



# HALLGARTEN & COMPANY

## Coverage Update

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## Cerro Resources (CJO.v, CJO.ax) Strategy: Long

| Key Metrics                          |    |               |                           |
|--------------------------------------|----|---------------|---------------------------|
| Price (AUD)                          | \$ | 0.285         |                           |
| 12-Month Target Price (AUD)          | \$ | 0.33          |                           |
| Upside to Target                     |    | 16%           |                           |
| 12mth hi-low                         |    | \$0.11-\$0.37 |                           |
| Market Cap (AUD mn)                  | \$ | 213.3         |                           |
| <b>Shares Outstanding (millions)</b> |    | 748.3         |                           |
| <b>Diluted Shares o/s</b>            |    | 796.8         |                           |
|                                      |    | <b>FY10</b>   | <b>FY11e</b> <b>FY12e</b> |
| Consensus EPS                        |    |               | n.a    n.a                |
| Hallgarten EPS                       |    |               | n.a    n.a                |
| Actual EPS                           |    | (\$0.00)      |                           |
| P/E                                  |    | n.a           | n.a    n.a                |

# Cerro Resources

## Palmarejo Redux

- + The (re)merger of San Anton with the former parent Kings Minerals in the second half of 2010 (with a more apropos name) tidied up a hangover from the bull market pre-2008
- + Holder of a sizeable resource with NI 43-101 Measured & Indicated Mineral Resource of 461 million tonnes grading 0.27 g/t gold (3.9 mn oz), 11 g/t silver (163 mn oz) and 0.11% copper (1.09 bn lbs) and an Inferred Mineral Resource of 166 million tonnes grading 0.11g/t gold (0.6 mn oz), 7 g/t silver (39 mn oz) and 0.10% copper (0.36 bn lbs).
- + Cerro is managed by the team that was responsible for the Magistral, Ocampo and Palmarejo discoveries and now has a former Sherwood director on board
- + Its partner on its main project (with a 30% stake) is Goldcorp
- + Low end capex at \$71mn for the First Stage is not enormously challenging
- + The recent Namaquipa purchase shows a strong interest in silver resurfacing in the management group
- + The recent financing left the company with over \$21mn on hand.
- ✗ Grades are low and the company is dependent upon gold prices remaining above \$1,000
- ✗ The uncertainty remains as to whether Goldcorp will exercise its back in rights

### **Bending to the inevitable**

We initially stumbled on this asset several years ago when a Mineweb article included a table showing *in situ* gold values (based on market capitalization). Not only were we boggled by the exceptionally low valuation on this asset but also we had never heard of the company concerned (San Anton Resources). Some elementary investigation proved that the company was indeed well-resourced and moreover was partnered with Goldcorp. This then posed the question as to why the stock was so low profile. The answer came to us when we looked at the convoluted history of the listed entity (which we shall discuss anon). A series of actions in 2010 put the company back on a sensible track and it has been rewarded with a strong stock price run by a newly interested marketplace.

Cerro Resources (the name of the remerged entity) has as its principal assets the El Gallo deposit in Mexico, a number of prospects in the famed Mt Isa district in Queensland, Australia and a recently added silver project, Namaquipa, also in Mexico.

### **The convoluted reassembly process**

Several years ago the San Anton corporate vehicle was spun out from an ASX-listed gold and metals exploration and development company Kings Minerals NL (KMN.ax). Its purpose was to be the TSX-listed vehicle for tackling the highly prospective San Anton property in Mexico.

As a result of that spinout, KMN was the controlling entity for San Anton (holding 71.3% of SNN's equity). The origins of this stake lie in the backdoor listing of the San Anton property on the TSX in 12 December 2006 via the business combination and merger between Kings Canada Inc and Andaurex Industries Inc and the completion of a C\$17.25mn fund raising. The business combination and merger was effected by the delivery of Kings' 51% interest in the San Antón Project in exchange for 75 mn common shares and 10mn SNN Common Share Purchase Warrants (five years at an exercise price of C\$1.20) of SNN. However, it was not a proper demerger, instead it was a float of around 28.7% of Mexican asset with the rest staying in the hands of Kings. This meant that liquidity was reduced and San Anton was virtually takeover proof. To those in the know however it was clear that Kings were disposed to sell down at the right price or even to be diluted should financing opportunities arise but the tumultuous state of the markets during 2008 and 2009 and the vicious cycle of disinterest that particularly afflicted San Anton put paid to either of those outcomes.

We presume this complex transaction was effected under the assumption that investors in TSX-listed stocks understood LatAm mining better than Australian-based investors. In that they would not have been wrong. This had a certain irony as Australians were very prominent in LatAm in the late 1980s and early 1990s when the operating environment was significantly more difficult and then they retreated leaving a mere handful of Australian-listed companies working in an area that has since become a mining hotspot.

### **The offer – getting back together again**

Kings Minerals announced, in February 2010, that it intended to acquire all of the issued and outstanding shares of San Anton not presently owned by Kings in exchange for two shares of Kings for every SNN share held, essentially reversing the spinout. In connection with the transaction, Kings applied for a listing on the TSX, spoke of changing its name and completing a financing for the development of the San Anton Project. Ostensibly the offer looked like a premium for SNN shareholders for on the last trading day before the announcement of the proposed transaction, the closing price of San Anton's common shares on the TSX was C\$0.25 and the closing price of Kings' ordinary shares was A\$0.155. However market conditions (the sagging Kings price and relative firmness of San Anton) resulted in a change in May when the offer to San Anton shareholders was upped to 2.5 shares of Kings for every San Anton share. The former minority shareholders of San Anton now hold approximately 16% of the expanded capital of Kings post-merger.

### **Kings Minerals in standalone mode**

During the "trial separation" between San Anton and Kings, the latter busied itself developing in its own right the Kalman project, which is an exploration stage molybdenum/copper/gold/rhenium project, which it calls the Mount Isa project. Kings sustains that it is of significant promise. We shall discuss this further on.

### **Copper is the New Gold?**

Discussing the merits or dynamics of gold is somewhat superfluous at this point as it is a subject that is well-aired and never shall the varying contesting sides concede the other sides' points (inflation/deflation et al.).

Meanwhile copper is the quintessential base metal and has in recent years become a sort of honorary precious metal in Canadian mining circles where the rest of the base metals are greeted with a yawn and disinterest. Even though copper may have gone up very much from its lows of the late 1990s it still doesn't warrant being called precious or even semi-precious. It does not even merit being termed a money metal, at least not any more than nickel does.

Copper over the last year has forged back from its late 2008 woes and hit new highs before retreating in recent weeks. It appeared to us that a lot of the rebound was non-trade players with well-cashed up Chinese buyers being a major consideration. At the start of the recovery of the copper price that driving force was Chinese stockpiling. This gave the Chinese a stash with which to discipline the marketplace. They have done it before and they will do it again. They are not going to sell into unstoppable demand but they certainly will wait their moment for global markets to make a pratfall and then move in for the kill. Ramping up the offer when there is temporarily no bid and blasting copper back to between \$3 and \$4, which we perceive is their happy hunting ground. Strangely enough this is what appears to have happened in recent weeks. The initial pullback from the recent highs coincided with reports out of China that the country had so much copper on hand that holders were lending it out to end-users and to traders. This sounded like there was a flood of copper out there but while prices eased they did not plunge until the more serious silver-led pullback of last week. This makes us think that the Chinese were only half-hearted in their attempts to talk it down. The strengthening renmimbi is another means by which Cu gets cheaper for them without divesting their stockpiles.

