HALLGARTEN & COMPANY

Coverage Update

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Chesapeake Gold (TSX: CKG)
Strategy: LONG

Key Metrics	
Price (CAD)	$ 2.15
12-Month Target Price (CAD)	$ 4.10
Upside to Target	91%
High - Low (12 mth)	$1.39-$2.90
Market Cap (CAD mn)	$ 95.5
Shares Outstanding (millions)	44.4
Fully Diluted (millions)	48.8

	2014	2015e	2016e	2017e
Consensus EPS		n/a	n/a	n/a
Hallgarten EPS		($0.09)	n/a	n/a
Actual EPS	($0.09)			
P/E	n/a	n/a	n/a	n/a

Chesapeake Gold

Quantum Reduction in CapEx

- + The Metates project has truly massive Proven and Probable mineral reserves of 18.3 million ounces gold, 502 million ounces silver and four billion pounds of zinc
- + The company is well-padded financially with over $24mn in liquid assets
- + The project has now been reengineered for lower capex advantages and the NPV of the updated PFS is now $1.8bn, albeit using lower metal price assumptions
- + The updated PFS shows Metates is a scalable project – unlike some of its peers
- + A sizeable Zinc component to the resource thereby adding one of the most prospective metals of current times as a bonus
- + Goldcorp as a large strategic shareholder, and with a director in common
- ✘ The stock price of the company has been overly punished due to the quiet M&A scene in Big Ounce projects of late
- ✘ Financing environment remains challenging for big projects
- ✘ The absence of financings means no work for the denizens of Bay Street, which has resulted in the company not being covered in a manner commensurate with the size of its resource

Reshaping the Grand Plan

In these times of tough financing conditions companies on a track to production are moving to "right-size" their projects. This frequently means that companies need to commission a recalculation and rewrite of previous Feasibility Studies based upon a new set of premises. The capex for the Metates project was certainly large in its original version and begged the question of where economies could be made and where the timeline could be adjusted, with modified volumes, to produce a project that would appeal to gold majors wishing to plug upcoming gaps in their pipeline.

Now that the totally overhauled PFS for Metates has come out we can see some major improvements in the strategy while achieving a significant drop in the capex. Here we shall review the changes and their implications.

