x but as the majors search for reserves this could well increase to 9x to 12x

Free Cash Flow Per Share (FCFPS)

It is important to note that negative free cash flow is not bad in itself. If free cash flow is negative, it could be a sign that a producer is making large investments (acquisitions). If these investments earn a high return, the strategy has the potential to pay off in the long run. A measure of a mine's financial flexibility is determined by dividing free cash flow by the total number of shares outstanding. This measure serves as a proxy for measuring changes in earnings per share.

Free Cash Flow is defined as a measure of financial performance calculated as operating cash flow minus capital expenditures. In other words, free cash flow (FCF) represents the cash that a mine is able to generate after laying out the money required to maintain or expand its asset base. Free cash flow is important because it allows a mine to pursue opportunities that enhance shareholder value. Without cash, it's tough to develop new products, make acquisitions, pay dividends and reduce debt. Earnings can often be clouded by accounting gimmicks, but it's tougher to fake cash flow. For this reason, some investors believe that FCF gives a much clearer view of the ability to generate cash (and thus profits). It can also be calculated by taking operating cash flow and subtracting capital expenditures.

This measure signals a mine's ability to pay debt, pay dividends, buy back stock and facilitate the growth of business. Also, the free cash flow per share can be used to give a preliminary prediction of future share prices. For example, when a mine's share price is low and free cash flow is on the rise, the odds are good that earnings and share value will soon be on the up, because a high cash flow per share value means that earnings per share should potentially be high as well.

ROCE/WACC

A company's return on capital employed (ROCE) compared to its weighted average cost of capital (WACC). The thesis behind the concept is that companies destroy shareholder value if the return (crudely, operating profit minus tax) on their capital employed (equity plus debt capital) falls below the WACC.

ROCE :

A ratio that indicates the efficiency and profitability of a company's capital investments.

Calculated as:

$$= \frac{\text{EBIT}}{\text{Total Assets} - \text{Current Liabilities}}$$

ROCE should always be higher than the rate at which the company borrows, otherwise any increase in borrowing will reduce shareholders' earnings. A variation of this ratio is return on average capital employed (ROACE), which takes

the average of opening and closing capital employed for the time period.

WACC:

A calculation of a firm's cost of capital in which each category of capital is proportionately weighted. All capital sources - common stock, preferred stock, bonds and any other long-term debt - are included in a WACC calculation.

WACC is calculated by multiplying the cost of each capital component by its proportional weight and then summing:

$$WACC = \frac{E}{V} * Re + \frac{D}{V} * Rd * (1 - Tc)$$

Where: Re = cost of equity Rd = cost of debt E = market value of the firm's equity D = market value of the firm's debt V = E + D E/V = percentage of financing that is equity D/V = percentage of financing that is debt Tc = corporate tax rate

Broadly speaking, a company's assets are financed by either debt or equity. WACC is the average of the costs of these sources of financing, each of which is weighted by its respective use in the given situation. By taking a weighted average, we can see how much interest the company has to pay for every dollar it finances.

A firm's WACC is the overall required return on the firm as a whole and, as such, it is often used internally by company directors to determine the economic feasibility of expansionary opportunities and mergers. It is the appropriate discount rate to use for cash flows with risk that is similar to that of the overall firm.

How well this works particularly for mining companies, is open to question, but it is widely used. Unfortunately it is quite possible to adjust one of the WACC factors, e.g. the cost of debt, to a company's advantage as Anglo American did when it moved its incorporation from South Africa to the UK. Using long dated gilt rates for the calculation, Anglo's theoretical WACC fell sharply as UK gilt rates were in the 5-6% range against South African gilt rates in the 12-13% range.

The thesis of destroying shareholder value, however, can be too theoretical, and during bear markets even if the ROCE/WACC ratio is above 1.0, i.e. the company is supposedly creating value for shareholders, the chances are that the company's share price, in line with the market, is falling in value which is the most painful manifestation of capital destruction, particularly at the portfolio level. In contrast a few years ago in an unpublished look at ROCE/WACC and the mining sector, the global research team at Paribas discovered that in the 90s Canadian Aluminium giant, Alcan, had consistently posted a ROCE/WACC ratio below 1.0; its share price, however, steadily improved throughout decade.

