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Morning view

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Gold hits new record of US\$1,234/oz in morning trading in response to concerns over EU debt and budget deficit.

Economic News

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Dow Jones Industrials	-0.34% at 10,748.26
Nikkei 225	-0.16% at 10,394.03
HK Hang Seng	+0.13% at 20,171.85

Please refer to the Economic calendar at the end of the note.

TED spread - The measure of perceived credit risk increased to 0.31% last Friday, the highest level since the end of July 2009. The spread reduced slightly to 0.28% after EU announced Eur750bn package.

- Libor rates continued to rise as banks require additional premium to lend to each other. Quality of banks credit portfolio fell with recent sovereign rating downgrades in the EU.
- Banks have little intention to lend to their counterparts who are exposed to EU sovereign debt market.
- Proposed Eur750bn package should be sufficient to support liquidity within the banking system in the short term. However, structural changes needed to promote long term stability

Europe – European financial institutions hold around Euro61bn in Greek and Portuguese bonds. That is almost 16% of aggregate debt of two countries that stood at Euro382bn at the end 2009.

- EU financial companies have around Euro73bn in Spanish government debt that is 13% of total sovereign debt at the end of 2009.
- Greek government bonds lost 28% this year, Portuguese dropped 10% while Spanish gained 0.8%.
- Q1 GDP in Germany grew unexpectedly by 0.2% qoq on stronger exports that were boosted by significant weakening of Euro against US dollar. Capital investments have also contributed to GDP growth in Q1.
- Euro zone GDP is due later today.

UK – Conservatives to rule the country for the first time in 13 years. David Cameron agreed a five-year deal with Nick Clegg. It will be a first coalition government in more than 60 years. Brown resigned while Cameron moved into Number 10.

- New coalition government tax package include an increase in capital gains tax to 40% for non-business assets from current 18%.
- UK industrial production surged by 2% mom in March, the highest growth rate since July 2002. Consensus showed 0.6% growth. Average GBP/USD exchange rate dropped almost 3% mom in March supporting exports and promoting growth in production. Sterling lost around 25% against trade-weighted basket of currencies since November 2009.

Australia – Australia targeting A\$1bn budget surplus in 2012-2013, up from an estimated deficit of A\$40.8bn in the year to June 2011. Budget spending growth is expected to be limited to 2% pa until budget surplus will reach 1% of GDP or around A\$11bn.

South Africa – Large labour union Utatu may soon join the strike action that started on Monday.

- There are 54,000 workers at the state owned transport company Transnet Ltd. Currently around 18,000 workers are on strike. Utatu labor union has 21,000 members and may soon decide to join the strike.

- Transnet operates rail services and may disrupt transportation of iron ore, ferrochrome and coal to the export port.
- Labor unions demand 15% increase in wages to meet rising food prices. Transnet has offered 11% increase so far.

Currency – Euro lower to US dollar overnight as proposed Eur750 is not a long term solution.

US\$1.270/eur vs \$1.274/eur yesterday. Yen93.02/\$ vs 92.63/\$ SA7.468/\$ vs 7.530/\$ \$1.502/GBP vs 1.482/GBP

Commodity News

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Precious Metals

Gold US\$1,229/oz vs US\$1,208/oz yesterday – Gold hit an all time record this morning on safe heaven demand.

- Investors are concerned with the increasing amount of global debt that may erode paper money value in the future.
- Gold and the US dollar show strongest positive correlation in 14 months. Usual negative relationship broke in mid April on evolving EU debt crisis.
- **SPDR unchanged at 1,192.15 (38,328moz) current value US\$45.8471bn.**

Platinum US\$1,701/oz vs US\$1,679/oz yesterday – Rising gold prices lifts PGMs due to attraction as an investment metal.

Palladium US\$531/oz vs US\$523/oz yesterday –

Rhodium US\$2,825/oz vs US\$2,825/oz yesterday –

Silver US\$19.32/oz versus US\$18.44/oz yesterday – Prices influenced by gold.