The Main Changes

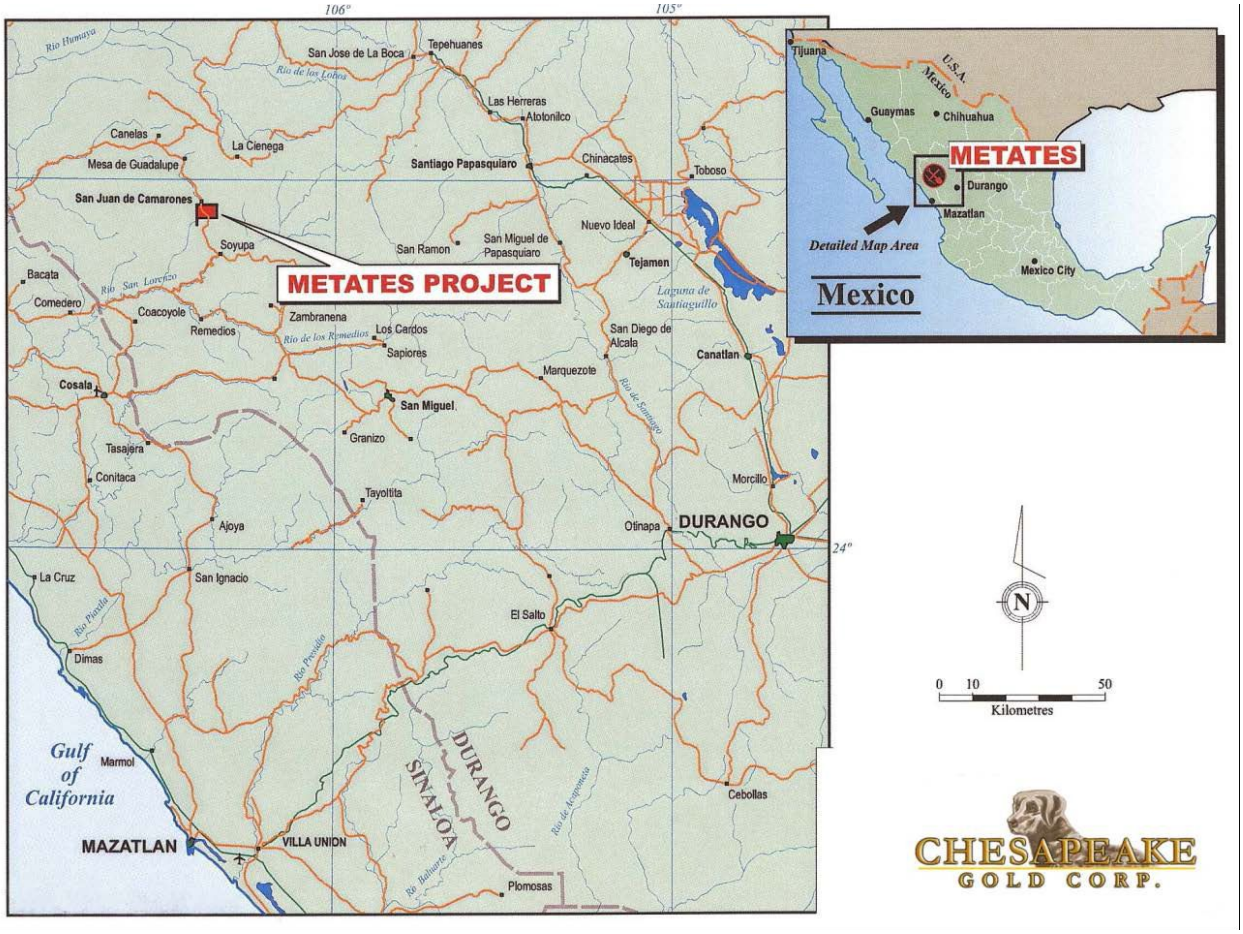
Our reading of the new PFS throws up the main changes being:

- ➢ Introduction of phasing with smaller production in the first years to generate cashflow
- ➢ Moving of the process complex from Ranchito to El Paso (thus nearer to existing infrastructure)
- ➢ Desalination plant to be built by an independent operator
- ➢ Only one autoclave for early years of production
- ➢ Leased mining fleet to lower capex
- ➢ Outsourcing of water, electricity production

The Metates Deposit – Massive by Any Measure

The main play for Chesapeake Gold is its Metates deposit which is one of the largest undeveloped gold and silver projects in the world. The deposit is located in northwest Mexico in the northwestern part of Durango State, some 160 km northwest of the city of Durango and 175 km north of the coastal resort city of Mazatlan.

