LOEWEN, ONDAATJE, McCUTCHEON LIMITED

EQUITY RESEARCH
MINING
REPORT
August 2, 2012

PROSPECTS FOR GOLD AND A PORTFOLIO APPROACH

Michael Fowler, M.Sc, MBA
Senior Mining Analyst
416-964-4440, mfowler @lomltd.com

Bullish Outlook

- Gold price movements are strongly tied to the macroeconomic environment and investment flows related to it. Specifically the expansion of the money supply and printing money are important positive influences on the gold price. These actions devalue currencies and spur gold as the ultimate store of value. We see the gold price potentially increasing to US$2000 per ounce in 2013.
- Currently investors prefer US bonds to gold, but sentiment may change as the debt ceiling will have to be raised again focusing investors on a heavily indebted nation. Gold may rise against the US dollar at that time.
- When looking at gold stocks, it is useful to categorize them into segments based on their risk reward fundamental characteristics. In reality we are looking for growth at an acceptable price.
- These segments are: senior producers, mid-tier producers, companies with turnaround potential, emerging producers, development companies and explorers. Expected return increases from left to right and so does risk.
- This approach can be used to a structure a gold stock portfolio.

Sample Portfolio

Slow Growth Senior Companies	**10% Goldcorp (G-$36.20), Kinross Gold (K-$8.38).**
Fast Growth Junior Mid-Tier	**40% Alamos Gold (AGI $15.72), SEMAFO (SMF-$3.16), Centamin Egypt (CEE-$1.03), Aurizon Mines (ARZ-$4.45).**
Turnaround Situations	**20% Wesdome Gold (WDO-$0.86), Brigus Gold (BRD-$0.83), Lakeshore Gold (LSG-$1.01).**
Developers Late Stage	**10% Fortune Minerals (FT-$0.61), Tyhee Gold (TDC-$0.08).**
Emerging Producers	**15% Atna Resources (ATN-$0.95), Golden Minerals (AUM-$4.25).**
Explorers	**5% Clifton Star-(CFO-$0.85), Moneta Porcupine (ME-$0.155), Intl Northair (INM-$0.245), Northern Freegold (NFR-$0.10).**

Table of Contents

TORONTO

Head Office

55 Avenue Road
Suite 2250 East Tower
Toronto, ON M5R 3L2
Tel: 416-964-4455
Fax: 416-964-4490
NA: 1-800-567-1566 (Toll Free)
EU: 00-800-5660-5660 (Toll Free)