Base metals:

Copper US\$7,080/tvs US\$6,970/t yesterday – contractors strike at Collahuasi, third biggest copper mine in Chile.

- The mine has not been operating at full capacity as contractors block the entrance to the mine. Collahuasi mine produced 535,856t of copper last year.
- Refined copper output in China rose by 6.1% mom and 15% yoy to 380,000t in April. Copper production rose by 16% yoy to 1.455mt in the first four months of the year.

Aluminium US\$2,114/t vs US\$2,080/t yesterday – Production of primary aluminum in US and Canada dropped by 0.2% mom (-1.8%yoy) in April to 4.73mt annualised.

Nickel US\$22,825/t vs US\$22,450/t yesterday –

Lead US\$2,046/t vs 2,050t yesterday –

Zinc US\$2,100/t vs 2,076/t yesterday –

Tin US\$17,645/t vs US\$17,700/t yesterday –

Energy:

Oil US\$80.98/bbl vs US\$79.54/bbl yesterday – Prices continue to be volatile due to concerns over Eu bailout.

- IEA cuts estimate by 400,000bbl/day for oil OPEC will need to pump this year to 28.7mmbbl/day in order to meet demand this year. World oil demand is expected to average 86.4mmbbl/day, 220,000bbl/day down from last month's estimate. The revision is largely a consequence of changes to historical demand data for 2008.
- IEA also indicates that OPEC's compliance to quotas fell to 54% as Iran boosted output.
- Brent's premium to WTI likely to fall back from 9 month high as US demand could bring down stockpiles as economy recovers and the driving season approaches.

Gas US\$4.163/ MMBTU vs US\$4.177/MMBTU yesterday –

Coal – Explosion at the Rapsadskaya mine in Kemerovo is unlikely to affect global supply.

- Two explosions at the Russian coal mine took life of 60 people and injured 70 last weekend.
- The mine capacity is 8mtpa that represent 10% of Russian coal production. Russia share of the global

coal market is only around 6%.

Other:

Steel – Major producer Hyundai Steel is to spend US\$5.5bn on new plants and plans to pursue mining projects along side Korea Resources Corp in order to secure raw materials.

- A number of steel producers are becoming increasingly active at securing mining assets due to concerns over raw material supplies.

Stainless Steel – Volatile nickel prices could be hurting demand with many buyers reported to be taking a wait and see approach.

- Nickel is traditionally a highly volatile base metal and is used in around 60% of stainless steel production, but has been losing market share to low/zero nickel stainless due to volatility.

Iron Ore – Quarterly contract prices could rise 32% in Q3 according to Japan Metal Daily taking the price to US\$158/t from the current provisional price of US\$120/t. This is derived from the three month average spot price March to May.

Company News

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Mining:

Medusa Mining* (MML AU) 271p mkt cap £506m – Exploration work to add to production base

Corporate – 15 page research note sent out earlier today

- **Medusa is now producing at 100,000ozpa from its Co-O mine in the Philippines which produced 25,505oz in Q1 of this year at cash cost of US\$180/oz. We have recently been to site and observed first hand the progress made at Co-O and obtained a clearer impression of the potential within the company's tenement package. Consequently we are raising our valuation from 289p/share to 314p/share and feel that future developments will continue to add value.**
- **Valuation** – Our recent visit has given us a clearer idea of how future production growth is likely to evolve. We have taken a conservative approach to this by raising the production profile from 100,000ozpa to 130,000ozpa by 2012 through incremental expansions from Co-O, maintaining a long term cash cost of US\$200/oz which takes up our target price to 314p/share from 289p/share. This figure factors in cash and equivalents in March (US\$48m), a 50% premium on the NPV of freecash flows (US\$442m) from Co-O (8% discount rate), and US\$52m for exploration (US\$32m for 650,000oz resource at Bananghilig and US\$20m for exploration potential).
- **Co-O** – A key observation from our recent site visit is the team's competency at developing an asset in the appropriate manner for the resource and local environment. Co-O is a high grade narrow vein mine that has some exceptional veins. However, such deposits are not easy to mine with many companies trying to over mechanise these sorts of deposits. Mining is carried out largely with air leg mining, although where veins are wide enough, long hole stoping is planned. The asset is now well developed with considerable infrastructure in place and significant stockpiles which puts the mine in a strong position minimising risks from production difficulties.
- **Exploration** – In this note we have given considerable detail on the various exploration projects in the company's portfolio, including growth potential at Co-O. The company has provided considerable newsflow in recent months on various projects which include additional potential at Co-O, other gold projects and copper targets. Management is budgeting US\$18m on exploration this year and next and anticipates expanding its production base to 300,000-400,000ozpa through organic growth. Our site visit gave us a clearer idea of how this growth is likely to evolve. Ongoing newsflow will define how this potential will be realised.