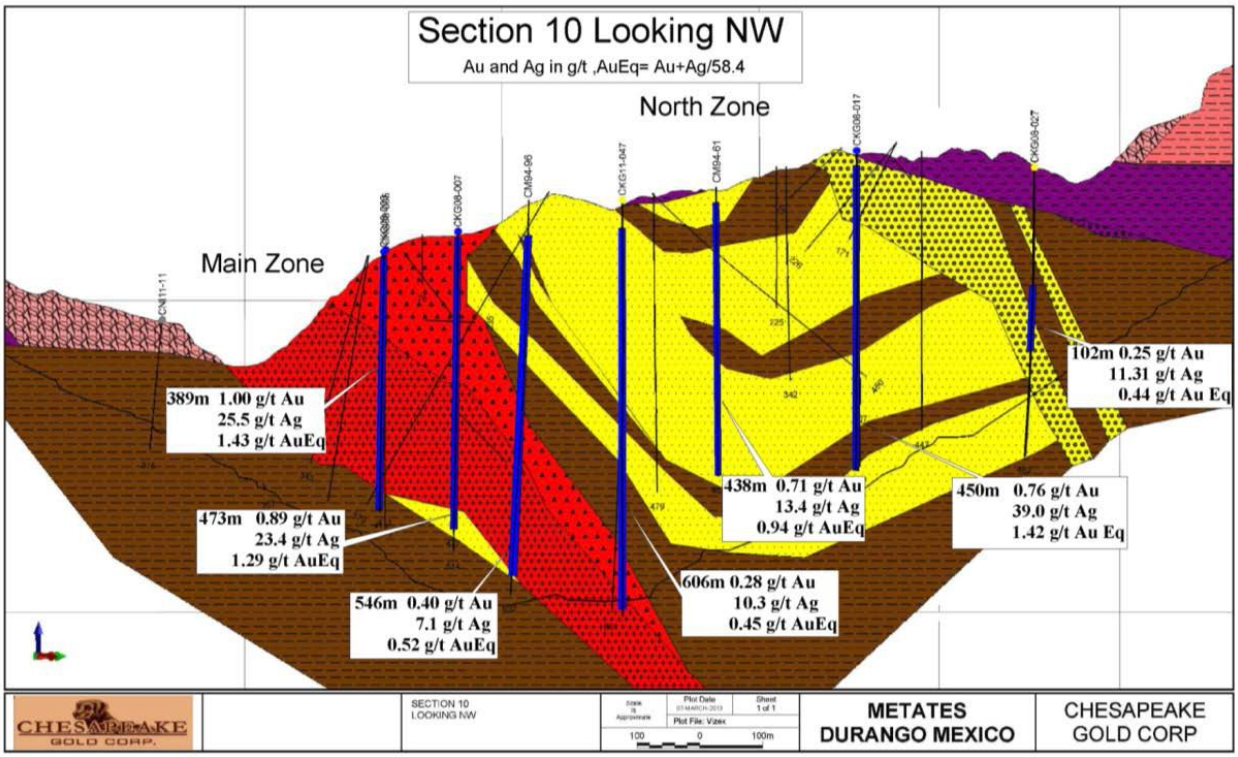
The locale is rugged with elevations in the general region ranging from 620 meters in the west near the village of San Juan de Camarones to 2,300 meters along the ridge line to the southeast. Elevations in the immediate Metates Project area range from 650 to 1,180 meters in the area of the concentrator site. The elevation used for the design is 1,100 meters above mean sea level.



In terms of infrastructure there is a 70-person camp which was established at Metates by Cambior, which Chesapeake rehabilitated and expanded. National power grid electricity is currently available within 22 km of the Metates site at the La Cienega Mine of Fresnillo, but the operations at both the Metates and El Paso sites will require the construction of a new, large-scale power line. Owing to the significant water demands a water storage reservoir will be constructed near the minesite. This water supply will be augmented by water collected from mine pit dewatering wells, dedicated groundwater supply wells, and a portion from local stream flow.

Geology

The Metates deposit is hosted by Mesozoic sedimentary rocks that have been intruded by a quartz latite body up to 300 meters thick and 1,500 meters long. At the core of the deposit is an intrusive body, the emplacement of which took place in the Early Cretaceous as a submarine volcanic dome of quartz latite/dacite composition within the earlier sediments. Continued sedimentation, along with uplift and growth of the submarine dome resulted in subaerial or shallow submarine erosion of the dome, and surrounding sediments generating mineralized igneous and sedimentary clast breccias surrounding the dome.



The original PFS included an interesting analysis in which the authors noted that the Metates deposit is broadly analogous to several other deposits commonly known in Mexico, as well as the Pueblo Viejo deposit in the Dominican Republic.