MEMBERS

TMX Exchange

TMX Venture Exchange

Investment Industry Regulatory Organization of Canada

Investment Industry Association of Canada

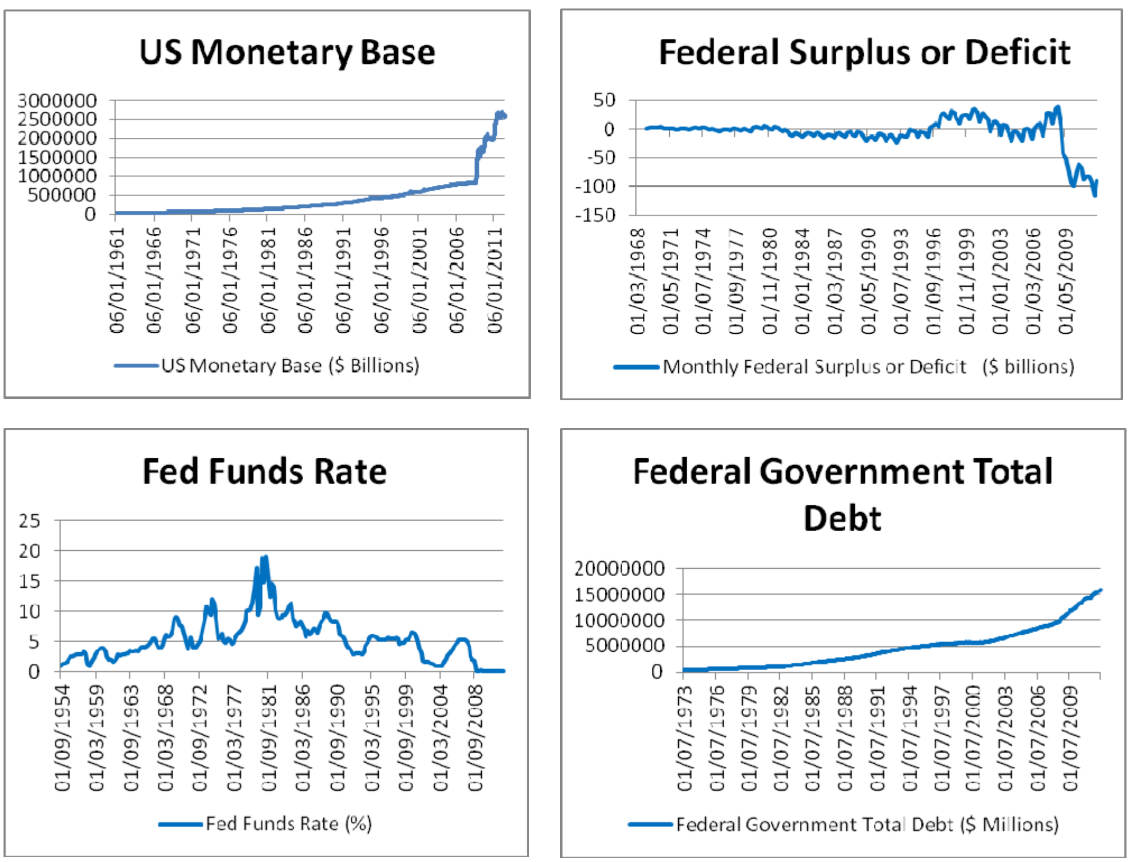
Canadian Investor Protection Fund

Gold - ultimate store of value from depreciating currencies? We think so

The rise in the gold price in the last twelve years has been essentially due to increased investor demand, right from the collapse of the internet bubble and has carried on through the current financial crisis. A big element is jewellery demand but this typically underpins gold and does not appear to drive the price. In fact most evidence suggests that there is a negative correlation between the two. As the gold price goes down, jewellery demand actually increases and vice-versa. We believe that the gold price is more a function of the world macroeconomic environment and investment flows related to that.