Year End June		2008A	2009A	2010F	2011F	2012F
Gold Price	US\$/oz	822	880	1080	1100	950
	z					
Gold Produced	koz	19	48	90	120	130
Revenue	US\$m	15.9	42.9	96.0	131.9	126.4
EBITDA	US\$m	5.8	27.3	70.9	97.8	87.5
Pre-tax profit	US\$m	-0.1	22.5	61.0	85.2	75.7
Post tax profit	US\$m	-2.2	24.2	61.0	85.2	75.7
EPS	USc	-1.4	14.2	32.4	45.3	40.2
PER (x)	X	nm	28.6	12.5	9.0	10.1

Freecash US\$m	US\$m	-9.9	-1.4	33.6	72.1	66.2
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Source: Fairfax estimates

N.B. Historicals based off published A\$ numbers and converted to US\$ at average exchange rates so subject to change once final US\$ denominated results are published.

* Fairfax acts as Nomad & Broker to Medusa Mining

Minera IRL (MIRL LN) 67p mkt cap £57.4m – Drilling result at new zone at Ollachea

- Minera has published some drill results from the new Concurayoc zone at its Ollachea project in Southern Peru with five intersections over a 500m strike length including 20.9m at 3.07g/t Au, 14m at 2.91g/t Au and 8m at 5.08g/t Au.
- This new target is 300m along strike from the Minapampa zone which has an inferred 1.3moz resource at 4.5g/t Au and is currently the subject of a pre-feasibility study.
- This is a promising development with the new mineralisation thought to be part of the same gold-bearing lenses intersected in late 2008. Two rigs are committed to Minapampa, but as rigs become available, management plans to send them to Concurayoc.

Conclusion: This is a positive development for Minera and indicates that there is considerable potential yet to come at Ollachea which could evolve into a substantial operation. We look forward to further drilling updates and results of the pre-feasibility study.

Hambledon Mining* (HMB LN) 4.63p mkt cap £23.9m – Final results show maiden profit

Corporate

- Hambledon's final audited results for 2009 show the company has exceeded expectations and generated a small profit of £42,000, we were anticipating a loss. The company produced 20,050oz in the year up 60% yoy.
- That the company has exceeded expectations indicates that we are overestimating costs as the company has suffered many production difficulties since start of operations in 2008. We are in the process of reviewing our numbers accordingly.
- **Sekisovskoye:** Despite a tough Q1 this year, we understand that production in recent weeks is running well, and if this continues then the company could come close to the annualised 40,000ozpa from the open pit once the current of peak stripping is past.
- The underground mine to which is to be developed should take production to around 100,000ozpa in the coming 2-3years and if achieved at a cash cost below US\$500/oz, as appears possible, then the company appears significantly undervalued at these levels. We would expect a significant re-rating if positive news follows concerning production at Sekisovskoye in the coming months.
- Underground development should lead to substantially lower operating costs and also lower risk in some respects as operations in the open pit have struggled with high stripping and extreme temperatures. The company expects to properly get into the underground in 2012.
- A 12,000m drilling programme has been designed for the underground development targeting the 320m level down to the 120m elevation. To do this the existing surface shaft is being refurbished to get access to the 320m level. This month the contract for the development is likely to be awarded to local company Vostakshakhtostroy to start developing the decline this summer and will take 12months. Part of the development will allow access to some of the ore.
- The plant now appears capable of functioning above capacity and has the potential to treat at an annualised rate of 1mtpa, although as seen in Q1 extreme cold weather can impact this. Recovery rates have been consistently over 80% in recent months despite the difficulties of Q1.
- With spare capacity at the processing plant, as previously announced, management has entered into an agreement with a local miner to process some high grade ore. Although this initially is low (10kt at 4.5g/t), should the arrangement work well, then its contribution could become more significant generating more cash.
- **Ognevka:** This asset has been on care and maintenance and since the government controlled rehabilitation process has failed, the operation is to be placed into bankruptcy this and liquidated this year, the proceeds of which will largely go to Hambledon. We have not included this project in previous valuations.
- **Balance Sheet:** At the end of 2009, Hambledon had cash of £1.462m and had the Alfa bank loan facility available which has been renewed till December 2012 for US\$2.0m. With current high gold prices (new record this morning), the company should be generating more cash and be in reasonable shape to support underground development from cash flows.