In Mexico, possible similar deposits could include: the Cerro de San Pedro gold-silver-zinc deposit of New Gold (TSX:NGD), in the state of San Luis Potosí; the El Castillo gold-silver-zinc property of Argonaut Gold (TSX:AR) in Durango State; and the Peñasquito silver-zinc-gold-lead deposit of Goldcorp in Zacatecas State. All of these other deposits are relatively close to Metates, and are generally in northwestern or north central Mexico.

The authors then went on to note that published descriptions of other deposits outside of Mexico suggest that Metates may be similar to Barrick Gold /Goldcorp's Pueblo Viejo deposit in the Dominican Republic. In particular Pueblo Viejo, like Metates, is hosted in submarine sedimentary rocks, has an association with altered intrusive rocks, and is very large in size. It also contains significant amounts of

sulfides in both ore and waste rocks, and hosts significant gold, silver zinc and copper mineralization that are refractory in nature.

The photo above shows the alteration and the different elements of the deposit. Mineralization occurs in two zones: the Main Zone which is centered around the intrusive and the North Zone, which is wholly within sediments including sandstone, shale and conglomerate.

The gold-silver mineralization occurs as sulphide (pyrite and sphalerite) veinlets and disseminations in both the intrusive and sedimentary host rocks.

The Resource

Since acquiring the Metates property in 2007, Chesapeake completed extensive drilling and related assaying in order to validate the previous data collected by Cambior and this was used for an initial NI 43-101 compliant resource and reserve estimate in 2010 that has subsequently seen further iterations.

In February 2012 the results of a resource estimate prepared by Independent Mining Consultants of Tucson, Arizona were announced. This new resource was based on assumed metal prices of $1,200 per ounce gold and $24 per ounce silver and a cutoff grade of 0.35 g/t gold equivalent. This resulted in a NI43-101 compliant resource as shown below:

Metates Mineral Resource

	Tonnes 000s	Gold Eq. (g/t)*	Gold (g/t)	Gold (Koz)	Silver (g/t)	Silver (Koz)	Zinc (%)	Zinc (Mlbs)
Measured	344,832	0.87	0.6	6,663	15.9	176,377	0.179	1,361
Indicated	834,527	0.68	0.46	12,347	12.8	342,314	0.153	2,824
Measured + Indicated	**1,179,359**	**0.74**	**0.5**	**19,010**	**13.7**	**518,692**	**0.161**	**4,184**
Inferred	67,557	0.54	0.38	818	9.7	21,158	0.088	130

The Previous PFS

In March 2013, M3 Engineering & Technology of Tucson, Arizona completed a positive Pre-Feasibility Study on Metates. The PFS indicated a large 120,000 tpd open pit operation with a 25-year mine life. The study posited average annual production during the first six years of full production at 845,000 ounces of gold, 25 million ounces of silver and 190 million pounds of zinc at a gold equivalent cash cost of $355 per ounce, net of zinc credits.

The Reserve

The PFS from March 2013 included 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 of 0.35 g/t gold equivalent.

The newly updated PFS contained the numbers below which considering the hefty reductions in price assumptions did not do noticeable damage to already prodigious bottom line amounts of gold, silver and zinc in the Metates deposit.

Metates Reserves

	Tonnes 000s	Gold (g/t)	Gold (oz)	Silver (g/t)	Silver (Koz) 000s	Zinc (%)	Zinc (lbs) millions
Proven							
Mill Ore	283,777	0.696	6,350,000	17.2	156,929,000	0.171	1,070
Probable							
Mill Ore	515,849	0.535	9,056,000	13.5	224,398,000	0.147	1,672
Proven/Probable Reserve							
Mill Ore	799,626	0.599	15,406,000	14.8	381,327,000	0.156	2,742
Probable stockpile	302,703	0.295	2,873,000	12.4	120,229,000	0.188	1,256
Total Proven/Probable	**1,102,329**	**0.516**	**18,279,000**	**14.2**	**501,556,000**	**0.164**	**3,997**

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 provides icing on the cake that so many other major gold projects do not have.