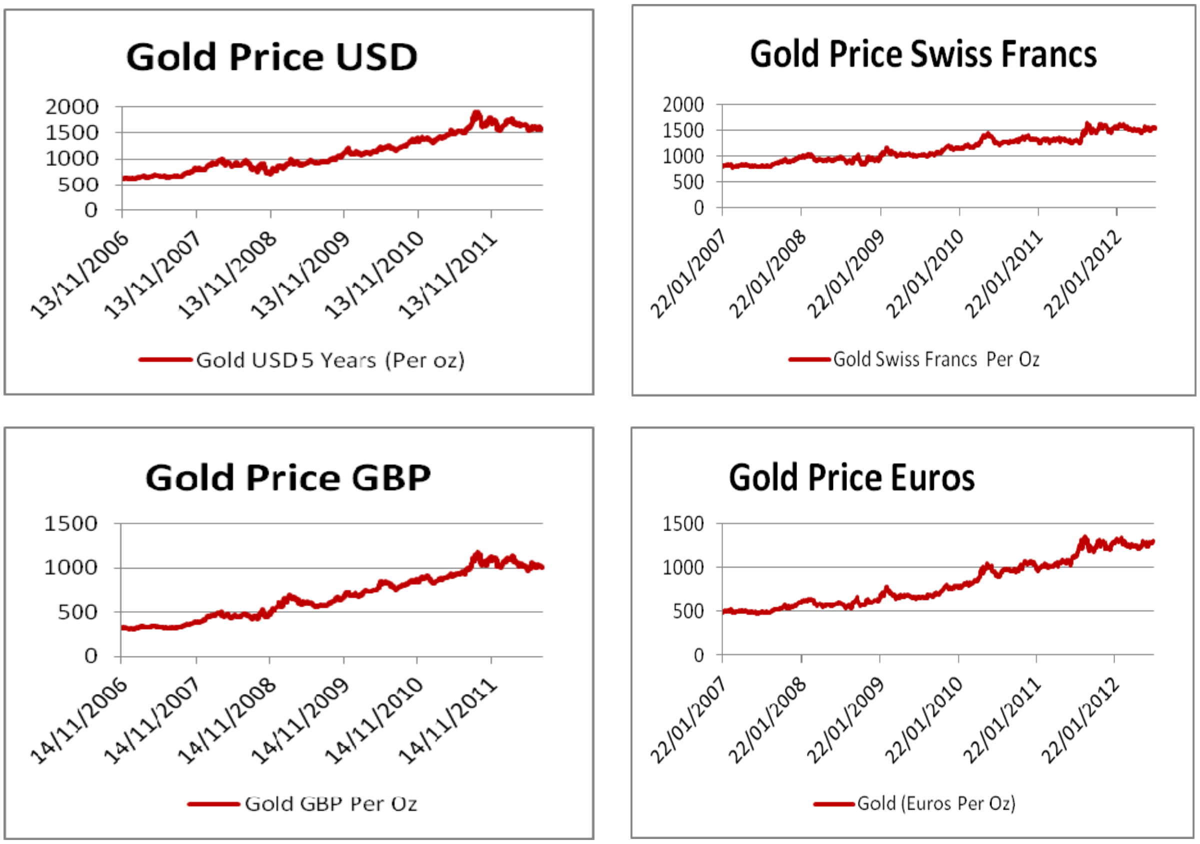
For thousands of years gold has been a medium of monetary transactions to buy goods and services. Indeed in the past paper reserve currencies were backed by gold until 1971 when the gold standard was severed. After 1971 this allowed government treasuries to rapidly expand their money supplies and deficits in order to promote growth. Fast forward to today and at the end of a long cycle of deficit spending, the world is swimming in debts and governments are now struggling to reduce them. See following charts. The options open to politicians are: (1) default on debts, (2) maintain austerity measures such as large cuts to government obligations and increase taxes, and (3) reflate economies by essentially printing money. Since the plain vanilla options (1) and (2) are politically non-starters, countries will continue to predominantly follow option (3) as a way out of their problems. We have seen this action followed in the US, UK, the ECB and even Switzerland. We think that countries around the world will continue to follow this course in the future. Politicians need to get elected and the prospects of riots, high unemployment and discontent are too high a price to pay.

Exhibit 1: Expansion of the US Money Supply, Federal Deficits, Interest Rates and Government Debt



To reflate an economy requires ample availability of capital, which means further increasing the money supply and maintaining low interest rates. The gold price is strongly correlated to monetary liquidity and real interest rates. Both indicators are still positive for gold and we believe that low interest rates and high money liquidity will continue in the future. As we feel that governments will essentially inflate their way out of problems, this means that they will de-facto devalue their individual currencies. As gold is essentially a form of currency, we believe that it will rise against all currencies in the near future. See figures below for gold's performance against major currencies in the last 5 years.

Exhibit 2: Gold Prices In Various Currencies Over 5 Years



Currently there is a view in some quarters that gold has lost its safe haven status. Investors have flocked to deeply liquid bond markets, such as US treasuries and German Bunds. Currently there is confidence in US and German bonds. This has taken some of the shine off gold and also the reluctance of the US Fed to institute QE3 hasn't helped (although we think it is only a matter of time before QE3 is announced). However, German Bunds are vulnerable to German banking concerns (Germany's sovereign debt rating has been cut recently) in view of their exposure to some of Europe's problem countries. As far as US sovereign debt is concerned, it was downgraded last year, although it still has a high rating. In addition, we may have the spectacle of the US having to raise the debt ceiling yet again in September, prior to the US Presidential election. This may focus the media and public on this issue again. In our opinion, gold will benefit as the ultimate store of value against devaluing currencies in the longer run as governments find it hard to cut deficits and debts.

The world's central banks obviously believe that gold has value since they have been buying gold in the last 3 years themselves. Countries that have bought recently include: India, China, and Mexico.

What is the bear case for gold?

Most analysts provide analysis of the bull case for gold. So what is the bear case? We see two main possibilities: (1) anti-reflationary policies or deflationary actions without monetary stimulus, (2) higher real interest rates associated with solid economic growth .We don't think that the first option is palatable politically.

