Brent Cook's Exploration Insights
Turning Rocks Into Money

Prospect Generators
by Brent Cook

Exploration is primarily a game of odds with luck at the end of a drill bit being the great unknown. I have discussed the very poor odds of discovering an economic mineral deposit numerous times in this esteemed publication. The fact that gold used to sell for over $900 an ounce and people can make money on rock containing 0.03 of an ounce per ton should tell you this stuff is hard to come by.

Nonetheless, there are literally thousands of junior exploration companies listed on the Canadian and Australian stock exchanges that are combing the world looking for gold, copper, silver, uranium, etc. Last year alone over $11 billion was spent searching for metals (Metals Economic Group data) yet you would be hard pressed to point to a dozen legitimate significant discoveries in the past five years. For the rare company that is successful, however, the rewards can be fantastic. That is why this letter takes an interest in the junior exploration sector.

How these junior companies go about their business directly affects how extraordinary our rewards or losses can be. There are three basic business models the junior explorers employ in their efforts to succeed.

1. Acquire a known deposit and work to improve its economics.
2. Continually raise money and hope like hell the next drill hole is the big discovery you have been looking for.
3. Bring in a partner to fund the heavy expenditures required to make the big discovery.

Model # 1 above works for a very select group of people who have the skill and financial connections to successfully pull it off. **Hunter Dickinson** and the **Lundin Group** are good examples of companies successfully employing this model. There are, however, many other companies that try to bootstrap themselves into a positive, free cash flow position by developing small mines. From my experience this rarely works.

Mining is a very tough and complex business in which misjudgments, delays, cost increases and metal price changes are inevitable. A large, well funded mine can normally endure these problems. A small marginal operation will go bankrupt. Although there are many notable exceptions to this rule (First Quantum, FNX Mining and Capstone) there are hundreds more small, broken mines and worthless stock certificates scattered around the lonely deserts and urban jungles of the world.

On the rare occasion that we here at Exploration Insights invest in these situations the production costs have to fall within the lower third of the industry costs, and/or the net present value must be significantly higher than the current company market capitalization. We don't do small marginal deposits!!

Model # 2 above is the preferred model for the majority of junior explorers and speculators. It gives you 100% of the upside associated with any discovery and produces huge capital gains for anyone fortunate enough to have been a shareholder. Recent examples include Aurelian Resources and Canplats Minerals. They ran from $0.65 to $30 (pre-split) and $0.20 to $5.00, respectively. On the other hand, the downside unfortunately is nearly 100%.

This "go for broke" junior exploration model requires continual financing and can work when the market is all whipped up, money is cheap and even turkeys can raise capital. However, the resulting shareholder dilution to fund the next big play means your share of any future discovery is diminished with each property drilled and gone bust.

Let's play with the numbers and assume you are able to do a bit of research and avoid the outright frauds. This generously puts the chance of a discovery at, say, 1 in 100. That being the case, statistically you would need to fund 100 drill programs for that single legitimate discovery. Put another way, assuming that you "invest" $10,000 in 100 drill-hole plays or companies you would need a 100-bagger to get your money back. A single 10-bagger means you *only* lost 90% of your one million dollars. There are of course other ways to make money in these companies. Often just the perception of a discovery and market sentiment can work for you but the actual odds of making money betting on the drill bit over the long run are really not good at all.

I feel that we here at EI are able to improve the odds of drill-hole success through careful research, years of experience, site visits and global contacts in the industry. That is why the portfolio is populated by a small number of high-risk exploration plays and developing discoveries. I do not believe in the shotgun approach and do not stay married to any company if the facts change. When the grounds for owning a stock shifts from conviction to hope, it's time to exit that stock. There are no guarantees attached to the EI portfolio and I stress anyone playing in this market should be doing so with risk capital only.