The New PFS

M3 Engineering & Technology, together with several industry leading international consultants, have recently completed the updated PFS and are currently finishing the supporting NI 43-101 compliant technical report.

The updated PFS is based on a lower initial ore throughput rate of 30,000 tpd (Phase 1) with a staged expansion up to 90,000 tpd (Phase 2) to be funded primarily from internal cash flow. This scalable approach addresses the market's concerns on the upfront financing required under the previous plan. Phase 1 production will operate for the first four years of the mine life with Phase 2 production starting in year five. Active pit mining is planned for a total of 27 years followed by 10 years of processing the stockpiled low grade ore.

The revised mine plan and analysis has optimized the mining of high-value ore with a low sulfur content which will now require only one autoclave (versus the previous three) and related ancillary equipment to process the majority of Phase 1 ore production. The single autoclave has resulted in a further reduction in the initial capital cost versus the two autoclaves required with the earlier mine schedule.

The initial Phase 1 capital costs are $1.91 billion, while the combined Phase 1 and Phase 2 initial capital, both including a 18% contingency allowance, is $3.49 billion or approximately US$211 per recovered ounce of gold production (not including the silver and zinc component).

Key Production Differences

The latest PFS contains a quite substantially altered target production from the previous version:

- Average annual gold production of 700,000 ounces for the first 10 years of Phase 2 operations (years 5-14)
- Average annual production of 14 million ounces silver for the first ten years of production
- Average annual production of 115 million pounds of zinc for the first 10 years of production

Due to high-grading to maximize revenues at the start to pay for Phase 2, the average gold cash cost on a by-product basis is -$339 per ounce for years 1-4 rising to $346 per ounce for years 1-10.

Under the previous PFS the payable gold and silver production in the first six years of full production (years 2-7) averaged 843,000 ounces gold and 25 million ounces silver per year. Total cash cost per gold ounce for production years 2-7 was -$272, net of by-product credits for silver and zinc. From ore through dore production, gold and silver recoveries were estimated at 89% and 76%, respectively.

Price Assumptions

The price of the underlying metals at Metates has been a wild ride over recent years but curiously enough the gold price used in calculations has moved only in a range of $1,200 to $1,350 per oz.
The silver price in the latest iteration is fairly generous at $20 and we feel it's over-optimistic. We are more silver bulls than gold bulls but we would have gone with $16.

Our bullish stance on Zinc suggests that the $1.00 per lb used in all the models so far will be severely short of the mark by the time the mine actually reaches fruition. In which case, it will be potentially a very substantial kicker to the revenue streams.

Price Points Utilised

	Resource (Feb 2012)	PFS (Feb 2013)	PFS (March 2016)
Gold	$1,200	$1,350	$1,250
Silver	$24	$25	$20
Zinc		$1.00	$1.00
Copper		$3.00	

Outsourcing

One of the keys to the massive capex reduction has been a dramatic shift to outsourcing. This essentially shifts the capex to a supplier and makes the financing their responsibility and a burden on their balance sheet rather than that of Chesapeake. Conventional wisdom is that this results in higher opex but we have been becoming increasingly skeptical of this in recent years as the party being outsourced to is usually far more skilled at the activity in question and thus less prone to mistakes and capex overruns.

The areas in which outsourcing is envisioned are:

