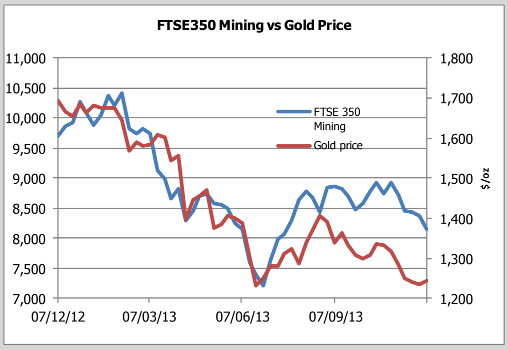
HYBRIDAN

Gold Review

16th December 2013

Elephants never forget



Source: Fidessa

The phony debate over tapering in the financial media has not helped the gold price and gold equities, although it has been a boon for gold buyers. The hysteria generated by random GDP and employment numbers and how these might influence central banks merely seeks to deflect attention from the elephant in the room, which controls the giant Ponzi scheme. The good news for gold investors is that elephants don't forget and this elephant remembers that the world economy collapsed in September 2008 because debt held by US households had contracted by $61bn in six months, equivalent to just 0.1% of the entire US credit market.

The only reason why the Fed is considering tapering is because the US private sector is building on its debts again. Consumer credit is growing at 6% pa and it may not be long before the US debt is growing at its long-term average of 8% pa without any help from the Fed. Interestingly, total UK household debt recently passed its previous peak set in September 2008.

Therefore, tapering or no tapering, conditions remain favourable for gold investors as real economic growth will always struggle to keep pace with the supply of fiat money. It is only a matter of time before the gold price starts moving upwards.

- **No respite for gold equities....**
  Most gold and other mining stocks are continuing to lose ground reflecting the downward trend in underlying commodity prices and industry profitability. Even if the gold price may appear to have stabilised in the $1,200-1,300/oz range, few gold companies are profitable at these levels. There is a lag before the supply side fully responds to the price and we expect more gold companies to go out of business over the next year if gold prices don't recover.

- **....but is gold demand being underreported?**
  Official data point to a continuing decline in gold demand particularly from ETFs and India where the government has introduced measures to curb imports. However, export data from Switzerland to China suggests that official statistics are under-reporting Chinese demand by as much as 50%.

- **Conroy Gold and Bullabulling remain our top picks**
  We continue to believe that even if the gold price recovers strongly, investors need to be selective when investing in gold equities. In some regions costs will continue to rise due to political uncertainties. Kenya is the latest country in Africa to unexpectedly increase royalties and revoke certain mining licenses. Conroy Gold and Bullabulling continue to offer most upside potential based on valuation and location of their operations. We also believe Ariana offers good value given the valuation and lower geographical risk associated with Turkey. The company has completed a DFS and is on target to begin production in 2014.

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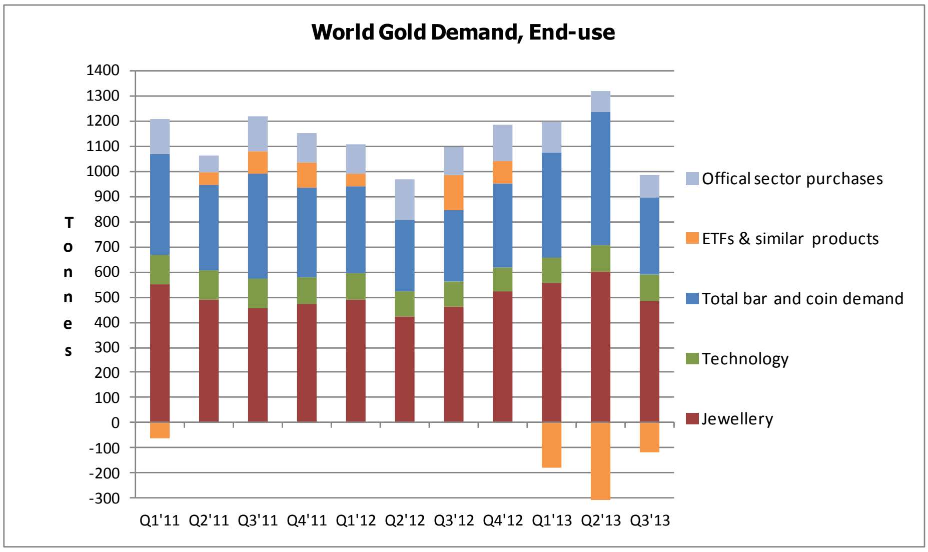
1. Gold Demand