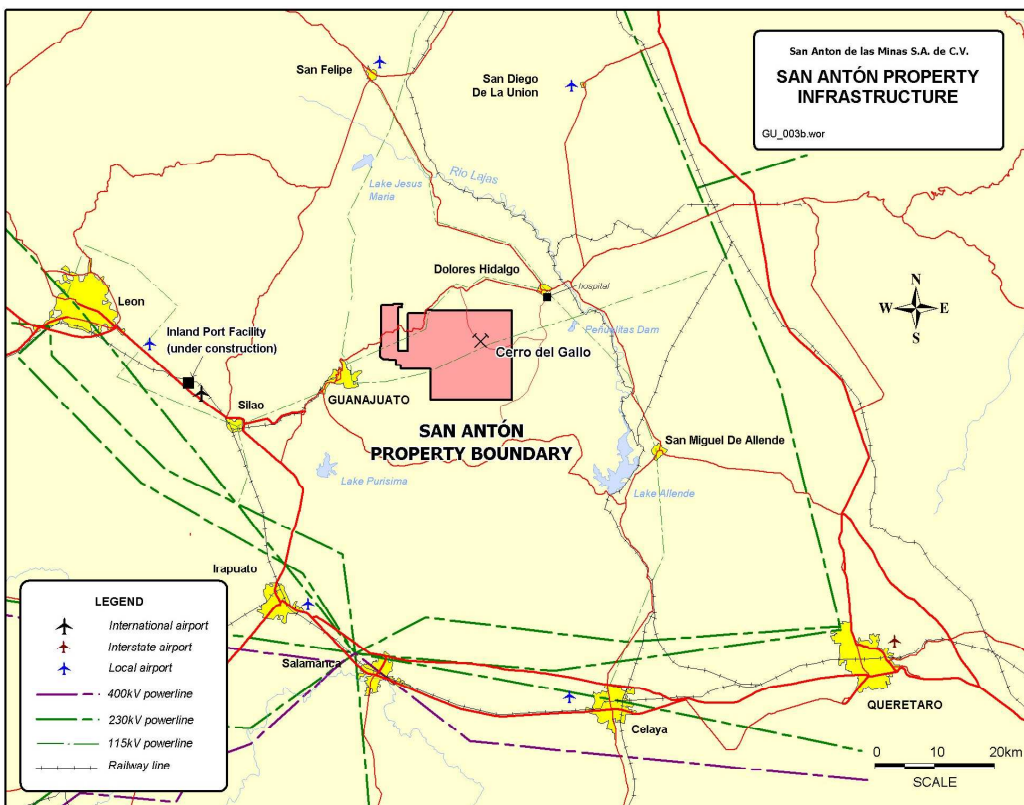


More preoccupying is the strength of the global recovery. The danger is recent months has been observers confusing unused excess liquidity slopping into the base metals space as real demand. We had feared that this might herald a day of reckoning if the liquidity is withdrawn (reversing QE2 for example) or redirected to more than just hedge fund stockpiling. Just how real that demand really is concerns

miners and industrial users at this point. At least the West finally appears to be coming to life again to pick up the slack if emerging markets start to cool off.

The over-arching long term dynamic remains weak supply, dying mega-mines and the eventuality of resurgent demand driven mainly by emerging market catch-up on infrastructure. We are medium- and long-term bulls and short-term hyper-wary. Copper has an excellent supply dynamic (i.e. not enough of the stuff likely to come out of the ground). Mega mines are winding down and all that is replacing them is mid-sized operations (look at the struggle over Equinox to evidence that), with the exception of Ivanhoe's substantial Tuyun Olgoi project in Mongolia. The market has very much focused on this rising crisis (while ignoring, we might note, the even worse predicament in the Zinc space). Nevertheless this has underpinned copper prices and ensured that new buyers appear to take positions in the space when longer-term holders flag in their enthusiasm.

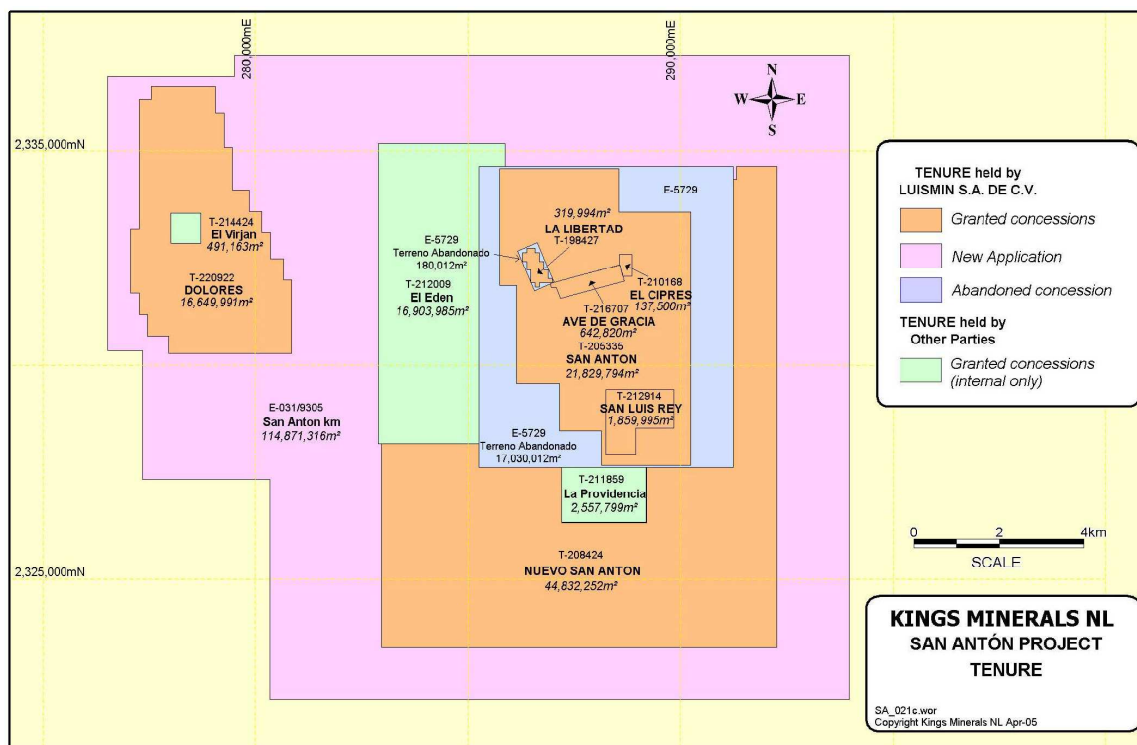
The \$4.50 per lb price level seems to present a current ceiling on copper's price move. With interest rates likely to move higher in many emerging markets and liquidity tightening generally around the globe, it is less likely that stockpile holders will have a tolerance for conserving stocks when the upside appears capped for a while. Be that as it may the \$3-\$4.50 price range is profitable for existing mines and for most likely mines.



### The love-child of Wheaton River and Kings

Cerro's Cerro de Gallo (Rooster Hill) project is located in the state of Guanajuato in central Mexico, approximately 270km northwest of Mexico City. The property lies within the central-southern segment

of the Mexican Silver-Gold Belt. Cerro's interest in the project has its origins in a joint venture agreement between Kings and Wheaton River Mining (now Goldcorp) that was established in 2004. Under this accord Kings could earn a 75% interest in the project by spending US\$13 million on exploration. Goldcorp then has a right to earn back into the project to a 70% interest by spending US\$39 million. After the earn-ins are completed Cerro Resources and Goldcorp will contribute in accordance with their respective interests. Cerro is the operator whilst it is earning its interest in the project. Thereafter Goldcorp may, at its election act, as the operator.



Cerro's holdings cover an area of 23,562 hectares (approximately 15km north-south by 16km east-west) and consist of ten granted contiguous exploitation and exploration concessions all owned by San Antón de las Minas S.A. de C.V., a resident Mexican company owned 51% by Cerro and 49% by Desarrollos Mineros San Luis S.A. de C.V. (DMSL), a subsidiary of Goldcorp.

