

Chesapeake Gold – in Goldcorp's Comfort Zone

It might be a stretch to call Chesapeake Gold Corp. (TSXV: CKG) “Son of Goldcorp” but there is a definitely a familial relationship and they are definitely on speaking terms. Estranged they are not.

The first nexus of this relationship is that Randy Reifel, CEO of Chesapeake, is a long-time director of Goldcorp having sold Francisco Gold to Glamis (before Goldcorp took it over) more than a decade ago.

The second nexus is the 9% stake that Goldcorp holds in Chesapeake's shares.

The back history to Randy Reifel is that he has been a senior executive in the exploration business for thirty years. Prior to establishing Chesapeake, he was president of two exploration companies focused in Latin America, Carson Gold Corp. and Francisco Gold Corp. His recognition of the Kilometer 88 gold district in Venezuela led to Carson Gold being acquired in 1993. At Francisco Gold, he was key to the development and financing of the El Sauzal and Marlin gold discoveries and the sale in 2002 to Glamis Gold for \$390 million. He holds a Bachelor of Commerce and a Master of Science in Business Administration.

The Assets in Question

Chesapeake is focused on the exploration and development of precious metals projects in Mexico. Its major project is its 100% owned Metates gold deposit located in Durango state. It does have some smaller prospects in the same state and farther afield.

Metates is one of the largest undeveloped gold and silver

projects in the world. Last year Independent Mining Consultants of Tucson, Arizona prepared a NI 43-101 compliant proven and probable reserves of 18.5 million ounces of gold, 526 million ounces of silver and 4.2 billion pounds of zinc. The metal prices assumed for the reserves are \$1,350 per ounce gold and \$25 for silver per ounce at a cutoff grade of 0.35 g/t gold equivalent. These cut-off grades are now old history and the resource could do with a rework. What cannot be denied though is that the stripping ratio of 1:1 is exceptionally low for a gold project of this immensity. For us at the current time that massive Zinc component gets the pulse racing because it provides icing on the cake that so many other major gold projects do not have.

Naysayers have zeroed in on the Capex issue which is always a criticism that gains traction, rightly or wrongly, these days. In the company's days of "build it and they will come" thinking the project was sized to attract elephant hunters with a \$4.3bn capital spend and a 25 year mine life. As elephant hunting is out of fashion, literally and metaphorically, the company is currently working on "right-sizing" the project to suit the tenor of the times.

While comparisons might be odious it is relevant to draw attention to the size of Metates compared to projects such as KSM and Galore Creek in out of the way, hostile environments, or even less fortunately to Tasiast or Pascua Lama. Metates is almost a cakewalk compared to these "available" alternatives.

Reasons for Goldcorp to Move

The market is not rewarding Goldcorp in the way it should for walking away from a stupid transaction. When the bid for Osisko began it had some commercial logic but became a total travesty when two companies that should have known better threw caution to the winds and waded in with a rather ridiculous carve-up of Osisko that owed more to "circling the wagons" type thinking than creating shareholder value.

That the market responded so negatively to Goldcorp walking away is perverse as Goldcorp has done exactly what most pundits said should have happened in the boom years. Osisko was not the only fish in the sea and Goldcorp is not up against any imminent decline in production. Thus it has the leisure of being able to look for bolt-ons that are synergistic, not merely opportunistic. Ideally, it can have its cake and eat it too at this point in the market's desperation and capitulation.



So what rationales can we put forward for going after Chesapeake:

- □ Cheap, cheap, cheap
- □ Familiarity with the story
- □ Confidence in the CEO
- □ Mexico being familiar territory
- □ Substantial size of gold resource
- □ Extensive mine-life

Conclusion

Goldcorp appear to be in a total funk in the wake of the "failed" Osisko bid. We regard it as a lucky escape. However the market has rewarded Goldcorp's caution by slapping down its share price. With Chesapeake, wrongly or rightly, being regarded as a planet circling at some distance from Goldcorp's "sun" it also have suffered inordinately. The feeling is around and about that if Goldcorp is on the rebound and doesn't buy Chesapeake then maybe it never will. Let's just put it this way, Goldcorp is not holding its shares in CKG for the dividend flow..

To us it seems somewhat inevitable that Chesapeake will be brought closer into the Goldcorp orbit. While gold is down and out currently the pace of corporate actions is hotting up. In the size category where Goldcorp shops, there is not much on

offer. Mexico is a known quantity for Goldcorp. Whatever the country's problems might be its familiar territory for Goldcorp and distinctly within the gold major's comfort zone.

Compared to any of the other potential buys out there, Chesapeake represents the best way of Goldcorp plugging a production decline in its mid-term outlook. Other majors have more pressing production declines and thus need to outbid Goldcorp to plug those gaps. Goldcorp on the other hand has the time to develop Metates to fill a future need IF it moves in the next year to eighteen months. Therefore, in our humble opinion, Chesapeake Gold looks like the turkey all dressed up for Thanksgiving which if bid for, even at a multiple of its current market cap, would represent an inexpensive, significant and synergistic move by the most likely acquirer.