1.1 ETF outflows continue to drive total demand lower…

Gold demand in Q3 2013 saw a 21% contraction from the same quarter in 2012 to 869 tonnes. The outflows from ETF positions, although much slower in pace than the previous quarter, were the main reason for the weaker quarterly total. However, demand at the consumer level was resilient; Eastern markets remained the driving force behind growth in demand for gold jewellery, bars and coins. Central bank net purchases were again a solid pillar of demand.

The substantial outflows from ETFs have been caused by investors in Western markets exiting their positions in anticipation of tapering. Conversely, at the consumer level, demand for gold jewellery, bars and coins for the first nine months of 2013 reached a record high.



Source: World Gold Council

1.2 …as do restrictions in India

Consumer demand would have been higher but for the Indian government's measures to reduce gold imports, in an effort to control the current account deficit. Latent demand in India remains very strong as reflected in the persistence of local price premiums above the international gold price. Higher excise duties and import payment restrictions had a limited impact in Q2/13, so the Indian government took a different approach in July. On top of a total ban on the import of gold coins, tight restrictions were imposed on gold bullion imports tying them to a fixed level of exports. The 80:20 rule now in place stipulates that 20% of all gold imported must be exported before further imports can be made. The confusion over complex new legislation has hampered imports to India.

1.3 …but is official data under-reporting China's demand?

Gold continues to flow eastward as ETF redemptions were offset by demand from Asian and Middle Eastern consumers. According to the data from the World Gold Council, demand in Greater China for jewellery, bars and coins reached 1,050 tonnes in the twelve months to September 2013. However, data from Switzerland, which is one of the largest trading, refining and storage centres in the world, suggests that total Chinese demand so far this year has already crossed 1,800 tonnes and could be in excess of 2,000 tonnes by the end of 2013. As the table below shows, Greater China was the largest buyer of gold in Q3. We believe this is part of China's strategy to reduce exposure to the US dollar and internationalise the renminbi, a currency that other countries can use to denominate the prices of their traded goods and international loans. Earlier this year, a survey from the Bank for International Settlements showed that the renminbi entered the list of top 10 most traded currencies for the first time. And in early December, a report from financial-services firm SWIFT revealed that the renminbi had overtaken the euro as the second most used currency in global trade finance, with its share jumping from a mere 1.89% in January 2012 to a more respectable 8.66% in October.

Total Jewellery demand by Country (tonnes)

	Q3'12	Q3'13	% change	Q4'11-Q3'12	Q4'12-Q3'13	% change
Greater China	134.1	172.2	28%	551.1	696.5	26%
India	136.1	104.7	-23%	512.5	605.2	18%
Middle East	35.4	38.7	9%	150.0	179.2	19%
USA	30.8	35.3	15%	110.6	116.5	5%
Russia	17.2	18.4	7%	68.2	72.1	6%
Turkey	20.5	23.4	14%	61.5	72.8	18%
Indonesia	8.0	9.5	19%	30.4	35.6	17%
Europe	6.7	6.0	-10%	46.6	41.4	-11%
Vietnam	1.8	2.1	17%	11.8	11.7	-1%
Japan	4.3	4.6	7%	17.0	17.2	1%
South Korea	2.2	1.9	-14%	11.0	9.6	-13%
Thailand	0.4	0.6	50%	3.3	3.5	6%
Other	64.2	69.3	8%	271.2	306.5	13%
Total	**461.7**	**486.7**	**5%**	**1845.2**	**2167.8**	**17%**

Source: World Gold Council

Total bar & coins demand by Country (tonnes)