Enterprise Value (EV)

Another valuation measure much used is Enterprise Value which is simply the aggregate of a company's market capitalisation plus the market value of all non-equity finance (debt, convertibles, warrants) and minus any cash holdings.

$$EV = \text{Market Cap.} + \text{Total Debt-Cash}$$

This is a possibility for valuing large mining groups where an appreciable percentage of the assets are fully developed and providing steady cash flow, but where there are enough new products to enhance that cash flow over the medium term represented in part by the non-equity finance. In order to get a multiple that can then be compared with peer group companies a profit measure, often EBITDA

(Earnings before interest, taxation, depreciation and amortisation), can be selected and divided into the EV.

EV/EBITDA multiple

Theoretically the higher the multiple the more expensive or, conversely, the more highly rated the share.

Enterprise Value per Unit of metal in the Ground

Another ratio often used is Enterprise Value divided by Reserves in ounces (EV/Reserve oz or Resource oz).

It is one of the most simplistic valuation metrics used for early stage development projects. Unfortunately it ignores the capital cost for construction, the operating cost for production and the recovery component of ounces in nature to ounces for sale. It also ignores the "mineable" aspects of taking a resource into a reserve.

Option Modelling

What should be immediately evident is that if you pay more for mining stocks than they are worth, on the speculation that the price of the underlying commodity will increase, you are merely gambling on the commodity price. Fortunately there is a way to quantify the premium that one should pay for a mining stock to incorporate the leverage it has to the underlying commodity price. There is a formula called the Black Scholes Model that can be used to calculate the "option" value of a mining stock. The discounted net present value of the all the company's mines is calculated, and then added to the "option value" of the mines as calculated by the Black Scholes formula to obtain a more realistic asset value per share. By adding the optionality of mining shares to the net present value of the mines themselves we can account for the fact that mining shares trade at a premium to their net asset value because of their leverage to the underlying commodities.

For the most part DCF calculations underestimate the true market value of an asset primarily because there is a built in expectation of finding more gold in the ground. Likewise there is a belief that there is an embedded premium for gold in the ground. In other words investors consider ownership of shares as a deep in the money option on gold prices for the future. This is based on a strike price derived from operating costs-see Gearing section below.) The size of the option is the attributable share of gold resources in the ground, whilst the expiry of the option is the mine life of the deposit adjusted for production levels. Run these inputs into the B & S Model and an option can be derived for each recovered ounce of resources. Further inputs can be assigned to management decision-making on mine maintenance or continuation using binomial lattice variations in the B & S Model.

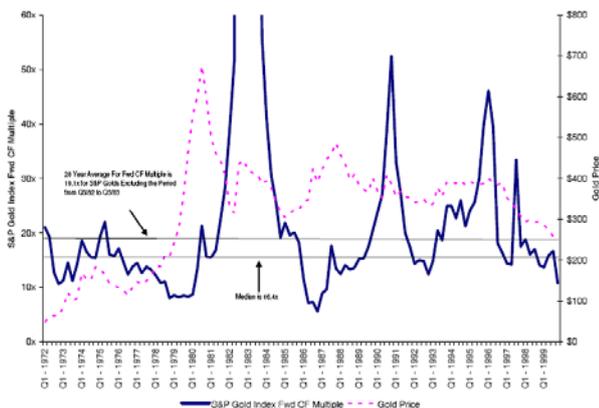
If you calculate the net asset value of a mining stock as described above you will get a result that can be used to compare different mining companies to each other, and mining companies to investments in other sectors.

Gold Equity Valuation Overview

We tend to use a Share Price to Net Asset Value (P/NAV) metric where NAV is based on a discounted cashflow (DCF) model constructed using estimates for potential and existing mining operations. NAV is interchangeable here with NPV. Our assumptions for future gold prices (and other metal by-products) entails using the forward curve approach. [This unlike many analysts who use regression analysis of historic prices to project long-term prices. The outcome of which is a long-term price some \$200 dollars below current spot prices.]