Model #3 refers to companies that joint venture their projects to partners who will then spend the big dollars needed to test the exploration targets. In doing so, shareholders' eventual ownership of a bona fide discovery is diluted but their ownership in the generating company is not. This dilution at the property level versus the corporate share structure level is not popular among most junior resource market investors. The majority of gamblers in the junior sector tend to believe that the company is giving away their shot at a 10-bagger.

The prospect generator companies, and most of the people who invest in them, tend to view their company as a long-term business venture. The management behind these companies has probably learned the hard way that despite their eternal optimism, the earth rarely deposits economic quantities of metal in one place. They recognize that actually discovering an economic mineral deposit requires considerable time (years) and money ($10's to $100's of millions). Hence, it takes a lot of looking and drilling to find the unique set of circumstances responsible for an economic mineral deposit.

Let's look at some numbers again. The typical joint venture requires the incoming partner to spend X dollars over a period of time to earn a piece of the property. Ideally the partner upgrades the property to or through the feasibility stage for a 60% to 80% interest if a resource is defined. The prospect generator is thereafter required to fund their portion (call it 30%) of the development costs or dilute their interest. This roughly 30% of a defined resource and possible 10-bagger discovery has cost investors relatively little in terms of share dilution. The same holds true if nothing of value is defined.

More importantly, the investor in a generator is ultimately exposed to more chances of a success for the same investment dollar. This is because the prospect generator continually brings in new partners to drill-test targets. Often the same old targets get worked over and over again but with a new twist. Almaden Minerals' Caballo Blanco project has seen at least four companies drill it and walk away yet each time the property became more valuable. Discoveries are usually made through a series of trials and errors where the knowledge base improves with each drill program.

I include below a spreadsheet displaying some of the more important comparables for what I believe to be the best companies following the prospect generator model. I also include brief comments on these companies. If there is one "takeaway" from this discussion it is that minerals exploration is really a long-term business that requires patience and critical analysis.

Prospect Generators						
'April 10, 2009						
Company	**Altius**	**Almaden**	**AuEx**	**Eurasian**	**Kaminak**	
Symbol	ALS	AMM	XAU	EMX	KAM	
Shares Out	28,381,818	45,759,145	34,383,457	28,515,645	36,467,520	
Share Price	$6.88	$0.77	$2.12	$0.98	$0.10	
Market Cap	$195,266,908	$35,234,542	$72,892,929	$27,945,332	$3,646,752	
Cash	$160,000,000	$12,000,000	$10,400,000	$9,500,000	$4,300,000	
Marketable Securities	$10,287,000	$650,000	$0	$800,000	$760,000	
Enterprise Value	$24,979,908	$22,584,542	$62,492,929	$17,645,332	-$1,413,248	
Cash/share	$5.64	$0.26	$0.30	$0.33	$0.12	
Securities/share	$0.36	$0.01	$0.00	$0.03	$0.02	
Hard Asset/share	$6.00	$0.28	$0.30	$0.36	$0.14	
Premium to Assets	13%	64%	86%	63%	-39%	
JV's	14	11	11	3	4	
09 JV expenditure	$3,500,000	$5,000,000	$11,700	$5,000,000	$625,000	
09 Co expenditure	$2,000,000	$750,000	$9,000,000	$3,000,000	$500,000	
Past JV expenditure	$80,000,000	$60,000,000	$10,000,000	$3,300,000	$12,000,000	
Company	**Lara Res.**	**Miranda**	**Mirasol**	**Rimfire**	**Riverside**	**Virginia**
Symbol	LRA	MAD	MRZ	RFM	RRI	VGQ
Shares Out	19,246,501	44,892,010	29,258,181	25,707,251	17,800,000	29,201,776
Share Price	$0.29	$0.27	$0.17	$0.24	$0.44	$3.70
Market Cap	5,581,485	12,120,843	4,973,891	6,169,740	7,832,000	108,046,571
Cash	$3,300,000	$10,500,000	$4,500,000	$7,000,000	$3,000,000	$39,000,000
Marketable Securities	$3,000,000	$300,000	$0	$300,000	$0	$55,000,000
Enterprise Value	-$718,515	$1,320,843	$473,891	-$1,130,260	$4,832,000	$14,046,571
Cash/share	$0.17	$0.23	$0.15	$0.27	$0.17	$1.34
Securities/share	$0.16	$0.01	$0.00	$0.01	$0.00	$1.88
Hard Asset/share	$0.33	$0.24	$0.15	$0.28	$0.17	$3.22
Premium to Assets	-13%	11%	10%	-18%	62%	13%
JV's	2	8	3	8	3	4
09 JV expenditure	$1,500,000	$1,500,000	$1,000,000	$3,750,000	$730,000	$5,000,000
09 Co expenditure	$1,500,000	$1,900,000	$1,600,000	$1,400,000	$1,300,000	$3,000,000
Past JV expenditure	$1,500,000	$9,000,000	$3,000,000	$32,000,000	$0	$23,000,000