If there was no more quantitative easing or LTRO in a recessionary environment, there would be a very real possibility of a meltdown of the financial system and political consequences that go with it. One could observe that at the outset of the 2008/09 financial meltdown, gold tumbled alongside others, but rebounded when the central banks increased global monetary liquidity.

The second possibility of higher real interest rates is a real threat, but we feel this may be a long way off. In this scenario economic growth starts to be robust and with that real interest rates rise to choke off a possible inflationary effect. The 1980 to 2000 period was effectively this. Inflation was out of control in the early eighties and real interest rates were generally high, causing gold to be a poor returning asset in that period. As the debt to GDP ratios were a lot lower in that period, the risk of default from higher interest rates was also low. Given all of the current debt problems in the world, we see slow economic growth in the near-term and central bankers will be very hesitant to raise interest rates, which is positive for gold.

Conclusion-we are bullish

We see the greater probability of higher gold prices in the near future. We feel that there is only about a 10% chance of the bear case happening and the odds are more in the bullish camp. We have a working average price target of $2000 per ounce for 2013.

Different types of gold stocks –portfolio approach

Gold stocks have significantly underperformed the gold price. Gold to date is up 4%, whilst the stocks, as defined by the S&P gold index, are off 19%. In 2011 the gold price advanced 11%, whilst the stocks were down 5%. The reason for the decline is probably due to a number of reasons: (1) general market risk has increased and multiples have shrunk, (2) disappointing results by gold companies due to high cost inflation in the sector, (3) a more negative view on the gold price going forward, (4) increasing country and political risk around the world and (5) numerous production problems. At the same time gold producers in general are producing strong cash flows and importantly the oil price is declining and this should have a strong positive cost effect on companies. We believe the stocks will rebound, but nowhere near the high historic multiples of the past. In the 1990's and early 2000's gold stocks traded at 2.5 to 3 times net asset value. Currently the stocks are trading at a 50% discount to net asset value. As far as we know this is a record and in our view, overly pessimistic. We are therefore predicting a rebound of the gold stocks into 2013 as we see a gold price rise outpacing cost inflation and for operating margins to increase.

For developing a gold stock portfolio, we find it useful to segment gold stocks for ease of analysis. We have defined the following types and the risk profile increases to the bottom. These categories are generally based on the internal fundamentals of companies and not on the gold price:

a) Senior Producers–(expected stock upside potential of 10% per annum).

b) Junior-Mid-Tier Producers.-Fast growth companies - (10 to 20% per annum expected upside).

c) Turnarounds Candidates- (greater than 30%-50% per annum expected upside).

d) Emerging Producers - (30% per annum expected upside).

e) Development Companies. - Asset plays (40% per annum. expected upside).

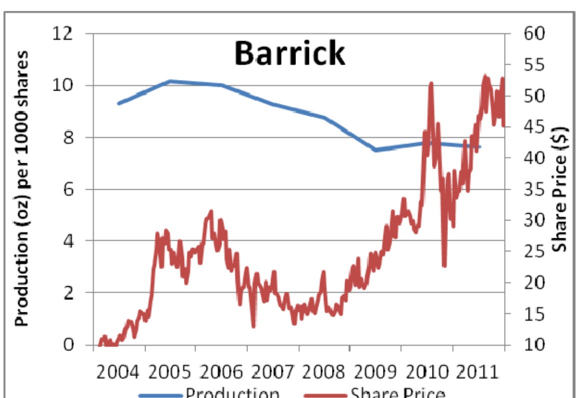
f) Explorers. - Speculative stocks (greater than 50% per annum expected upside).