	Q3'12	Q3'13	% change	Q4'11-Q3'12	Q4'12-Q3'13	% change
Greater China	51.6	47.9	-7%	260	354	36%
India	83.0	43.5	-48%	275	372	35%
Europe	67.7	68.9	2%	303	269	-11%
Thailand	15.4	35.0	127%	86	132	53%
USA	10.3	8.1	-21%	57	69	21%
Vietnam	15.5	20.8	34%	75	74	-1%
Turkey	7.9	24.3	208%	59	100	70%
Middle East	7.2	12.4	72%	31	47	49%
Indonesia	3.5	8.2	134%	25	31	24%
South Korea	0.5	0.4	-20%	3	3	3%
Japan	-4.9	1.4	-129%	-18	-1	-96%
Other	29.8	33.3	12%	122	141	15%
Total	**287.5**	**304.2**	**6%**	**1277**	**1589**	**24%**

Source: World Gold Council

1.4 Technology demand picks up

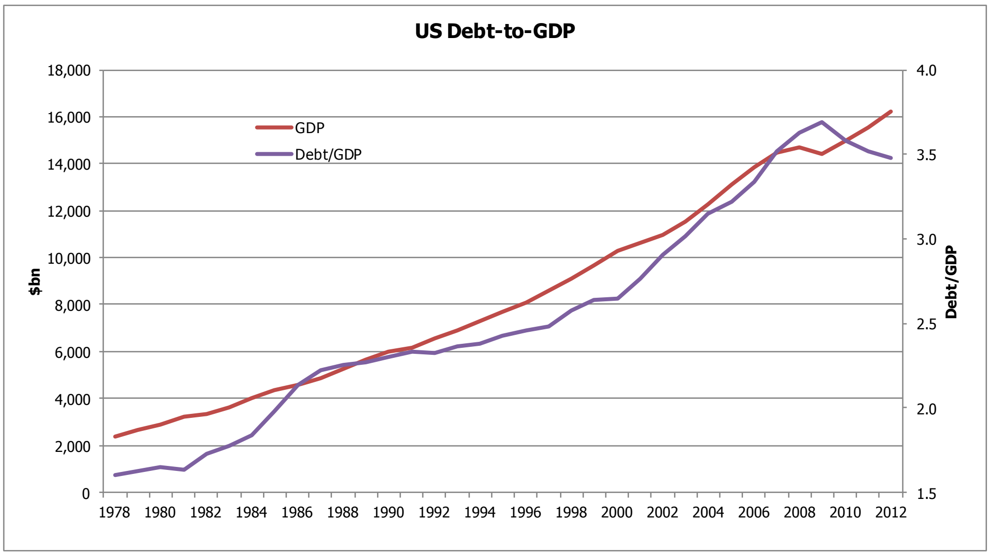
Gold demand in the technology sector reported a modest gain in Q3/13, increasing by almost 1% year-on-year for the second consecutive quarter, as lower average prices continued to support the sector, particularly in the growing smart phones and tablet market. On the downside, gold continued to lose ground to copper and increasingly silver in bonding wire production.

1.5 Central bank buying is steady

Central banks added a further 93.4 tonnes of gold to their reserves in the Q3/13 bringing year to date purchases to almost 300 tonnes. Purchases continue to be dominated by central banks within the CIS region with Russia remaining the most prominent. In October, when asked for his thoughts on precious metals as reserve assets, the ECB head, Mario Draghi, said: "I never thought it wise to sell gold, because for central banks this is a reserve of safety." But Draghi did not stop there, he went on to explain, "in the case of non-US$ countries, it (gold) gives you good protection against fluctuations of the US$."

1.6 Investment demand set to rebound

In the *August Review*, we discussed how the central banks the world over have been printing money at exponentially growing rates in recent years. As the graph below shows, the Federal government and the Federal Reserve in the US has been trying to counterbalance the deleveraging in the households and financial sector since Q3 2008 and keep the giant Ponzi scheme going.