(Fig. 1- Prospect generator spreadsheet as of April 10, 2009)

Altius Minerals is the quintessential prospect generator and an EI portfolio member. With the help of John Tognetti, Haywood Securities, the company went public at C$0.20 right at the beginning of the resource bear market of 1997. Over the ensuing 11 years Altius spent C$10 million on developing and vending conceptual exploration ideas. These ideas were subsequently turned into C$80 million worth of partner exploration through 50 joint ventures. They also paid C$13 million for a small royalty on the Voiseys Bay nickel mine. Last year the royalty stream paid back the initial investment and is set to continue pumping out cash for at least another 20 years. Their overall business has generated over C$220 million in sales and shows a compound share growth of 37%. They are now perpetually funded, with the revenue streams more than covering their annual burn. Al Korelin of the Korelin Economics Report and I sat down with VP Exploration Roland Butler in Calgary last week. You can listen to the interview here: Korelin link

Next is Almaden Minerals with $14 million in cash, and gold bullion from their deposit worth about C$1.5 million. Almaden has consistently been able to bring in joint venture partners as evidenced by the 11 current joint ventures and the recent deal struck with Antofagasta Minerals. The deal covers what appears to be a new porphyry copper prospect in Puebla, Mexico: yeah- a grassroots porphyry copper agreement in this lousy base metal environment. For a 60% interest Antofagasta must spend US$7 million in exploration and pay $1 million to Almaden over a five-year period. They can then take their interest to 75% by funding and delivering a feasibility study. From what I have seen of the data this is a very sexy property. When and if I get to it you will be the first to know.

Both AuEx Ventures and Eurasian Minerals are in the EI portfolio and have previously been discussed in some detail. AuEx has a 49% participating interest in a developing gold discovery in Nevada. Eurasian has what I believe to be a high potential gold project in Haiti. We will have more to say on Haiti after a property visit.

Kaminak Gold recently spun out their Angilak uranium project into Kivalliq Energy. This resulted in Kaminak holding 11.7% of Kivalliq. Kaminak shareholders received 0.8 of a common share of Kivalliq plus 0.5 of a purchase warrant. This deal illustrates the company's commitment to shareholders both by issuing them shares and by offsetting the KAM dilution to another entity.

Lara Exploration actually made a C$2.4 million profit last year from the sale of a phosphate deposit. This year they will continue their strategic alliance with Sprott Resource and are actively working on new advanced phosphate targets. Concerning their current portfolio projects (nickel, tin, copper and iron), they are primarily updating and refining the data package to present to potential partners. Fieldwork has slowed as President Miles Thompson and his team review a number of new opportunities. Miles says that "so far a number of interesting projects are showing up but by and large the damage in the exploration sector is not yet bad enough for us to see real bargains. As work, spending and holding costs start to accelerate we should see more reasonable deals over the next 18 months."