Senior Producers-Slow Internal Growth Companies

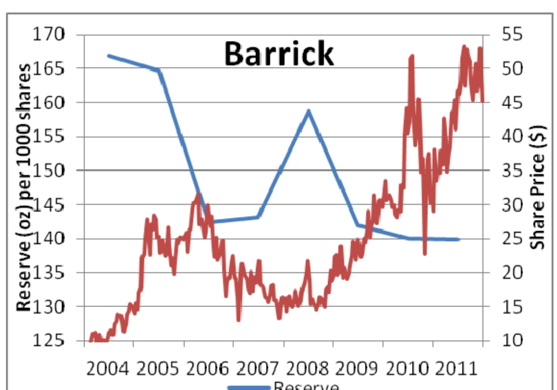
Generally these companies show low amounts of future margin and reserve growth and therefore are fairly poor investments from a growth standpoint. In fact most of them show growth rates of less than 10% per annum and some no growth at all. For example, if we look at graphs of Barrick Gold (ABX-TSX-not rated), there has been no growth in reserves or production per share over the last 6 years. These are measures that we use for growth characteristics. The increase in the share price over that time is only due to a rise in the gold price and the margin expansion from that. If we take a 5 year window, Barrick Gold has underperformed its peers. We currently do believe that on a valuation basis, trading at just 8 times trailing earnings that it is very inexpensive and the low multiple is probably discounting margin deterioration in the future. We also believe that these types of producers should try to increase their dividends even further.

The lower graph shows the big problem for the senior gold companies namely lack of organic growth. In the following graph we have looked at future margin and reserve growth. In that way we have a way of measuring internal growth rates. In this depiction Goldcorp (G-TSX-not rated) appears to have the best growth profile, but based on attractively priced growth, Kinross (K-TSX-not rated) may surprise. In any event, growth investors with a high risk tolerance would be wise to primarily look at the junior to mid tier sector.

Exhibit 3: Barrick Gold- Stock Chart and Reserve and Production Growth

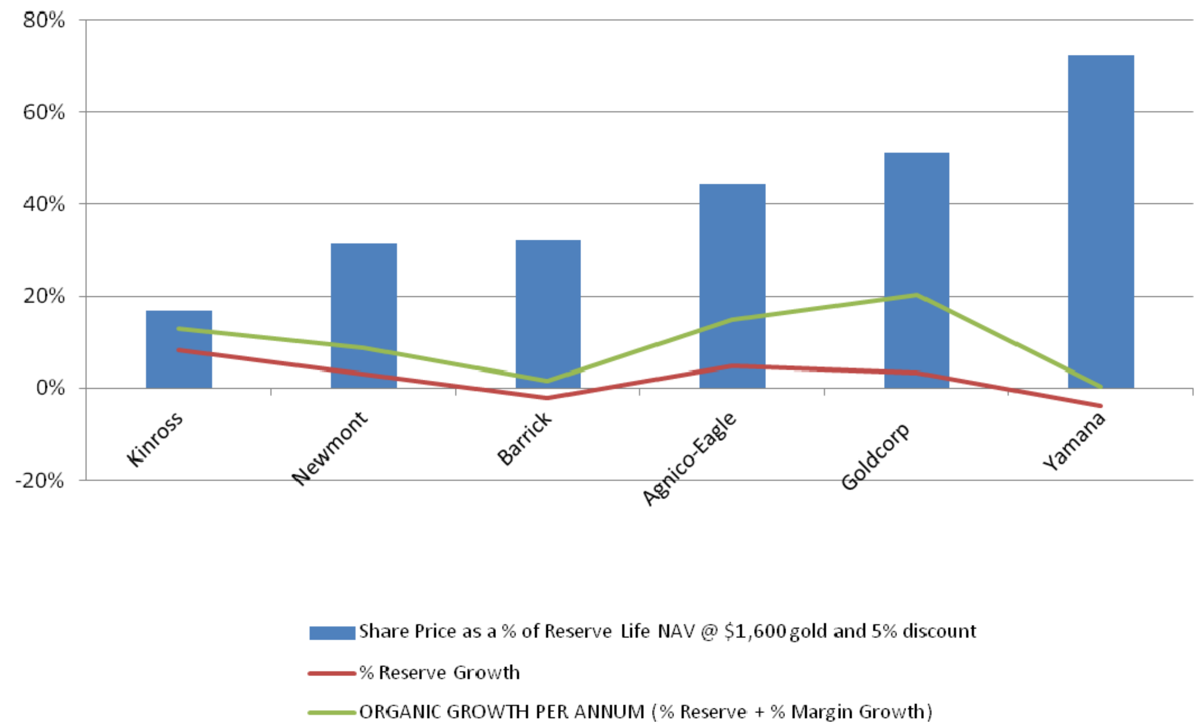


Source: Bloomberg, Company Reports



Source: Bloomberg, Company Reports

Exhibit 4: Price to Net Asset Valuation and Future Organic Growth for the Seniors