### History – meaningful past production

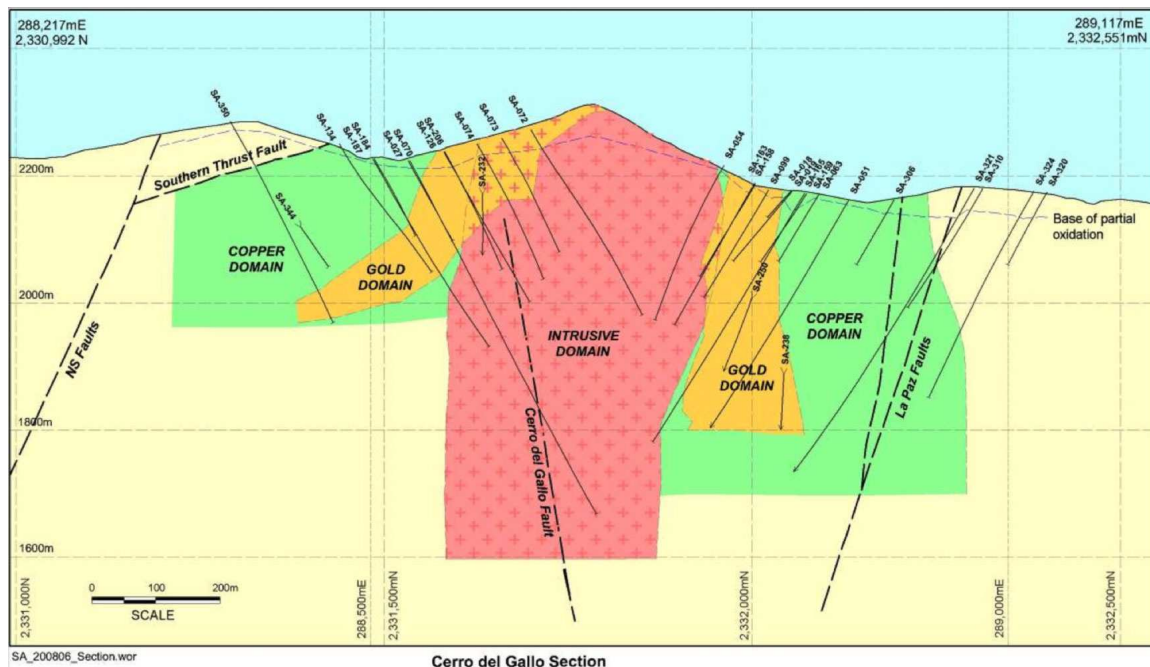
The Cerro de Gallo property encompasses the old San Antón de las Minas mining district, centered 23km east northeast of Guanajuato city and the historic Guanajuato Mining District where production from 1700 to 2004 is reported to be 1.14 billion ounces of silver and 6.5 million ounces of gold. Although the Guanajuato Mining District has a long history of silver and gold mining and production extending back to 1558, production records at San Antón only date back to the 1860's although mining is reported from Spanish colonial times. Historic mining within the San Antón de las Minas area was concentrated on epithermal veins. The photo below shows the headframe of the abandoned Dolores mine that is in close proximity to the Cerro de Gallo prospect.

## Geology

The San Antón Property is known to host a variety of styles of mineral deposits, including porphyry gold-rich copper deposits, intrusion-related gold deposits, epithermal silver-gold deposits, and gold-copper skarn deposits. All of these styles of mineralization are known to occur within the company's mining concessions. The main area of present interest is the large low-grade bulk mineable gold-copper-silver deposit at Cerro del Gallo, where a significant mineral resource has been identified.



The Cerro del Gallo gold-copper-silver deposit lies within an inlier of deformed clastic sediments and volcanic rocks of probable Triassic-Jurassic age. At Cerro del Gallo a sequence of felsic ash-crystal and lithic crystal tuffs has been intruded by a small elongated upright felsic stock of broadly granodioritic composition. The enclosing host rocks have undergone strong pervasive hydrothermal alteration. Gold mineralization is concentrated in a gold-rich annulus within wallrock proximal to the felsic intrusion.



At the current time the majority of the Inferred Mineral Resources occur in the outer copper domain, and remain open to the north-west, south-east, and at depth. The cross-section above shows the deposit with the rings of the copper domain surrounding the gold domain, which then surrounds the intrusive domain.

### Mineral Resource Estimate

The 2008 resource statement updated the mineral resource estimate and represented a significant increase in both tonnage (44%) and contained metal (25%). This new estimate contained 654,000 tonnes of copper, 4.5 mn oz of gold, and 202 mn oz of silver.

The significant amount of new drilling from both infill and step-out drill holes allowed for the significant increase in the size and confidence of the mineral resource with an increase in the Measured and Indicated Mineral Resources of 43% in tonnes and 28% in contained metal. The Inferred Mineral Resources increased by 48% in tonnes and 14% in contained metal.

As mentioned previously the majority of the Inferred Mineral Resources occur in the outer copper domain, and remains open to the north-west, south-east, and at depth. The mineral resource has only been reported for material above the level of 1800 metres over sea level, which is currently considered to be the maximum depth with reasonable prospects of eventual economic extraction with the prevailing metal prices at the time of the 2008 report. As prices have settled at substantially higher levels since then, we would not be surprised by the potential for this to be further expanded.

The classification of the mineral resource estimate, reported with a 0.2g/t Au cut-off grade in the gold domain and 0.07% Cu cut-off grade in the copper and intrusive domains, is shown below.

| Resource Category | Tonnes<br>mn | Au<br>g/t | Ag<br>g/t | Cu<br>% | Au<br>Mn oz | Ag<br>Mn oz | Cu<br>kt |
|-------------------|--------------|-----------|-----------|---------|-------------|-------------|----------|
| Measured          | 225          | 0.35      | 13        | 0.11    | 2.5         | 91          | 245      |
| Indicated         | 236          | 0.19      | 10        | 0.11    | 1.4         | 72          | 248      |
| Inferred          | 166          | 0.11      | 7         | 0.10    | 0.6         | 39          | 161      |
| Total             | 627          | 0.22      | 10        | 0.10    | 4.5         | 202         | 654      |

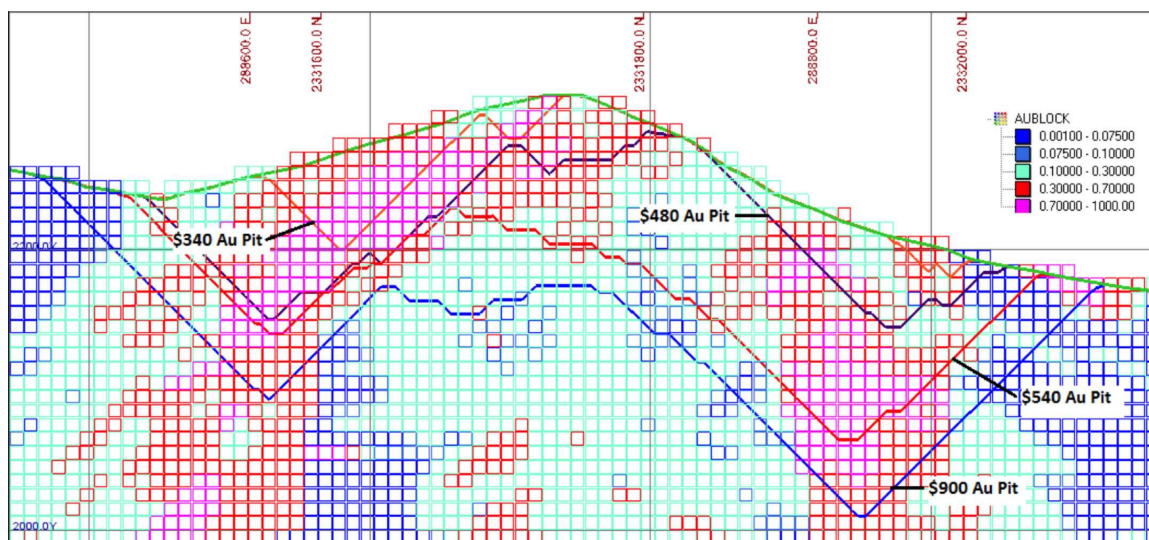
### Moving towards development

In February 2009 the company announced it was focusing on advancement of the Cerro del Gallo gold-project towards development with a focus on metallurgical test work and engineering studies to complete a Pre-Feasibility Study (PFS). In 2009 it re-logged all the drill core and chips to generate new cross sections with improved geological data, interpretation and understanding. The resource was then be remodeled with this new data and a new NI43-101 was released in April 2010. This technical report/Preliminary Assessment modeled both the bulk tonnage copper-gold-silver resource and the higher gold grade resources as separate models. The 'gold zone' was modeled with smaller blocks to make it more suitable to plan the more selective mining methods appropriate for this style of mineralization.