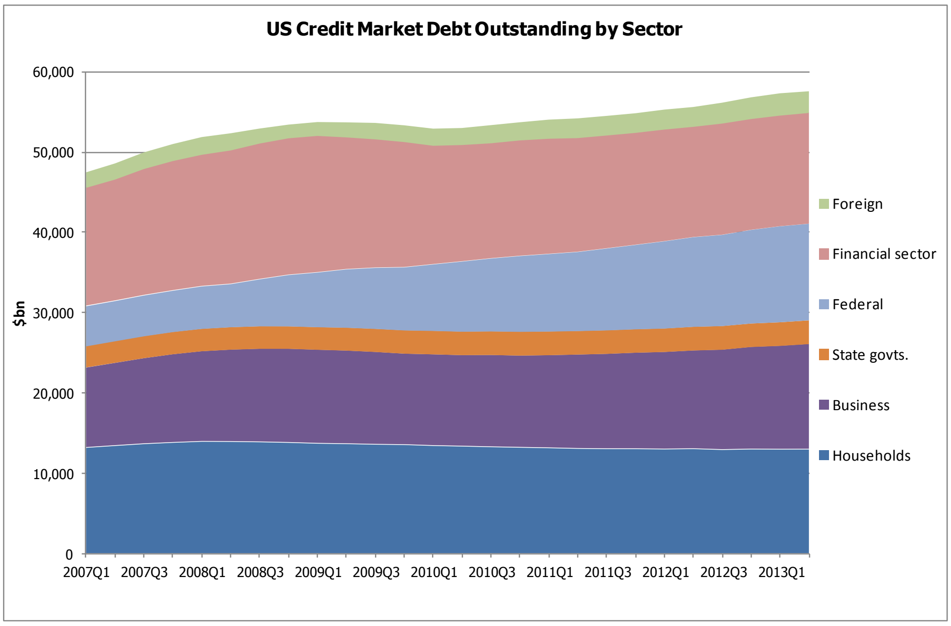


Source: The Federal Reserve, Bureau of Economic Analysis

The increase in US Federal debt is not productive; it is just piling on the already huge debt burden which is unlikely to be fully repaid without monetisation. As the graph above shows, the US debt-to-GDP ratio has been climbing since 1978 which means that the US economy has to take on an increasing amount of debt to produce the same amount of GDP.

However, it is hard to unwind the debt without causing an economic collapse. In September 2008, the economic system stopped functioning as panic over the credit crunch grew. Even a small correction in debt can cause huge damage. Between April and September 2008, total US household debt fell by $61bn, a mere 0.1% of total US debt.

However, as the graph below shows the private sectors in the US are starting to build debt again and this is the reason why the Fed is considering tapering its bond buying programme. While the growth in US private sector debt is still below is historical average of 8%, some areas like consumer credit are already growing at 6% and it may not be long before all private sector debt is growing strongly. This will allow the Fed to take its foot of the pedal.



Source: The Federal Reserve

Gold cannot possibly be expected to keep up with the fast growth in paper and electronic money floating around the world. You can't print gold after all, you need to find it, dig it out of the ground, refine it, etc., a hugely expensive and time-consuming process which practically ensures a stable rather than exponentially growing supply. Once investors realise that the central and other banks are in the game indefinitely, gold and silver will lurch higher and faster than anyone anticipates.

At current gold prices, gold output will almost certainly decline as most producing mines are struggling to make money. We estimate that the average all-in-cost of gold production is now just under $1,600/oz but with average grades declining we estimate that the gold price will have to rise above $2,000/oz and stay there to revive production.

2 Gold Supply

2.1 Supply continues to fall led by recycled gold…

Gold supplied to the market during Q3/13 totalled 1,146 tonnes, 3% below the same period in 2012. The year-on-year contraction is largely explained by lower levels of recycling, outweighing modest growth in mine supply. Year to date the supply of gold is 4% lower than the same period of 2012. The primary driver so far has been in the supply of gold from recycling to almost pre-financial crisis levels.