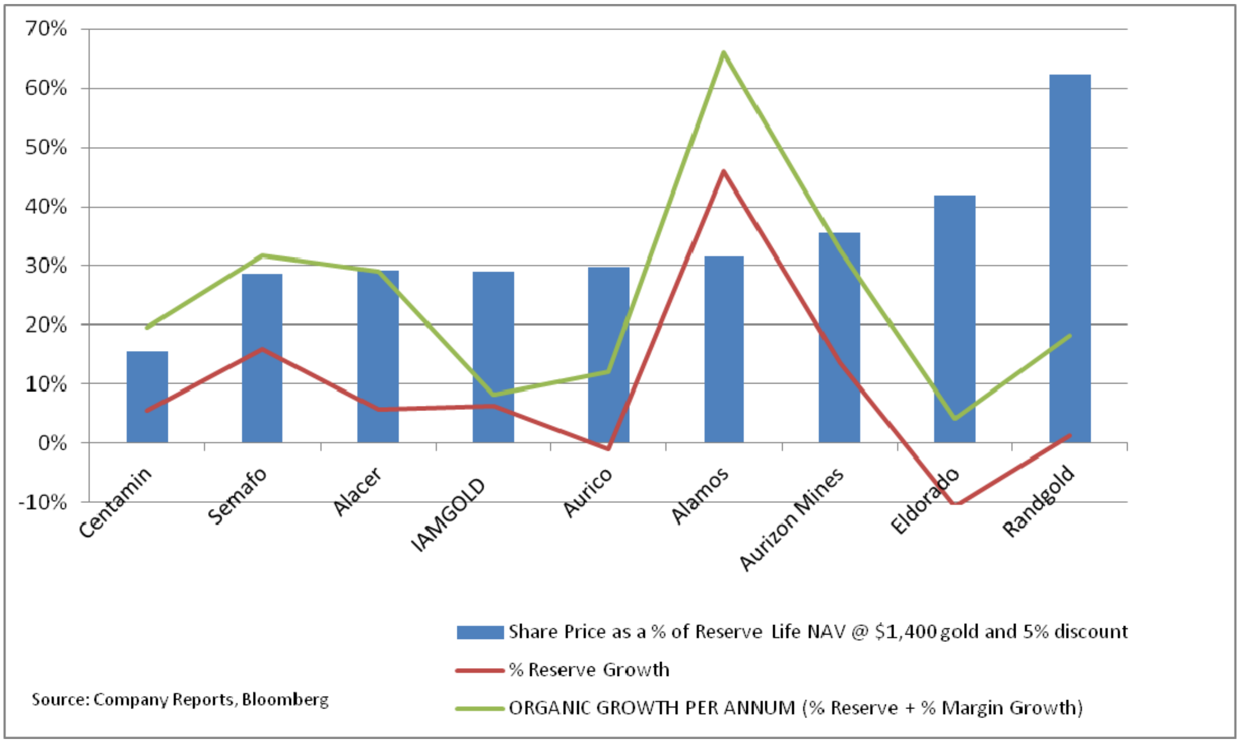


Source: Company Reports, Bloomberg

Junior-Mid-Tier Producers-Typically Fast Growers

This is the area where one finds margin and reserves growth rates of plus 20% per annum. In the mid-tier there are a number of companies with attractive growth rates. These include: Alacer Gold (ASR-TSX-not rated), Alamos Gold (AGI-TSX-not rated), Centamin Egypt (CEE-TSX-not rated), Randgold Resources (GOLD-Nasdaq-not rated), SEMAFO (TSX-not rated) and Aurizon Mines (ARZ-TSX-BUY). On a valuation basis: Alamos, Centamin Egypt, Alacer SEMAFO and Aurizon look inexpensive compared to others and maintain good growth rates. They exhibit growth at an acceptable valuation.