Miranda Gold will probably be facing a decreased drilling budget this year as some joint venture partners have cut back on exploration. Nonetheless, Miranda's geologic team continually impresses. They have been out staking claims based on some very original conceptual ideas that eventually should attract the interest of larger gold mining companies. With C$11 million in the bank and a burn of about C$1.9 million per year, President Ken Cunningham feels they are in a good position to expand upon their business model. However he points out that "we cannot afford to make a mistake with our money. There are a lot of tired old dog properties out there that junior companies are now trying to pass off. They are of no value to us."

Mirasol Resources has been stealthily executing their business model and is trading at slightly less than cash in the bank. President Mary Little has consistently managed to execute strong joint venture deals with mining companies. They currently have three active joint ventures on eight projects within a portfolio of 18 properties. Virtually all of these are on virgin properties (never systematically explored or drilled) which they generated through modern spectral analysis and good old boots on the ground. Mary is targeting the execution of three new joint ventures for this year.

Jason Weber, President of Rimfire Minerals, made a good point regarding the opportunities they are seeing now. Good exploration people that have been cut free from the majors are showing up on their doorstep. They are coming with ideas they may never have been allowed to pursue and are interested in a grubstake agreement with Rimfire. Jason also pointed out "that the majors are also coming back to us inquiring about some of the ideas we pitched them on five years ago. They are suggesting alliances and deals we can work with." I suspect we will see them add to their Australian and Canadian business portfolio this year.

Riverside Resources is a new entrant to the prospect generators having listed just over a year ago. They have structured a strategic alliance with Kinross covering Mexico, where President John-Mark Staude most recently worked for Teck-Cominco. They also have junior explorer Arcus Development working on two projects. Riverside is in the process of raising about C$1 million through a 2.5 million share unit financing at C$0.40.

Finally, Virginia Mines is going about business the same way they have for over 15 years: grassroots generative exploration and intelligent business deals in Quebec. Virginia knows Quebec geology better than probably any other company and benefits nicely from government rebates of up to 45% for exploration expenditures. A recent example of President Andre Gaumond's business savvy is the acquisition of Breakwater Resources' 50% interest in the Coulon base metal discovery. Approximately C$33 million had been spent on the property by Noranda then Breakwater, of which Virginia contributed C$11 million. After government rebates and C$2 million in management fees Virginia's expenditure amounted to ~C$4 million. Breakwater had earned the 50% from Virginia by spending about C$20 million on the property. Virginia bought that 50% back for 1.666 million shares: effectively C$4.75 million.

Virginia also receives a monthly C$100,000 royalty payment from Goldcorp. These are royalties paid in advance of a variable 2% to 3.75% royalty due to them when the Eleonore deposit goes into production. Assuming a 2.5% royalty on 300,000 ounces of annual production beginning in 2013 at an $800 gold price and discounted 5% returns them pre-tax C$55 million at a 1.2 US$/C$ exchange rate. This shows up in the spreadsheet on the marketable securities line. By the way, three Canadian securities firm analysts put a $90 million valuation on the royalty. In addition to the royalty from Goldcorp, shareholders of the old Virginia Gold received C$10 per share for the deposit when it was purchased and shares of the new Virginia Mines spin out which we are discussing today. Not at all a bad deal and exactly what the generator model allows a company to do over time.

So that's the generator list. I personally own and have been involved with all of the companies discussed above. Without exception they are run by honest, competent and experienced management teams whose goals are aligned with shareholders. It's probably obvious that these are not companies or business plans to speculate in hoping for a quick and easy payoff. These are long term investments in people who approach minerals exploration as a business that requires time and risk management. If this exploration model appeals to you, buy them when they are cheap after gaining confidence in the management. The spreadsheet provided today is a starting point.

For inclusion in the EI portfolio there is one additional criterion. I need also to see a project that could make a material difference to a company. Although I obviously will not get it right all the time, that is the edge I think we can capitalize on. We are currently betting on Eurasian and AuEx. Looking forward we do not know who is next in line for a big discovery: we are certainly keeping watch though.

That's the way I see it.

Brent Cook