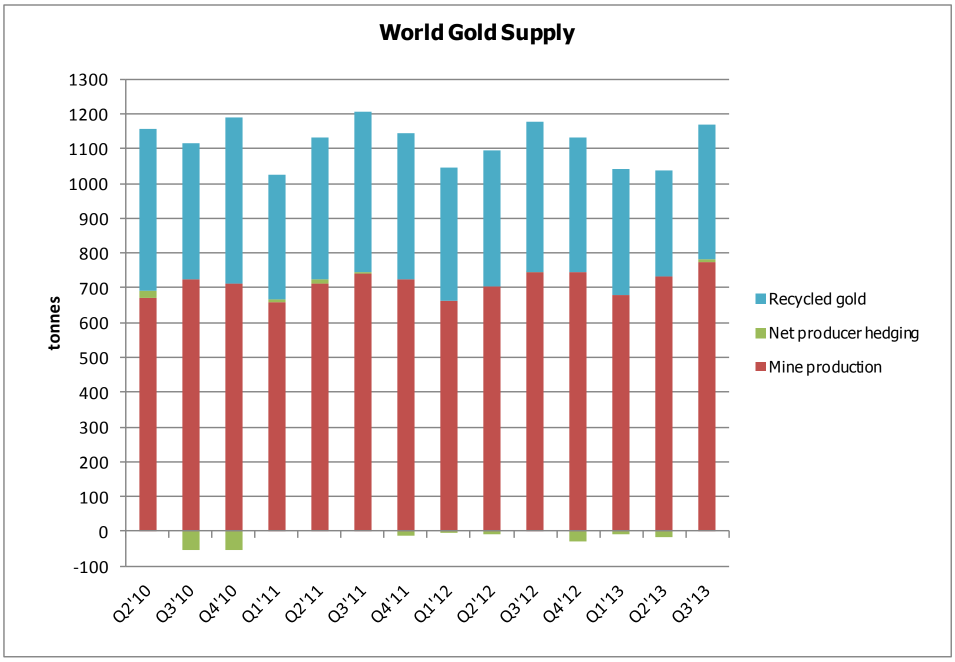
The prospects for the fourth quarter are somewhat price-dependent, but given the shrinking pool of available supplies of old gold (particularly in western markets) and the improving economic outlook, it is likely there will a notable decline in the supply of recycled gold.

Mine production is holding up better, however, the 4% year-on-year increase in Q3/13 reflects restrained conditions in the same period last year when labour disputes, operational issues and delays to projects impacted supply.

2.2 ...and mine production will follow

However, going forward, we expect mine production to decline in the medium term if the price of gold remains at current levels.

As we pointed out in our last review, lower grades means that many gold producing companies are struggling to reach their production targets and break even points. The number of new gold finds is also declining. The fall in the gold price has added to the pressure on gold supply as most gold producers are burning cash at current spot prices. If gold prices remain at current levels for long, more producing mines will be shut and more exploration/development projects abandoned. Unless the gold price rises, production must ultimately decline significantly. As demand is not expected to decline significantly, gold prices have to rise at some stage in the near future.

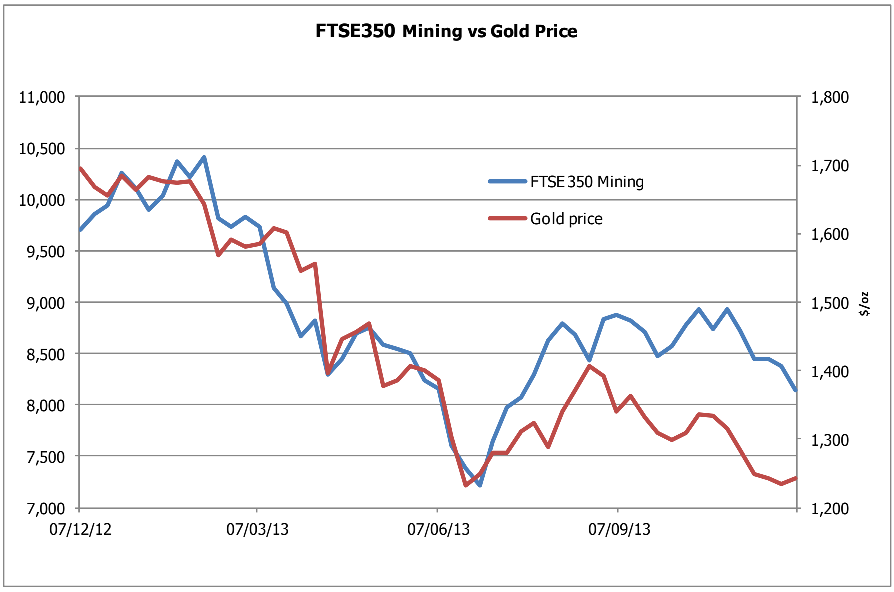


Source: World Gold Council

3. Gold Equities

3.1 Performance

The mid-year bounce in mining equities is tapering off and in recent weeks there has been further sell-off.