Future year cashflows are discounted using a base rate of 5% to which a premium is added, depending on the political and/or currency risk a country exhibits (the Frazer Institute provides a good starting point for assessing country risk). Often to apply a target multiple a number of other considerations are taken into account; growth, costs, type of mining projects etc. The forward strip has rarely been in backwardation, as the contango (fwd prices higher than spot) is primarily just a function of the risk free rate of cash minus the gold lease rate; i.e. the opportunity cost of holding gold versus cash. Note in an environment of low interest rates, where there is likelihood of negative real rates, there are no hurdles.

In a rising gold price environment, we believe price to cash flow (P/CF) metrics become increasingly important as they are often better for identifying both successful delivery companies and/or companies with better short-term leverage to rising gold prices. The potential for much higher cashflow multiples would seem in line with historical norms. The sector has seen P/NAV multiples using spot/fwd pricing exceed 2.5x on average and cashflow multiples exceed 20x. See the graph below which illustrates such expansion during the 1970s. A period we have already likened the current economic environment to. See CIBC Cashflow multiple expansion some 100% more than current levels:



Option valuation methodology: The embedded option for gold held in the ground has historically worked well at matching the value of ounces in the ground with market movements and the absolute prices of precious metals shares for the producers. However we have observed of late that the gap between “fair value” and market value has widened for further for projects that are not producing than those that producing assets. With much uncertainty with respect to costs, timing and “credit issues” the market seems unwilling and perhaps unable to pay up for the embedded right of the option. Without a defined period to or of production whereby the option can be seen to be “exercised” may be this appropriate. Possibly but we contend this has left some startlingly cheap assets open for a re-rating in the coming year.

Of more interest to us has been the lack of optionality assigned the producers. Again reasons for this stem back along the lines of Don Coxe’s maxim; denial that PM prices will hold such levels, belief cost expectations will continue moving higher (thereby raising the “exercise” price) and that producers have not got the ability to grow reserves and asset lives (in fact the story has changed to reserve contraction.)

Similarly CIBC highlights that contracting P/E multiples will entice the traditional fundamental investor into the market.

Gold stocks (up 25%) have outperformed gold (up 20%) so far in 2008 in contrast so some of the press indicating

otherwise. Differences in interpretation can occur in currencies and what start time is used in the analysis. Specific names have not kept up with the gold price over this period such as Newmont, IAMGOLD, and Centerra.

We think that **equities will continue to outpace bullion** driven off of earnings growth. In order to substantiate the view, the table below shows the earnings changes over the past two quarters and our expectations for Q1. As can be seen, collective earnings for the group rose 37% in Q4 and are expected to climb another 12% in Q1/08. It should be pointed out that **Q1 always has the highest uncertainty amongst estimates** as virtually no companies give quarterly guidance. It is only through a comparison of Q4/07 actuals versus Q1/08 actuals will we get a true feel for how the distribution of production will occur over the course of the year although in some cases (such as specific start-ups for new mines) the estimate of quarterly production can be gauged with higher accuracy than 2008 divided by 4. Nevertheless I have included our AVERAGE 2008 earnings estimates by this simple division as it too has implications to be discussed.

Our Q1/08 estimates are based on a gold price of about \$920/oz for the quarter. While this is the year to date figure, gold is currently trading about \$80 higher. It therefore makes sense that gold shares should be reflecting more forward looking figures than what Q1 EPS will be, if for no other reason than in the absence of a change in bullion prices, **Q1 will underestimate the earnings power of companies for the balance of the year**. As shown the current earnings multiple suggests that the stocks are slightly undervalued relative to Q3/07 and overvalued compared to Q4/07. If however one looks at the full year average, the stocks at 21.7x earnings are significantly undervalued based on a trading multiple of 32.7x in Q3/07 and 26x Q4/07 actual figures. The analysis pretty much takes into account the gold price fluctuations since our 2008 figures are driven off a gold price of \$1000. Consensus figures are driven off of gold prices of less than \$850/oz and should grossly underestimate the earnings capabilities for the gold stocks.