Exhibit 5: Price To Net Asset Value Net Asset Valuation and Future Organic Growth Rates for Mid-Tier Producers



Turnaround Situations-Recovery Stocks

These are situations where the company has hit hard times with its operations and typically it has incurred debt. However if the operations are beginning to turn around and the liquidity/solvency risk is low, then these companies could become fabulous investment opportunities. One turnaround story that we are following is **Wesdome Gold Mines** (WDO-Speculative Buy). This company has no short dated debt (it recently raised $7 million by a 5 year convertible debenture and retired a former $12 million debenture). It has positive working capital and its operations should show a turnaround through mining higher grade ore. **Brigus Gold** (BRD-TSX not rated) and **Lakeshore Gold** (LSG-TSX not rated) show similar turnaround potential.

Emerging Producers-High Risk But High Reward

These companies have just got initial mines into production or are about to put a mine into production. This section of the market place is fraught with risk since new mines are inherently difficult to start up. Fire River Gold (FAU-TSXV, HOLD), with its production ramp up problems, is a good example of this. However, if these companies succeed, stock prices should perform strongly in the market. Two companies that are making the transition are **Golden Minerals** (AUM-TSXV, not rated) and **Atna Resources** (ATN-TSXV, not rated). They have good quality mining teams, which we believe is a key element. The transition from developers to established producers is illustrated by the following graph. As risk is diminised, the market pays higher values for resources in the ground.

Exhibit 6

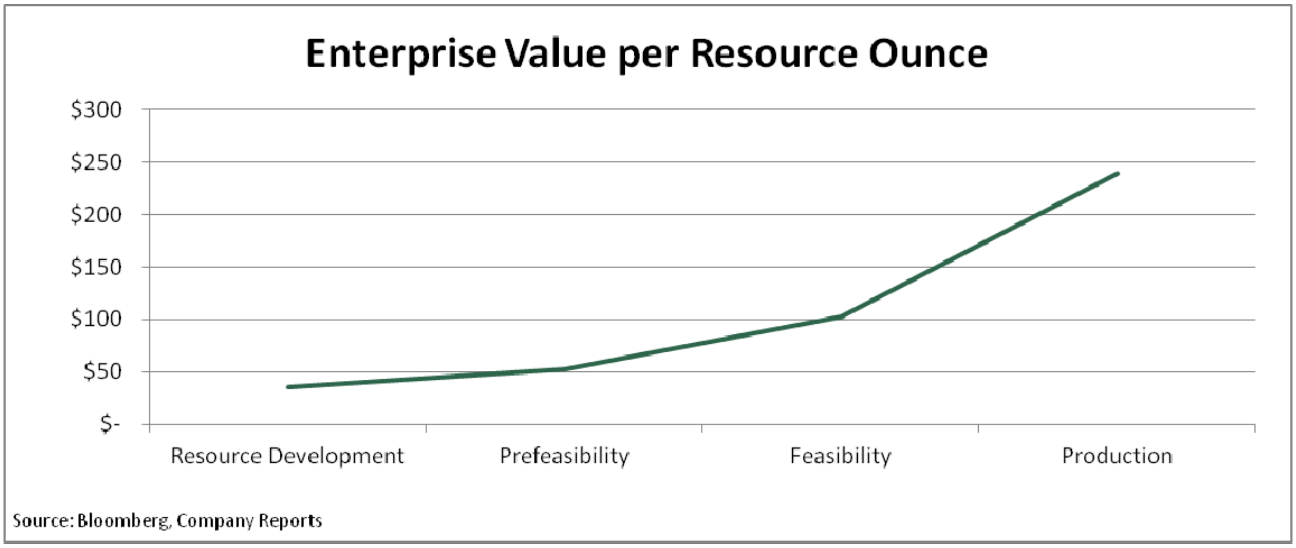
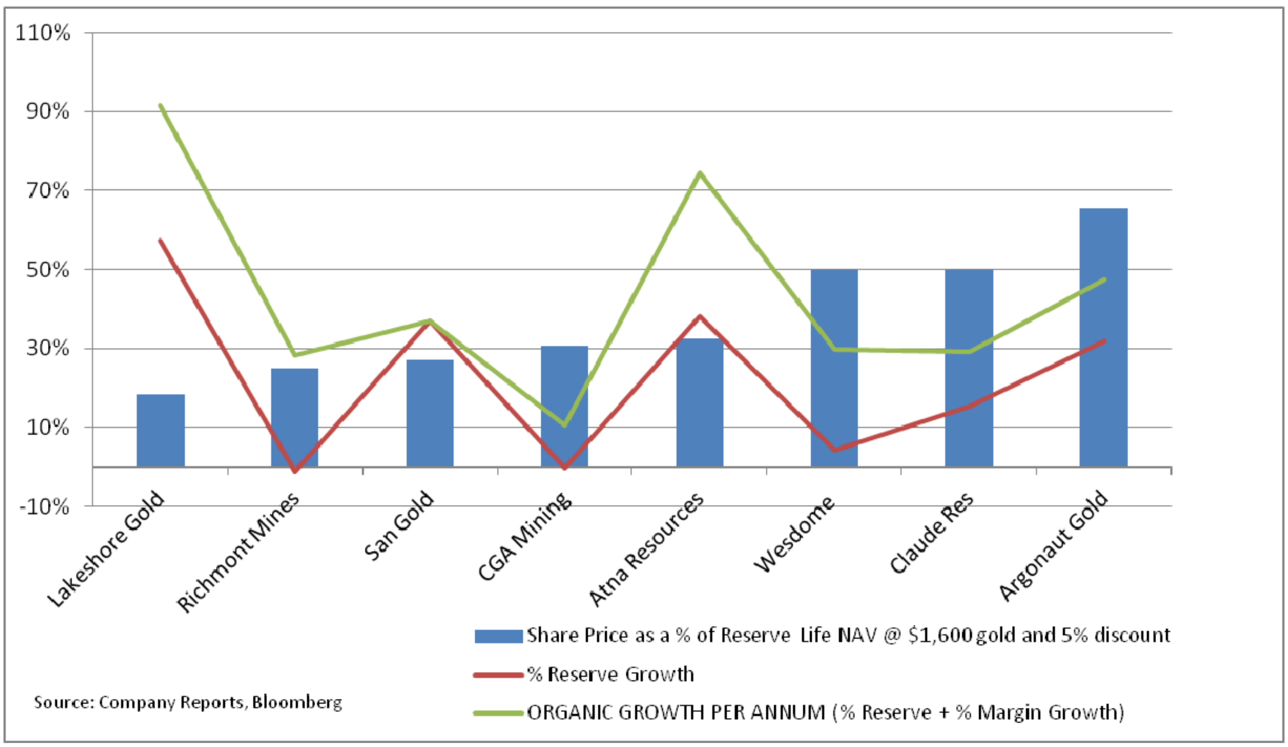