Source: Fidessa

Only a handful of gold exploration companies have shown a positive share performance in the past year including Conroy Gold and Natural Resources.

Performance of Gold exploration companies

		Market	Share price performance			
		Cap (£m)	1m	3m	6m	1yr
Patagonia Gold	Exp	94	-20.4	-18.9	-4.4	-51.7
Aureus Mining	Exp	91	-8.7	-13.9	1.9	-32.0
Metals Exploration	Exp	79	4.5	-11.5	-19.3	-36.1
Solgold	Exp	60	-4.6	-20.2	159.4	219.2
Condor Gold	Exp	31	-33.2	-37.3	-22.0	-51.9
Serabi Gold	Exp	23	-4.9	-15.2	-26.4	-17.0
ECR Minerals	Exp	15	30.1	25.0	239.3	50.8
Mariana Resources	Exp	13	-32.6	34.7	117.3	-18.5
Papua Mining	Exp	13	-29.6	-25.3	-53.5	-29.6
Kefi Minerals	Exp	12	2.3	-20.4	-27.4	-37.1
Bullabulling	Exp	9	-9.1	-44.4	5.3	-61.5
Orogen Gold	Exp	7	-10.1	-37.4	-1.6	-46.1
Noricum	Exp	7	-21.5	-34.9	2.0	-12.6
Ovoca Gold	Exp	7	-2.9	-19.3	-18.3	-11.8
Ariana	Exp	7	2.1	18.8	14.3	-7.7
Sovereign Mines	Exp	6	0.0	-8.7	23.5	-38.2
Ortac resources	Exp	6	-5.5	-16.1	-3.7	-42.2
Conroy Gold & Nat. Rsrcs.	**Exp**	**6**	**-7.1**	**0.0**	**-9.3**	**56.0**
Kalimantan	Exp	5	0.0	-14.8	-25.8	-28.1
Nyota Minerals	Exp	5	-33.1	-38.1	-54.0	-89.0
Wishbone Gold	Exp	5	17.6	-9.1	5.3	0.0
Goldstone	Exp	4	-38.2	-37.3	-30.0	-60.7
Greatland	Exp	3	33.3	-18.7	20.5	-20.0
Aurum Mining	Exp	3	-11.8	-21.1	-34.8	-37.5
Touchstone	Exp	2	-34.3	-27.0	-65.9	-87.9
Connemara	Exp	2	5.1	0.0	-4.7	-41.4
Scotgold	Exp	1	-24.5	-41.4	-35.9	-74.8
Average			**-8.8**	**-16.8**	**5.6**	**-22.5**

Source: Fidessa

Overall, gold producing companies have performed worse than gold exploration companies reflecting the pressure on P&L and balance sheets as producing gold has become a loss-making activity for most companies. The share price of only one producing company, Hambledon, has increased in absolute terms over the past year.

Performance of Gold producing companies

		Market	Share price performance			
		Cap (£m)	1m	3m	6m	1yr
Polyus	Prod	5731	-3.8	-6.2	-6.0	-8.1
Randgold Resources	Prod	3768	-12.4	-20.1	-20.2	-37.7
AngloGold	Prod	3490	-11.7	-8.7	-28.5	-55.5
Polymetal	Prod	1956	-16.0	-33.0	-25.9	-53.0
African Barrick Gold	Prod	638	-22.6	-17.5	14.2	-63.0
Centamin	Prod	480	-24.1	-17.9	0.1	-25.4
Hochschild	Prod	457	-26.9	-55.6	-46.1	-73.7
Pan African	Prod	222	-19.3	-11.1	-23.8	-37.8
Medusa Mining	Prod	192	-22.6	-38.4	-44.1	-76.6
Highland Gold	Prod	190	-17.5	-27.8	-31.3	-33.2
Petropavlovsk	Prod	113	-28.1	-41.2	-56.1	-83.0
Kirkland Lake	Prod	109	-27.4	-42.5	-57.3	-70.7
Shanta Gold	Prod	54	-14.7	-21.2	-2.1	-41.9
Avocet	Prod	28	-15.2	-31.2	26.2	-80.8
Amara Mining	Prod	27	-13.2	-38.7	-41.0	-82.5
Caledonian Mining	Prod	24	-4.1	-14.3	-35.9	-29.8
Charaat Gold	Prod	24	-16.3	-42.9	-10.0	-54.1
Vatukoula	Prod	23	-23.8	-33.0	-35.9	-79.0
Hambledon	Prod	20	-10.1	-2.4	70.2	21.2
Mwana	Prod	18	-3.1	-22.8	-62.4	-75.3
Minera	Prod	17	-32.0	-37.2	-53.3	-83.1
Trans-Siberian Gold	Prod	15	-12.5	-44.6	-39.1	-65.0
Goldplat	Prod	12	-13.8	-23.3	-6.7	-45.6
Peninsular Gold	Prod	11	-6.3	-11.1	-22.4	-35.0
Oxus Gold	Prod	11	-2.5	28.3	11.1	-16.4
Orosur Mining	Prod	8	-6.9	-12.0	0.0	-71.5
Kolar	Prod	6	-16.9	28.9	58.1	-10.9
Central Rand Gold	Prod	5	-14.7	90.2	-4.9	-63.8
Galantas	Prod	3	-24.6	-10.9	-2.0	-48.4
Average			**-16.0**	**-17.9**	**-16.4**	**-51.0**