If we look at the average quarterly figures for all of 2008, the EPS multiples for gold stocks come down significantly. Therefore if one is willing to look beyond Q1/08 figures the latter parts of the year imply much higher earnings or much lower multiples compared to where we are now if the stocks don't move. We think that on this measure, **there is catch-up to be made in the gold equity sector relative to the gold price** even in the absence of gold price increases (although this always helps). The group includes AEM, ABX, AGI, CG, EGO, GG, GSS, HL, IAG, KGC, NEM, NGX, AUJ/YRI and is market cap weighted. (CIBC 2008)

	Earnings			2008 Average
	Q3/07	Q4/07	Q1/08	Quarterly
Gold Price	\$743	\$834	\$1,000	\$1,000
Gold Price Increase		12%	20%	
Earnings For the Group (mln)	\$847	\$1,159	\$1,297	\$1,768
Earnings Growth		37%	12%	53%
Market Capitalization (mln)	\$110,748	\$120,381	\$153,617	\$153,617
Market Cap Growth		9%	28%	
EPS Multiples	32.7x	26.0x	29.6x	21.7x

Golden Girls & Golden Years

Anyone remember the Golden Girls? a bunch of sassy “maturing” women sexing up our TV nights with innuendos and hot topics. It became a run-away hit, *The Golden Girls* became a staple of NBC’s must see TV on Saturday nights. Well we think the Golden Years may well be back. Asset managers and investors will come to regard our “Golden Girls” these “mature” miners as sexy hot propositions.



Take the Big Four: Barrick (ABX), Goldcorp (GG), Kinross (KGC) and Newmont (NEM). Barrick reported net profit of 27% for 07 vs 06, and was sufficiently cash rich to buy Rio Tinto’s stake in the Cortez Hills mine for \$1.7bn. For Q4 2007 costs came in unchanged at \$375, and EPS was above consensus at \$0.58/share. Goldcorp announced fourth quarter profits had reason fourfold from previous quarter last year and KGC reported record profits up 3 times 06 fourth quarter. The only eye in the ointment was Newmont who announced a loss of \$1.8bn in 2007. This was primarily due to a one-off non-cash charge due to termination of its Merchant banking business. The market was aware of this and too our mind is a positive signal that their balance sheet was healthy enough to contemplate the action. Their current earnings stream was enough to off-set any potential damage to their share price. All the above have been growing assets, from NEM’s BC Hope Bay project to ABX’s and GG’s Pueblo Viejo Dominican Republic project.

Asset managers need to see the kind of returns they receive from the Base Metal Miners, or did receive, as valuations have grown less attractive.

GOLD/SILVER equity Catalyst

Once we see the margin expansion in the PM miners the traditional asset manager will come hunting. What then?

The gold equity sector is some \$200bn market cap. for the Big Boys, and all in the number is around \$340-50bn. Note \$200bn is the size of Google’s market cap. Of the \$57 trillion equity investment, this is comprises a mere 0.5%. Once mainstream investors come sniffing we could see multiple P/E expansion, and we would expect to move from a current discount on NAVs to a substantial premium. Coupled with cashflow multiples expanding due to real returns this makes for a potent mixture. To illustrate the type of returns one could see in an average environment I re-hash the analysis of John Hussman, mentioned in December letter.

Indeed in the rare instances when:

- 1) The rate of inflation has been higher than 6 months earlier,
- 2) Treasury bond yields have been lower than 6 months earlier,
- 3) the NAPM Purchasing Managers Index has been below 50, and
- 4) the Gold/XAU ratio has been above 4.0, the XAU has soared at an astounding rate of 123.63% annualized. In contrast, when none of these have been true, the XAU has plunged at -53.21% annualized. (Hussman 1999)

[The XAU Index is the Philadelphia Stock Exchange Gold and Silver Index and is a capitalisation weighted index which includes the leading companies involved in the mining of gold and silver.]

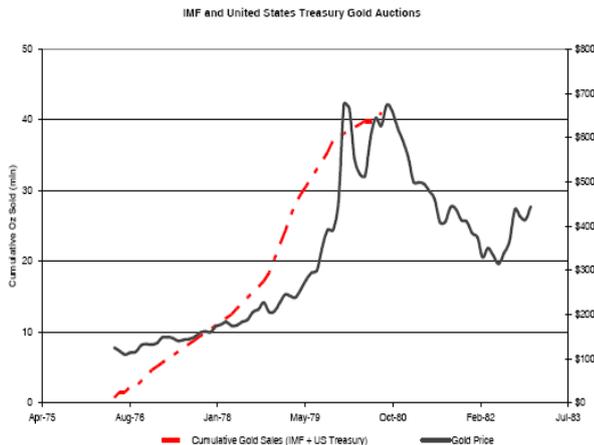
The timing for multiple expansion in the PM sector has probably never been better. If world markets come completely unglued it is quite possible that traditional asset managers will flock to this sector as they catch on to the this last bastion of cheapness. We have highlighted why there has been a lag, but let’s imagine our analysis going forward is correct. If so I say to the Gold miners:

SHOW ME THE MONEY

We think they will!