Exhibit 7: Net Asset Value and Emerging Producer Organic Growth



In the figure above, we note **Lakeshore, San Gold (TSX-not rated) and Atna Resources** have particularly favourable growth/ valuation characteristics. Lakeshore and San Gold will have to show definitive turnaround signs to get a valuation increase, as they both have underperformed production expectations.

Development Companies-Asset Plays-Takeover Potential

These are companies which have developed a resource/reserve and who have the potential to be taken over/merged or joint ventured with a more senior company. These are typically late stage development companies, who need considerable finance to get projects into production. They also tend to trade at a significant discount to their net asset value per share. One such company is **Fortune Minerals** (FT-TSX, Speculative Buy), which we follow. The sum of the net present values of its projects exceeds $5 per share, whereas the stock trades at $0.60 per share. **Tyhee Gold** (TDC-TSX, Speculative Buy) is another company that could attract a producer looking for additional production. The company is in the process of completing a full feasibility study soon.

Explorers-The Highest Risk Reward Plays

Currently this is a very tough time for explorers as the financing window is effectively shut and they have to raise capital to survive. Typically the window shuts for about 18 months and then reopens for approximately the same amount of time. We are about 13 months into this down period. Share price losses in a down period are typically 50% or more, however the upside is plus 100% in the up periods. We have a number of recommended juniors, namely **Clifton Star Resources (CFO-TSXV, Speculative Buy), Moneta Porcupine (ME-TSX, Speculative Buy), International Northair Mines (INM-TSXV, Speculative Buy) and Northern Freegold (NFR-TSXV, Speculative Buy)**

Loewen, Ondaatje, McCutcheon Limited