Source: Fidessa

We expect all gold stocks to bounce back once gold prices start to move upwards. However, given the poor infrastructure and political issues in several African, Latin American and Eastern European countries, we continue to urge caution and recommend selectivity. Among the junior explorers, a few companies including Conroy Gold, Bullabulling and Ariana Mining continue to stand out in terms of valuation and risk/reward profile of their locations. Bullabulling and Conroy Gold in particular look significantly undervalued given that they are located in Australia and Ireland, respectively, which are investor friendly. At current valuations, Ariana offers an attractive entry point, particularly as it is close to production.

Company	EV (£'m)	Operating Region	Gold Resource m oz	Cut off grade g/t Au	EV/oz. of gold
Bullabulling	9	Western Australia	3.5	0.5	2.4
Nyota Minerals	5	Ethiopia	1.9	2.3	2.5
Ortac resources	6	Slovakia	1.3	0.4	4.6
Conroy Gold & Nat. Rsrcs.	6	Ireland & Finland	1.0	0.8	5.6
Goldstone	4	Africa	0.6	0.5	6.8
Ariana	7	Turkey	0.9	0.5	7.5
Scotgold	1	Scotland	0.2	3.5	7.9
Condor Gold	31	Nicaragua, El Salvador	3.5	1.7	9.0
Serabi Gold	23	Brazil	2.5	0.5	9.1
Mariana Resources	13	Argentina, Chile & Peru	0.5	1.0	24.5
Patagonia Gold	94	Argentina	1.9	0.3	50.2
Aureus Mining	91	Cameroon	1.7	0.5	52.7
Metals Exploration	79	The Philippines	1.4	1.7	56.9
Aurum Mining	3	Spain	0	-	-
Connemara	2	Ireland	0	-	-
ECR Minerals	15	Argentina	0	-	-
Greatland	3	Australia	0	-	-
Kalimantan	5	Indonesia	0	-	-
Kefi Minerals	12	Saudi Arabia	0	-	-
Noricum	7	Austria	0	-	-
Orogen Gold	7	Serbia	0	-	-
Ovoca Gold	7	Russia	0	-	-
Papua Mining	13	Papua New Guinea	0	-	-
Solgold	60	Australia, Ecuador	0	-	-
Sovereign Mines	6	West Africa	0	-	-
Touchstone	2	Columbia	0	-	-
Wishbone Gold	5	N/A	0	-	-

Source: Company reports, Fidessa

3.2 Conroy Gold & Natural Resources

Since our last update, the company has made progress on several fronts. The Clontibret project is progressing well and has completed some of the essential elements of the pre-feasibility study, which is step 10 in our 14 step journey from exploration to production. In July this year, the company announced that the preliminary results of the BIOX® tests - which are being carried out in South Africa - were positive. Sulphide sulphur oxidation up to 98.6% has been achieved and gold dissolution up to 90.4% was recorded on the lode material. These were key technical tests in relation to the process technology and are in line with the projections in the Scoping Study.