Metallurgical work gave encouraging results with the leach test work indicating that gold is readily recoverable using a cyanide leach process with good kinetics.

Reserva International, a consultant, carried out preliminary pit optimisation studies based on the re-modeled gold domain resource, an updated geological model and metallurgical test work completed at SGS Lakefield Oretest in Perth, Australia.

The pit runs were based on a heap leach and carbon-in-leach flow sheet and representative costs for operations of a similar size and nature including mining costs, plus transport and refining costs which are variable on a per tonne basis. Preliminary metallurgical recoveries were assumed for each of the three modeled rock types based on the results of column test work and intermittent bottle roll tests. The pit shells at different gold price points are shown in the cross-section below.



As can be noted this mine plan is geared towards exploiting the gold halo around the intrusive and thus a W-shaped design (at least in the cross-section) is envisaged. Aerially this would appear more like a donut-shaped pit around the intrusive. Inevitably the intrusive would have to be reduced in height as the pit starts to get deeper. This plan essentially leaves the copper resource out of the equation.

**Assumed Heap Leach Process Recoveries**

| Weathering Classification | Process         | Gold Recovery Design | Silver Recovery Design |
|---------------------------|-----------------|----------------------|------------------------|
|                           |                 | (%)                  | (%)                    |
| Weathered Ore             | Heap Leach      | 75                   | 55                     |
| Oxidised Ore              | Heap Leach      | 55                   | 45                     |
| Fresh Ore                 | Carbon-in-Leach | 78                   | 20                     |

At a gold price of US\$900/oz and silver price of US\$15/oz, resources within the pit were estimated at 69.9 Mt grading 0.66g/t gold, or 1.49 million ounces of contained gold. Clearly the grade for the gold is low (as is the silver) but the massive nature of the deposit works in its favour. Below one can see the resources in the optimized pit shell. It should be noted that this encompasses nearly 70 million tonnes of

material while the Measured, Indicated and Inferred resource of the deposit is nearly nine times larger at 627 million tonnes.

**Summary of Resources in Optimised Pit Shell**

| Resource Category | Tonnes<br>(Millions) | Au<br>(g/t) | Ag<br>(g/t) | Au<br>(Moz) | Ag<br>(Moz) |
|-------------------|----------------------|-------------|-------------|-------------|-------------|
| Measured          | 60.2                 | 0.68        | 14.0        | 1.31        | 27.0        |
| Indicated         | 9.7                  | 0.56        | 11.2        | 0.16        | 3.5         |
| <b>Total</b>      | <b>69.9</b>          | <b>0.66</b> | <b>13.6</b> | <b>1.49</b> | <b>30.5</b> |

The Whittle work indicated that a low strip ratio of 0.74:1 could be achieved owing to the geometry of the mineralisation and topography. A preliminary LOM yearly mine schedule incorporated a series of push back pits that would optimise development of the heap leach material in the first years of mining.

In early April 2011, the company issued a news release with a Feasibility Study on the first Stage of the development (Years 1-8) and a Preliminary Assessment on the Second Stage (years 5-15). The difference in these stages is that:

- The First Stage is the development of a gold/silver heap leach operation
- The Second Stage is a heap leach and CIL processing facility

The First Stage functions exploiting the total proven & probable reserves: 32.2mn tonnes over the initial eight years of heap leaching producing 446,000 oz gold and 5.32 mn oz silver. The operation will consist of 4.5mn tpa heap leach with 3-stage crushing. Some 9mn tonnes of rock material will later be run through the CIL circuit of the Second Stage.

The Second Stage utilizes the additional in-pit measured & indicated resources: 45mn tonnes (and the aforementioned ore from the First Stage. This material from inside the optimised pit shall produce 0.682 Moz gold and 4.73 Moz silver from heap leaching and carbon-in-leach processing (pit optimised using US\$1,020/oz gold and US\$16.40/oz silver). This stage figures in expanded facilities for additional 3mn tpa CIL processing, increasing annual processing rate to up to 7.5mn tpa.

The model gives a projected mine life of 14.3 years and average annual production over mine life 90,800 AuEq (at a Gold price of US\$1,157/oz and a silver price of US\$19.81/oz with gold:silver price ratio of 58.4 and on assumption

| Year          | Material Processed<br>K Tonnes | Strip Ratio | Metal Sold   |               |                             |
|---------------|--------------------------------|-------------|--------------|---------------|-----------------------------|
|               |                                |             | Gold (koz)   | Silver (koz)  | Gold Eq. (koz) <sup>1</sup> |
| 1             | 4,512                          | 0.05        | 55           | 534           | 64                          |
| 2             | 4,442                          | 0.22        | 76           | 790           | 89                          |
| 3             | 4,466                          | 0.33        | 67           | 750           | 80                          |
| 4             | 4,500                          | 0.44        | 54           | 749           | 67                          |
| 5             | 7,188                          | 1.02        | 100          | 913           | 116                         |
| 6             | 6,878                          | 1.76        | 103          | 1,001         | 120                         |
| 7             | 6,325                          | 1.64        | 96           | 1,156         | 116                         |
| 8             | 6,273                          | 1.38        | 94           | 992           | 111                         |
| 9             | 5,181                          | 0.99        | 77           | 652           | 89                          |
| 10            | 4,902                          | 0.75        | 68           | 479           | 77                          |
| 11            | 4,712                          | 0.74        | 69           | 415           | 76                          |
| 12            | 5,312                          | 0.45        | 79           | 504           | 88                          |
| 13            | 5,294                          | 0.36        | 76           | 451           | 84                          |
| 14            | 6,138                          | 0.17        | 87           | 533           | 96                          |
| 15            | 1,107                          | 0.04        | 24           | 128           | 26                          |
| <b>Totals</b> | <b>77,231</b>                  | <b>0.74</b> | <b>1,127</b> | <b>10,048</b> | <b>1,299</b>                |

mineral resources will convert to mineral reserves). It also assumes that the project will be 66% owned by Cerro Resources and Goldcorp will hold 34%. It should be noted that this plan does not encompass any recovery of copper from the mine.

The volumes of production for both gold and silver are shown in the table that follows with the gold/silver ratio for equivalent purposes using the now well out-of-date 1:58.4 ratio. This plan has the gold output peaking at just over 100,000 ozs per annum.

The table below shows the capex for the 4.5 mn tpa heap leach operation.

|  | <b>Cost<br/>(000's US\$)</b> |
|--|------------------------------|
| <b>Direct Cost</b>                     |                              |
| Crushing                               | 18,832                       |
| Agglomeration                          | 7,500                        |
| Heap Leach                             | 8,967                        |
| Gold/Silver Plant                      | 9,081                        |
| Reagents                               | 130                          |
| Services                               | 1,903                        |
| Infrastructure                         | 1,538                        |
| Water Supply Dam                       | 1,904                        |
| <b>Subtotal</b>                        | <b>49,855</b>                |
| <b>Indirect Costs</b>                  |                              |
| EPCM                                   | 9,478                        |
| Insurance                              | 801                          |
| Mobile Equipment                       | 628                          |
| First fill                             | 920                          |
| <b>Subtotal</b>                        | <b>11,827</b>                |
| <b>Direct + Indirect Costs</b>         | <b>61,682</b>                |
| <b>Contingency</b>                     | <b>9,252</b>                 |
| <b>Project Cost 4.5mtpa Heap Leach</b> | <b>70,935</b>                |

The table below shows the capex for the 3 mn tpa CIL upgrade.