Conclusion: We are pleasantly surprised with this latest result, and despite a particularly tough Q1 largely due to extreme cold, we are increasingly optimistic that the worst is behind and shareholders could soon start to see

the benefits of the gradual improvements at Sekisovskoye. Should positive newsflow come through in the coming months, then we should see a significant re-rating in the stock.

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Economic calendar:

	Date		Event: G7, AU, China		Survey	Actual	Prior
Tue	10-14 MAY	CH	New Yuan Loans	APR	585.0B	774.0B	510.7B
	00:01	UK	RICS House Price Balance	APR	10%	17%	9%
	03:00	CH	Producer Price Index (YoY)	APR	6.50%	6.8%	5.90%
	03:00	CH	Consumer Price Index (YoY)	APR	2.70%	2.8%	2.40%
	03:00	CH	Retail Sales (YoY)	APR	18.20%	18.5%	18.00%
	03:00	CH	Industrial Production (YoY)	APR	18.50%	17.8%	18.10%
	03:00	CH	Fixed Assets Inv Urban YTD YoY	APR	26.00%	26.1%	26.40%
	07:00	GE	CPI - EU Harmonised (YoY)	APR F	1.00%	1.00%	1.00%
	09:30	UK	Industrial Production (YoY)	MAR	0.60%	2.0%	-0.10%
	09:30	UK	Manufacturing Production (YoY)	MAR	1.60%	3.3%	1.40%
	10:30	AU	Australia's 2010-11 Federal Budget delivered in Canberra	May-11			
		UK	NIESR GDP Estimate	APR	--	0.5%	0.40%
	18:30	US	Fed's Plosser Speaks at Atlanta Financial Markets Conference	May-11			
	21:30	US	API U.S. Crude Oil Inventories	May-07	--	362K	2951K
Wed	07:00	GE	GDP s.a. (QoQ)	1Q P	0.00%	0.2%	0.00%
	07:00	GE	GDP wda (YoY)	1Q P	1.20%	1.6%	-2.40%
	07:45	FR	CPI - EU Harmonised (YoY)	APR	1.80%	1.7%	1.70%
	07:45	FR	Gross Domestic Product (QoQ)	1Q P	0.30%	0.1%	0.60%
	07:45	FR	Gross Domestic Product (YoY)	1Q P	1.40%	1.2%	-0.30%
	09:00	IT	GDP sa and wda (QoQ)	1Q P	0.30%	--	-0.30%
	09:00	IT	GDP sa and wda (YoY)	1Q P	0.00%	--	-3.00%
	09:30	UK	ILO Unemployment Rate (3mths)	MAR	8.00%	--	8.00%
	10:00	EC	Euro-Zone Ind. Prod. wda (YoY)	MAR	6.50%	--	4.10%
	10:00	EC	Euro-Zone GDP s.a. (QoQ)	1Q A	0.10%	--	0.00%
	10:00	EC	Euro-Zone GDP s.a. (YoY)	1Q A	0.40%	--	-2.20%
	10:30	UK	Bank of England Quarterly Inflation Report	May-12			
	13:30	US	Trade Balance	MAR	-\$39.9B	--	-\$39.7B
	15:30	US	DOE U.S. Crude Oil Inventories	May-07	--	--	2755K
	19:00	US	Monthly Budget Statement	APR	-\$20.0B	--	-\$20.9B