IMF SALES BULLISH OR BEARISH!?

In early February we had the announcement of potential IMF gold sales and later in the month we saw ratification of potential sales by US Congress (*note-all seven leading members of the IMF -- the G7 group of wealthy nations -- agree that the IMF should be allowed to decide for itself. But any sales of the IMF's gold must be approved by 85% of the organization's total voting power. The United States, as the largest single member nation, holds a crucial 17% of that power -- giving it an absolute veto over that 85% requirement. And the US, as the largest single member of the IMF, also contributed the largest single share of the IMF's gold.*)



Source: CIBC, Chart Hinde Capital

Would Congress approve a sale of this "IMF gold" to help shore up IMF finances? The US blocked a previous attempt to sell IMF gold in 2005. And with an election now looming, the idea of selling "legacy gold" to cover a short-term funding gap might not appeal to US politicians. Or perhaps with inflation expectations rising as signalled by a rise in gold it may be in the US Govt's interest to have IMF sell gold to cap gold prices momentarily?

First, let's take a look at why the IMF was set up. It was founded at the end of World War II with donations of cash and gold from its member nations. The IMF works at economic "crisis prevention" worldwide. Using the \$338 billion or so in cash that it holds (but never the gold, which exists as a ballast of "fundamental strength," as the IMF explains), the IMF also lends to countries facing balance-of-payments problems. This is where the IMF earns its keep, charging interest on these short-term loans. The IMF also makes loans to low-income countries implementing poverty-reduction programs, currently helping 23 countries from Afghanistan to Sierra Leone. But more famously, the IMF offers advice and technical expertise to help developing economies emerge from crises by stabilizing their foreign-exchange rates and re-structuring government finances.

Since the Argentine crisis of 2001, however -- blamed partly on the IMF's questionable advice -- new IMF lending has contracted dramatically. Therefore, the IMF's income has also contracted. The world's developing economies have simply developed too fast; they don't need as many hand-outs from the IMF. So it is a means of raising some cash flow for projects? Possibly

To our mind the IMF announcement of potential sales has just made it easier for central banks who do not own enough gold, and SWF's who wish to take large positions in gold, possible to do so. This type of thing happened in the

1970's as well. Between 1976 and 1980, the IMF sold gold in a bid "to reduce the role of gold in the international monetary system." The IMF unloaded one-third of its total gold holdings -- 1,600 tonnes in all. Half of that IMF gold was sold back to member nations at just \$35 per ounce -- the old "fixed" gold price until 1971. (But remember, these sales took place during the late 1970s, when the gold price was several times higher than \$35 an ounce.) The other half of that IMF gold was sold via auction, but the auctions were so well subscribed that the impact on the gold price was actually to force it higher. The auctions were eventually suspended.

We believe "prior gold sales" like this actually attract big buyers to the market and removes overhanging supply i.e. it will not depress prices. This is definitely bullish, not bearish. The IMF owns about \$90-92 bln of gold, which is insignificant compared to China's \$1.3trillion in reserves. The Chinese are a counterparty ripe for such purchase as they are a nation diversifying their dollar holdings and seeking protection for their remaining holdings. The announcement and ratification by the US Undersecretary for Intl Affairs David McCormick to allow the Gold Sales is interesting in its timing both for fact we arrive at nominal new highs and a potential bailout of the bank insurers is on the table.

Reading further in to the details-"The US Treasury, in a significant policy shift, has decided it will support gold sales from the International Monetary Fund's reserves if they are part of a comprehensive package of reforms in the way the international financial organization operates." The administration -- which had, until now, opposed selling gold reserves -- would support a sale of the scale of roughly 8 pct of the reserves, or 12.9 mln ounces, to fund an endowment which would produce income to support IMF operations -- income in the range of 250-300 bln usd per year.