This was followed by an announcement in October this year that the final results of the mineralogical and metallurgical testwork programme on the ore grade material sent to Goldfields/BIOMIN has confirmed the amenability and technical viability of using the BIOX® technique to process the ore at Clontibret. The testwork results indicated fast oxidation kinetics, achieving over 90% oxidation for both lode and stock work concentrate samples. Maximum gold extractions achieved were 90.4% and 87.1%, respectively, with overall recoveries confirmed by Tetra Tech to be in line with their independent Scoping Study.

In a separate development, the Company has also reported that its licence area has yielded highly positive zinc results of up to 30%. Samples were taken from twelve of the old lead workings spoil heaps in the company's licence area. Most of these samples gave high lead values although a lead value of 7.31% at the Tassan workings in County Monaghan was particularly high. Two samples from the Cornaurney workings in County Cavan gave exceptionally high zinc levels of 30% and 18.4%, respectively. These samples also had elevated copper of 0.125 and 0.216%, silver of 9.2 and 3.8 ppm, antimony of 101 and 49 ppm as well as mercury at 27ppm and 14ppm, gallium of 200ppm and 100ppm and cadmium of 2,000 ppm and 688ppm.

As well as its gold discoveries, the Company has also discovered an extensive zinc-in-soil anomaly on its prospecting licences in Counties Monaghan and Armagh. The very high zinc levels detected in the old mine working spoil heaps in County Cavan add to the overall metalliferous potential of the licence area for both gold and base metals. The original gold discovery at Clontibret, where the Company is proposing to develop a gold mine, was made in the old workings for antimony.

The economic evaluation prepared by Tetra Tech Wardrop Engineering Inc. was based on a base case commodity price for gold of US$1,372 per ounce, which gave a 49.4% IRR and a NPV, at an 8% discount rate, of US$72.3m. Even if we assume that the gold price remains at $1,235 per ounce the Clontibret mine could generate a NPV of $38m.

3.3 Bullabulling

Based on our calculations, on an EV/resource basis, shares in Bullabulling at the current level provide the most value among the junior gold exploration companies. Meanwhile the company continues to build the case for investment. In October, it announced that on-going optimisation of the Bullabulling Gold Project has confirmed the potential for further improvement in the economic performance through the relocation of public infrastructure at the northern end of the project area. A series of four open pits have been proposed for development at Bullabulling. The northern most pits, Bonecrusher and Dicksons, are separated by an exclusion zone accommodating overhead power transmission lines and a below-ground telecommunications cable. Dicksons is separated from the Phoenix pit to the south by an easement for Great Eastern Highway and the Goldfields Water Supply pipeline.

Revised mine designs based on the recently updated resource estimate from 3.5m oz to 3.71m oz show that the relocation of the power line and telecommunications cable would enable the Bonecrusher and Dicksons pits to be expanded to capture an additional 5.4 million tonnes grading 0.87g/t for 150,000 ounces of contained gold. This would take total forecast mine production over a projected mine life of approximately 13 years to 94.7 million tonnes at 0.84g/t for 2.56m ounces of contained gold, compared with the previous internal forecast of 2.41m oz. At the current spot gold price, the additional production is estimated to increase potential net cash flow by approximately $35m after allowing for infrastructure relocation costs, operating costs, metallurgical recovery and royalties.

3.4 Ariana Resources

Ariana is an exploration and development company focused on epithermal gold-silver and porphyry copper-gold deposits in Turkey. The company is developing a portfolio of prospective licences selected on the basis of its in-house geological and remote-sensing database, on its own in western Turkey and in joint venture with Eldorado Gold Corporation in north-eastern Turkey. Eldorado owns 51% of this joint venture and are fully funding all exploration work on the JV properties, while

Ariana owns 49%. The total resource inventory within this JV is 1.09m ounces of gold.

The company has received a positive Definitive Feasibility Study for the Kiziltepe gold-silver project, demonstrating a gross project NPV of US$34.4m and a 37.8% IRR at a base case of US$1304 / Au oz and US$22.6 / Ag oz. The final environmental approvals process is in progress at the Ministry of Environment and Urban Planning, while the management is in discussions to raise the US$25m of debt required to build the mine.

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