|                          |                           | Cost<br>(000's USD) |
|--------------------------|---------------------------|---------------------|
| Direct Cost              | Process                   | 45,260              |
|                          | Tailings Storage Facility | 5,000               |
|                          | Infrastructure            | 6,940               |
|                          | Subtotal                  | 57,190              |
| Indirect Costs           | EPCM                      | 8,580               |
|                          | Construction              | 2,860               |
|                          | Subtotal                  | 11,440              |
| Direct + Indirect Costs  |                           | 68,630              |
| Owners Costs             |                           | 3,440               |
| Contingency              |                           | 10,810              |
| <b>CIL Addition Cost</b> |                           | <b>82,880</b>       |

The table below shows the Preliminary Assessments' cash flow model outputs using various trailing average metals prices and the most immediate month before the study's publication. To the critical eye the project looks most viable at recent elevated levels (over \$1,200 Gold and over \$20 Silver) and becomes merely pedestrian in returns if precious metals declined in value to levels seen in 2009 and before.

|   | Three-year<br>Av. Metal prices | Two-year<br>Av. Metal prices | One-year<br>Av. Metal prices | March 2011<br>Av. Metal prices |
|---|--------------------------------|------------------------------|------------------------------|--------------------------------|
| Net Cash Flow undiscounted & before tax (US\$m) | \$229                          | \$302                        | \$410                        | \$549                          |
| Net Present Value (6%) US\$m                    | \$104                          | \$142                        | \$199                        | \$321                          |
| Gold Price                                      | \$1,060                        | \$1,157                      | \$1,293                      | \$1,424                        |
| Silver Price                                    | \$17.77                        | \$19.81                      | \$23.87                      | \$35.81                        |
| Gold Sales ('000s ozs)                          |                                |                              |                              | 1,126                          |
| Silver Sales ('000s ozs)                        |                                |                              |                              | 10,048                         |

**In Summary:**

- ❖ Mine life of 14.3 years with average annual production of 90,800 AUEq
- ❖ US\$70.1M estimated initial capital investment to be paid back in less than two years
- ❖ Updated optimised pit results for combined heap leach/carbon-in-leach processing of:
  - 69.9 mn tonnes in-pit resource at 0.66 g/t Au and 13.6 g/t Ag
  - a low 0.74:1 average strip ratio over LOM
  - 4.5 mn tpa initial processing rate, expanding to around 7 mn tpa
  - metal price assumptions of US\$1020/oz gold and US\$16.40/oz silver
- ❖ US\$415 per ounce average life-of-mine operating cost after silver credits (from the PFS)

## **Namiquipa – diversifying in Mexico**

In March 2011 Cerro announced that it had completed its previously announced acquisition of the Namiquipa Silver Project. This is located in a farming area 180 km northwest of Chihuahua (in the state of the same name) and is easily accessible by sealed highway. It consists of three concessions totalling 4,400ha. These are the Tasmania Concession; the America Concession; and the Rolys Concession (shown in the map on the following page). Minera Tasmania owns the Tasmania and Rolys Concessions and has the right to acquire the America Concession from Minera Rio Tinto S.A de C.V. under an option agreement dated 22 July 2008 and varied by further agreement on 24 September 2010. Minera Rio Tinto retains a 2% NSR. Minera Tasmania can buy 1% NSR for US\$1mn (plus 16% VAT) before production starts.

The transaction with the shareholders of Minera Tasmania S.A. de C.V. had originally been announced in mid-December 2010. The company acquired all of the shares of Minera Tasmania in consideration for 30,000,000 ordinary shares of Cerro.

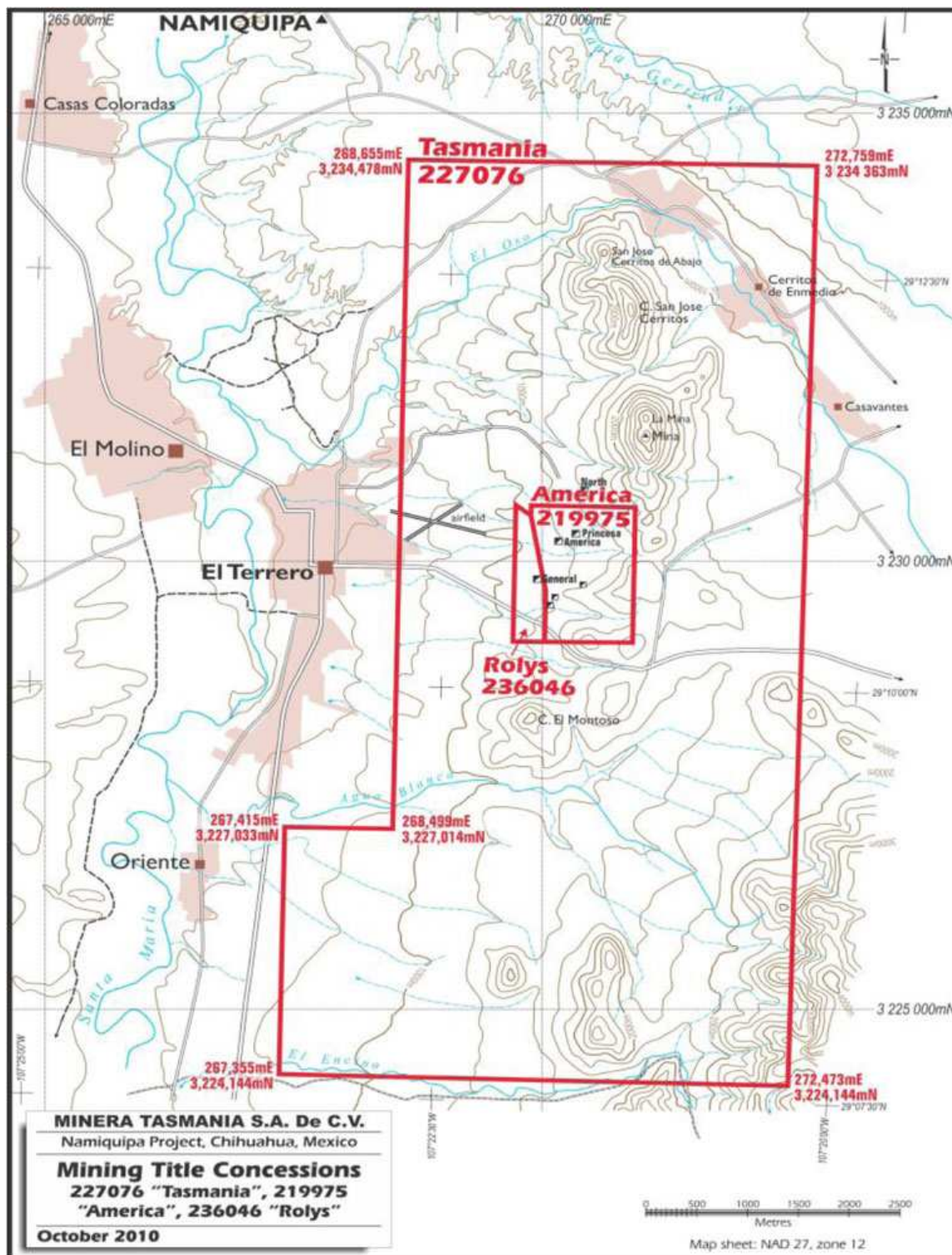
Completion of the acquisition gave Cerro control of the mineralized trend to the north and south of the La Venturosa mine, where no previous systematic exploration has been undertaken other than some shallow mine production drilling in the early 1990's. Several high priority targets have already been identified, including areas where mining occurred to depths of only 150-250m and along strike in both directions from the existing mine workings.

The centerpiece of the property is the aforementioned La Venturosa silver mine. Mineralisation was originally discovered in 1811. The deposit has been mined using underground mining operations for silver, lead and zinc from 1929 – 1936, 1948 – 1955 and 1990 - 2002. The last operator, Minera Namiquipa, stopped mining in the early 1990's because water flooded the mine. Mining at Namiquipa has taken place over a strike length of 1,250 meters, to a depth of 250 meters, using at least seven shafts and exploited a series of sub-parallel veins varying up to 8 meters thick.