Source: Bloomberg

Mining this week:

Ampella Mining (AMX AU) A\$1.70c/s, mkt cap A\$278m – Wide intersection of high grade gold at Kougloga

European Goldfields (EGU LN) 453p mkt cap £851m – EU moving to ban cyanide, that could impact Certej

African Aura (AAAM LN) 74.25p mkt cap £41.4m – New gold zone identified at Liberty Gold project

First Quantum Minerals (FQM LN) 4650p mkt cap £3,720m – Q1 results show a marked recovery in earnings

Petropavlovsk (POG LN) 1153p mkt cap £2,101m – Listing of iron ore business in HK could value iron ore at \$1.5bn

Medusa Mining* (MML LN) 270p mkt cap £517m – London roadshow this week to encourage new investors

Recent analyst site visit highlights scale of Great Hamish, high grade gold vein and expansion potential

Petropavlovsk (POG LN) 1226p mkt cap £2,232m – Potential for Hong Kong listing to value iron ore arm at US\$1.5bn, BUY – valuation 1795p (formerly Peter Hambro Mining)

Shanta Gold* (SHG LN) 20p, mkt cap £23m – Expect positive news as new money takes Shanta closer to

new mine GEM Diamonds (GEMD LN) 266p, mkt cap £370m – Interim statement shows impact of recovery in diamond prices Ampella Mining (AMX AU) A\$1.51c/s, mkt cap A\$245m – stock suspended pending drilling results STRONG BUY

M&A

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MacArthur Coal (MCC AU) A\$13.12 mkt cap A\$3,336m – Shares falling on Peabody bid concern

- Concerns that Peabody's takeover offer of MacArthur Coal may no longer succeed in response to new mining tax being proposed.

Red Back Mining (RBI CN) C\$24.82 mkt cap C\$5,769m – Kinross buys C\$600m stake

- Major producer Kinross Gold Corp has paid C\$600m for a 9.4% stake in Red Back as part of a private placement at C\$25/share. The funds are to be used for future expansions at Tasiast, and provides Kinross with access into opportunities in West Africa.

Lihir Gold (LGL AU) A\$3.75 mkt cap A\$8,882m – A\$9.5bn take over offer agreed

- News reports indicate that Lihir has accepted NewCrests latest offer in a deal that would create the world's fourth largest gold company. The recent Australian Henry Tax being proposed may not affect the merger.

Polo Resources (PLM CN) 5.15p, mkt cap £120m – possible merger with Caledon Resources

- Polo and Caledon reached principle understanding regarding merger of two companies. In case management decide to proceed with the deal, Polo will be prepared to make all share offer for 100% stake in Caledon at 11.4 Polo shares for 1 Share in Caledon.

Rio Tinto apparently in talks with Chinalco to develop the Simandou iron-ore project in Guinea.

- The project is expected to cost \$12bn
- Rio have declined to comment

Atlas Iron (AGO AU) A\$2.31 mkt cap A\$1,033m – Deal to acquire Aurox Resources for A\$131m

- All scrip bid agreed to buy Aurox resources to expand Atlas's port capacity and iron ore resources. The merger if agreed by shareholders is due to complete in May

Arrow Energy (AOE) A\$5.11 mkt cap A\$3,747m – Shell & PetroChina make A\$3.3bn offer

- Cash offer made by Shell and PetroChina for Arrow Energy, which is the largest holder of coal-seam gas acreage in Australia.

Chariot Resources (CHD CN) C\$0.64 mkt cap C\$234m – Sale agreement with China Sci-Tech

- Copper exploration company Chariot with a deposit in Peru has signed a sales agreement with China Sci-Tech Holdings to purchase all shares for C\$0.67/share.
- This highlights Chinese interest in securing copper assets.

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