Detailed records are only available for the last two phases of mining from 1948 to 1955 and from 1990 to 2002. During this period 447 tonnes of silver, 32,550 tonnes of lead, 43,530 tonnes of zinc and less than 1 tonne of gold was produced. Silver grades in the oxide material averaged 550 g/t. Sulphide ores graded 225 to 400 g/t Ag, 1.5 to 3.8% Pb and 7.5% Zn.

## **Geology**

The Namiquipa deposit is hosted by Tertiary age volcanics deposited in the Early to Middle Miocene. Namiquipa is one of a series of deposits hosted in the rocks of Northern Mexico's Upper Volcanic Series and lies within the Ag-Pb-Zn epithermal belt. The mineral assemblages present and the associated hydrothermal alteration suggests that mineralisation is a low to intermediate sulfidation type. As such and considering the levels of silver at Namiquipa the company feels it is strongly analogous to the Fresnillo-style of polymetallic vein systems which are silver rich and gold poor.



The principal host rock is an andesite. Mineralization is hosted by six northerly striking steeply dipping, vein sets. The veins are quartz replacement breccia fill fissures. The deposit exhibits repeated pulses of mineralisation. Principal vein constituents in the sulphide zone are quartz, sphalerite, galena, fluorite,

chalcopyrite with silver minerals and minor gold. Oxidation, which extends to about 100 meters below surface, leached out the lead and zinc minerals and redeposited them as cerussite, rarely anglesite & wulfenite. Vein mineralogy displays vertical zoning. Increased quantities of barite formed near the surface where silver occurred as native silver and cerargyrite. The veins show distinct zones of silver and lead enrichment at or near the base of oxidation. At least three significant vein systems exist within a 50- to 80-metre corridor. Mineralization is known to occur down to 250 metres below surface. Combined strike length of the veins is some 2 kilometres.

The company, as part of its due diligence process, had reviewed, digitised and re-mapped existing records of the old mine workings and had identified a number of drill targets. This shall be combined with a program of geophysics commenced in March with the intention to commence the initial drilling program in April 2011. No resource estimate exists as yet and so remains nebulous at this stage and needs a lot more drilling to quantify what the remaining resources in the existing mine might be and what the potential is on the larger land base that the company now holds.

### **Mount Isa**

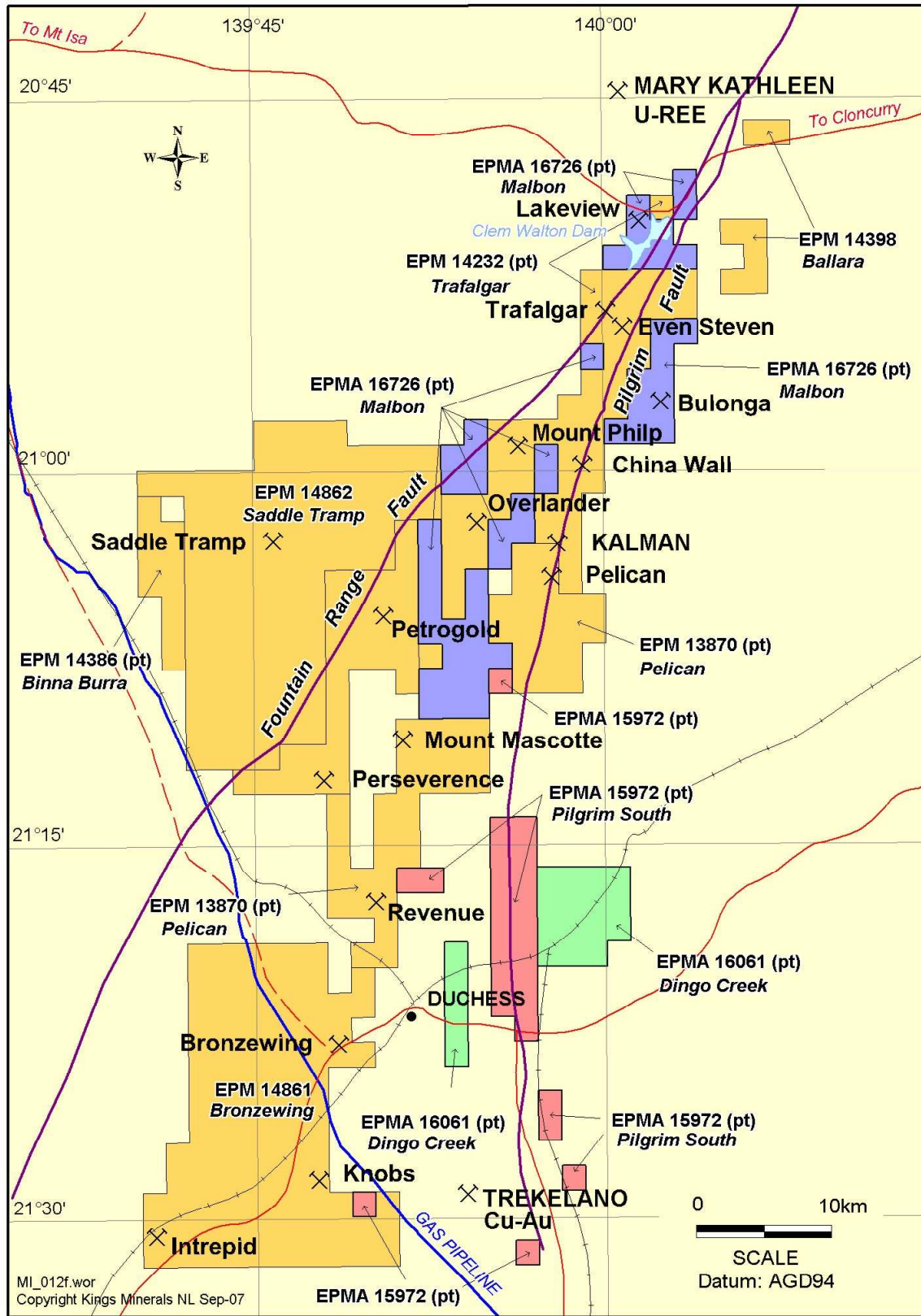
The remerged companies' interesting secondary asset is its extensive located near the historic mining center of Mount Isa in the Australian state of Queensland. This is composed of six exploration permits and three exploration permit applications. The staked claims are shown on the map on the following page.

Hietherto most of the focus was on the Kalman project, which is an intrusion-related hydrothermal copper-molybdenum-gold mineralisation hosted by calc-silicate rocks. Mineralisation generally occurs as fine-grained disseminations and discontinuous millimetre-wide veinlets. Pyrite averages <1% in zones of strongest copper-molybdenum-gold mineralisation. Rhenium is also present associated with the molybdenite. Copper grades are consistently elevated, although variable, over broad widths, and molybdenite grades are often highly elevated over narrower widths.

The Kalman project hosts a current mineral resource of 30,000 tonnes of molybdenum, 2,300,000 ounces of rhenium, 195,000 tonnes of copper, and 295,000 ounces of gold estimated in September 2008 (based on 74 drill holes for a total of 33,318 metres). Kings has commenced project studies to evaluate the opportunities for development of Mount Isa, with initial indications that underground mining is the preferred option, and a review of the geological model for input into more detailed underground geotechnical and mining studies has been initiated. Metallurgical test work results from six core samples showed excellent recoveries of all valuable metals in preliminary flotation test work on samples from the two mineralised domains. The results indicate that the primary recovery stages will yield high metal recoveries for the downstream cleaning/upgrading stages.

Interestingly we met with Syndicated Metals (SMD.ax) in mid-2010 and they revealed that this is the same property in which they own 49% and call Kalman South, something that was lacking from the King's version of ownership.

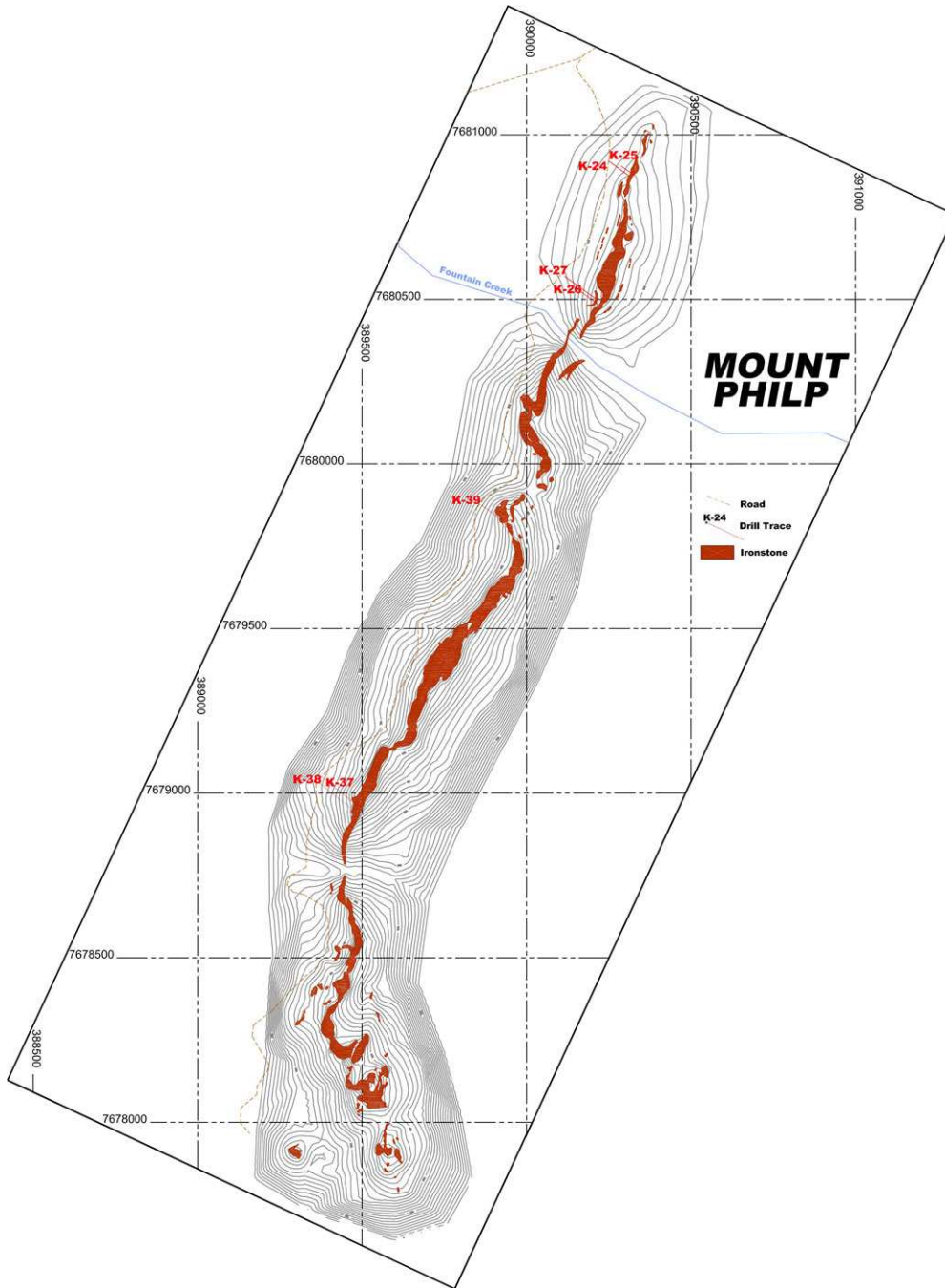
However, as can be noted from the map on the following page, Cerro's territory is very large and encompasses a number of past producing mines and shows potential for a broader array of minerals.



Mount Isa Project

With Moly being still in the penalty box pricewise, the focus has now shifted from Kalman to the Mt Philp iron ore deposit. The Mount Philp Ironstone is situated 54 km southeast of Mt Isa.

The prospect is located within 25km of the Mt Isa-Townsville highway, rail and electricity supply infrastructure and 8 km northwest of the Kalman deposit.



The ironstone outcrops (as shown in the photo at the right) for 3.7kms along strike. At its peak the ironstone ridge has a local relief of 60m. The ridge is composed principally of haematite with minor magnetite and variable, but generally low silica in the form of quartz veins.

The outcrop pattern suggests isoclinal folding, with associated thickening around a number of NW-SE cross faults. Where the ironstone has been intersected by drilling it displays a moderate to steep westerly dip.

Initial sampling by government officials in 1955 prompted them to venture a resource of the exposed ironstone at 4.2mn tonnes of 37% Fe and 39% Si with low sulphur, phosphorous, manganese and titanium dioxide.



The average width of the ironstone is 30 metres. Where previous drilling has intersected the haematite zone it has known dip continuity for 50 metres. Cerro has undertaken a total of 7 RC holes for 1,380 meters to test the depth extent of the haematite mineralisation. Holes were spaced at nominal 400m sections along the deposit. Results ranged from 11.5% Fe to 56.1% Fe with the longest intercept being at the latter grade over 25 metres.

The deposits certainly appears prospective and in light of iron ore being a flavour of the moment, we would not be surprised to see the whole of the Mt Isa project spun off into an ASX listed vehicle where it would obtain more focus and appreciation. Similarly some sort of combination of this asset with Syndicated Metals might make sense.

### **Financing**

The most recent fund raising by the company was in late March 2010 when the company held a deep discount 1:5 rights issue at 6 cts per share. Understandably they issue had a 60% oversubscription and raised \$5.094mn with the issue of slightly over 84.9mn new shares. As we noted recently in our review of the trend to burgeoning “shares on issue”.

This was the first financing the company had done (or had been able to even contemplate doing) for several years due to market conditions and the general unattractiveness of its “split personality disorder”. With a market capitalization of around \$100mn now it should be easier to arrange issues in the near future. Though there is no pressing need until a mine build is being contemplated.

In late February 2011 Cerro placed a total of 89,290,470 fully paid ordinary shares at a price of A\$0.20 cents per share to raise gross proceeds of A\$17,858,094. This was done through a major Australian brokerage firm to sophisticated and professional investors. The funding was to accelerate the

exploration of the newly acquired Namiquipa Silver project, to allow an increase in the activity at Mt Philp Iron Ore (post the first stage of resource drilling) and to pursue further exploration project opportunities in Mexico.

The company had over AUD\$21m in cash as at the end of February 2011.

### The Shareholder Base

As is usual in Australia, disclosure of the major shareholders is mandatory. As is clear from the table below institutions are conspicuously absent, unless buried in the HSBC custody account (which by all measures is small anyway). The rest are mainly large High Net Worths and one other listed corporate. San Anton did have a following amongst German-speaking private investors, who do not make this

| Top 10 Shareholders immediately post-merger                          | Shares Held | % of Total Shares |
|--|-------------|-------------------|
| 1 Permgold Pty Ltd <The Seckold Family Superannuation Fund>          | 49,883,907  | 6.67              |
| 2 OCJ Investment (Australia) Pty Ltd                                 | 40,933,668  | 5.47              |
| 3 HSBC Custoday Nominees (Australia) Limited                         | 33,198,409  | 4.44              |
| 4 Guina Developments Pty Ltd   | 30,000,000  | 4.01              |
| 5 Mr Terrence William Kahler & Mrs Suzanne Kahler <Kahler Super A/c> | 24,000,000  | 3.21              |
| 6 HSBC Custody Nominees (Australia) Limited - GSCO ECA               | 23,713,030  | 3.17              |
| 7 JP Morgan Nominees Australia Limited <Cash Income A/C>             | 15,949,801  | 2.13              |
| 8 UBS Nominees Pty Ltd   | 15,634,200  | 2.09              |
| 9 CS Fourth Nominees Pty Ltd   | 14,263,600  | 1.91              |
| 10 JP Morgan Nominees Australia Limited                              | 13,069,792  | 1.75              |

ranking, but conjointly represent an interesting sub-group.

### Management

While Kings was fundamentally an Australian company, and these have made little impact in Mexico, the company is currently shaping up as a reunion of various individuals who have been involved with some of the most successful Mexican mining stories of recent times, particularly those with a base metal component added to a precious metals story. In some respects might look at Cerro Resources as Palmarejo Redux.

**Norman A Seckold** has been the Non-Executive Chairman of Kings since July 2001. He was also the Chairman and a director of San Anton. He was the Chairman of Palmarejo Silver and Gold Corporation and Bolnisi Gold NL, which merged with Coeur D'Alene Mines in 2007.

He graduated with a Bachelor of Economics degree from the University of Sydney in 1970. He has spent over 25 years in management of natural resource companies, both in Australia and overseas. Beyond the aforementioned mining companies he has been the Chairman and Director of a number of other publicly listed companies including Moruya Gold Mines (1983) N.L. (which acquired the Golden Reward heap leach gold deposit in South Dakota), Pangea Resources Limited (which acquired and developed the Pauper's Dream gold mine in Montana), Timberline Minerals (which acquired and completed a feasibility study for the development of the MacArthur copper deposit in Nevada, USA, now owned by Quaterra),

Perseverance Corporation (which discovered and developed the Nagambie gold mine in Victoria, Australia), Valdora Minerals N.L., (which developed the Rustler's Roost gold mine in the Northern Territory of Australia and the Ballarat East Gold Mine in Victoria), Viking Gold Corporation, (which discovered a high grade gold deposit in northern Sweden) and Mogul Mining N.L. (which drilled out the Magistral and Ocampo Gold deposits in Mexico).

He also currently serves as Chairman and Director of Cockatoo Coal Limited and Planet Gas Limited.

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No sooner was the “ink dry” on the TSX listing of King’s than some interesting appointments were made that to us signalled that the company was moving out of its “hermit crab” mode. These were the appointment of **Anthony (Tony) McDonald** as Managing Director and Chief Executive Officer and **James Crombie** as Executive Vice-Chairman of the Company.

**Tony McDonald** graduated from the Queensland University of Technology, Brisbane, in 1981 with a Bachelor of Laws degree and was admitted as a solicitor in 1982. He has been involved in the natural resources sector in Australia and internationally for many years and in the past 10 years has been actively involved in management in the resources sector. Interestingly he is a reintegration as he was an executive director of Kings Minerals from 1996 until March 2007. He is also a non-executive director of Industrea Limited and Planet Gas Limited.

**Jim Crombie** graduated from the Royal School of Mines, London, in 1980 with a B.Sc. (Hons) in Mining Engineering, having been awarded an Anglo American scholarship. He has held various positions with DeBeers Consolidated Mines and the Anglo American Corporation in South Africa and Angola between 1980 and 1986. He spent the next thirteen years as a mining analyst and investment banker with Shepards, Merrill Lynch, James Capel & Co. and finally with Yorkton Securities. He was Vice President, Corporate Development of Hope Bay Mining Corporation Inc. from February 1999 through May 2002 and President and CEO of Ariane Gold Corp. from August 2002 to November 2003. Interestingly he was President, CEO and a director of Palmarejo Silver and Gold Corporation until the merger with Coeur d’Alene Mines Corporation and thus an old collaborator of Norman Seckold. Even more intriguingly he was a director of Sherwood Copper Corporation until its clever business combination with Capstone Mining Corp.

The former President & CEO of San Anton, **John Cook**, joined the board of Kings, as a director, after the merger. He has 45 years of professional experience in all facets of mining development, operations and management. He is also the Chairman of Premier Gold Mines Ltd. He has a B. Eng. Mining engineering from Sheffield University in the UK.

**Richard Keevers** has been a Non Executive Director since December 2007. He is a geologist by training, having held senior positions with BH South and Newmont during his 20 years in the mining industry. He then spent 13 years in the stockbroking industry. He also holds positions as the Chairman and CEO of Electrometals Technologies Ltd, a designer and manufacturer of electrowinning equipment for the recovery of metals. In the past he has also been a director of Pacrim Energy Ltd and Zicom Group.

**Robert Bell** is another Non Executive Director having carried out that role since August 2009. He graduated from Birmingham University in the UK in 1960 and moved to Australia in 1964, working as a geologist on the Roma gas fields. After a time with the Queensland Government Mines Department in the late 1970's he established a consultancy business, specialising in oil and gas exploration in Australia and overseas. He was one of the first geologists in Australia to recognise the enormous potential of coalbed methane (CBM) in Queensland. He is currently also a Non-Executive Director of Planet Gas Ltd.

**Nicholas Tintor**, also segued over as a non-executive director from San Anton (where he was a director since December 2006). He also holds the position of President and CEO of Homeland Uranium Inc and Southern Andes Energy Inc. He graduated from the University of Toronto (B.Sc., Geology) and has more than 25 years of experience in the mining industry. Additionally he is currently a director of DNI Metals Inc, and Southern Andes Energy Inc.

**John Skeet** is the Chief Operating Officer of Kings (and was formerly the principal consultant to the El Gallo project). He has 20 years of experience in the mining industry having most recently managed the permitting and development of the Bolnisi Gold's Palmarejo Ag/Au project in Mexico, prior to its takeover by Coeur d'Alene (CDM).

Previously he had been responsible for the successful development of Bolnisi's gold heap leach operation in the Republic of Georgia and was the General Manager for Valdora Minerals NL's projects and operations where he was responsible for the first gold production in over 80 years at the Ballarat goldfields in Australia.

### **Outcomes – nearer and farther**

The ideal outcome for all concerned would be for Cerro Gallo to move to production and finally have recognition through a vastly improved market capitalization. However in the short term that is not the most likely outcome. The recent merger has made the expanded company even more polymetallic than San Anton was by adding molybdenum and rhenium in the mix of the merged entity. Moly has gone from a glamour metal to an orphan in the space of last two years but we are rather sanguine about the fall and expect that its recovery should eventually catch up with that of the steel industry.

The next alternative is a takeover. The parties involved in this could be many and various. Capstone comes to mind as an ideal party. Other names occur to us but we shall keep those to ourselves should Kings decide to ever consult our opinion on the matter. If the company didn't have such a large base metals, particularly copper, component in the mix, we might see it as a target for Goldcorp. However, Goldcorp could swoop and then flip out the base metals as a NewCo.

### **Conclusion**

This company has been in the Model Mining Portfolio since its inception and was, for ages, one of the most static components, until the upmove spurred by the remerger and name change. It is no wonder that it stagnated for so long as nothing happened at the company over most of that time. While it husbanded its small pile of cash, investors steered a wide berth in recognition of its curious capital structure.

Finally the pace is heating up. The management team is in place, the market cap is up, the tailwind of solid gold and copper prices should help any financing requirements and the partner is Goldcorp (with almost bottomless financing resources). We feel that it would be pushing it to expect this company at the stage that it is at to achieve a market capitalization of much over \$150mn. The perceived upside is crimped somewhat by Goldcorp's back-in right, which could convert Cerro into a spectator. However in such an event, the likelihood rises of Cerro being taken totally out of the project and that might involve a substantial windfall for Cerro. However Goldcorp have passed twice on chances to move up their position and management feels that Goldcorp is not likely to want to become a major copper player, unlike Barrick's recent move.

There is always the chance that a player will appear to bid for Cerro de Gallo and this possibility starts to make sense of the Namaquipa project which would then become the company's flagship. The Australian asset looks like an almost inevitable spin-off candidate also.

The challenge now will be to get the project moving towards production. The low-grade but massive nature of the deposit is both a hindrance and an attraction for investors. The task now is for the company to convince funders that the mine would be viable at lower price points for its major outputs should there be a lasting market retreat.

At the moment we rate Cerro Resources as a **Long** with a twelve-month price target of 33 cents. This is definitely a stock to keep on the radar screen for eventual appearance as a low-cost gold and silver producer of consequence.



## Important disclosures

I, Christopher Ecclestone, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

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