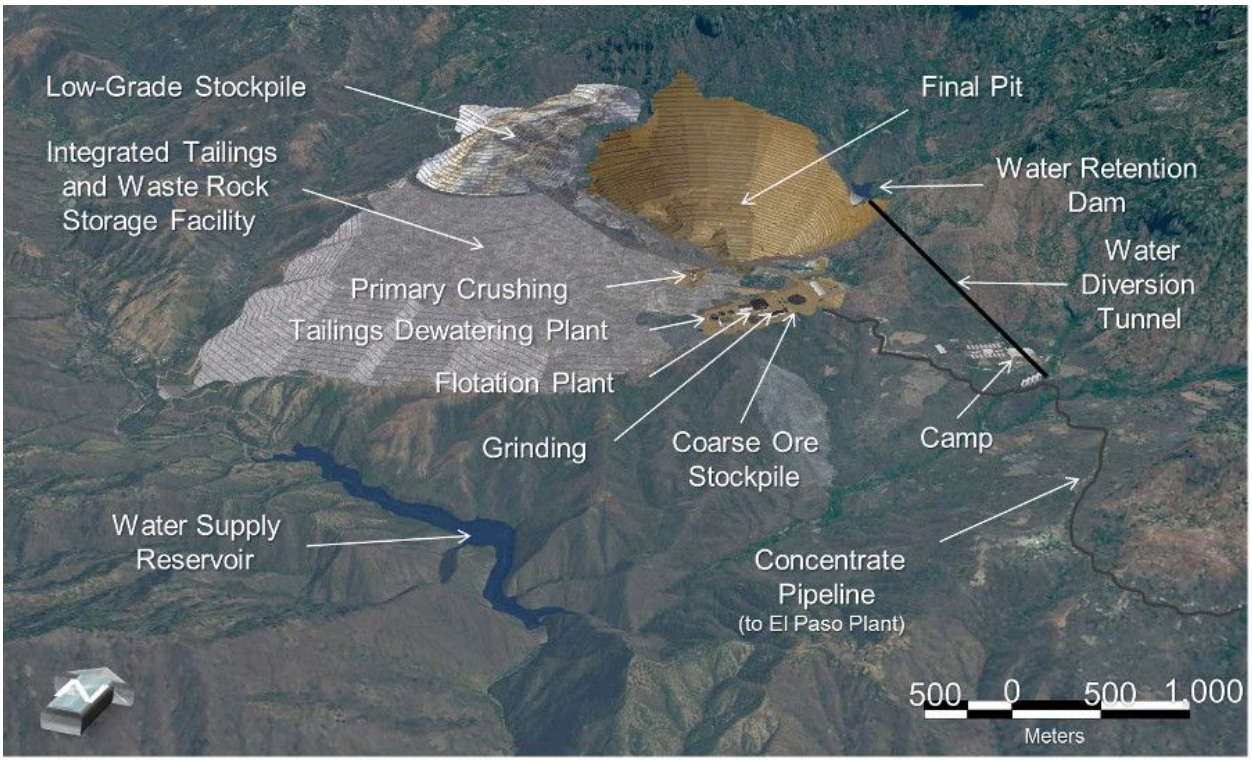
- Power supply
- Oxygen production
- Water desalination
- Limestone and lime production
- Mine equipment leasing and maintenance

In the first iteration of the PFS approximately 43% of the project's operating cost was related to power. The project was estimated to have a total demand of 500 MW. The outsourcing of electricity production relates to the energy needed for the complex at El Paso. This dedicated plant will be connected to the existing grid facilitating the sale of excess power. It shall be a build/own/operate (BOO) facility with AES as the counterparty. Natural gas to power this plant will come from the pipeline that runs down the West coast of Mexico bringing US-sourced natgas. Currently available grid power would be 10 cts per kwh while the outsourced energy plant will be 5 cts per kwh cheaper (the original PFS spoke of costs of 6.12 cts per kwh). This opportunity is one of the prime reasons to relocate the downstream processing to El Paso.

Oxygen is a major input to refractory processing. Air Products has provided Chesapeake with a budgetary proposal for the supply of oxygen to the Metates project with Air Products responsible for the supply of equipment and cost of construction of the plant and assuming full responsibility for the operation and maintenance. Air Products also provided an option whereby Chesapeake would be responsible for the cost of construction of the plant (at an approximate cost of $90 million), with a consequent significant reduction in the monthly fee. Chesapeake elected the latter option and these capital costs were incorporated into both the previous PFS and this newer PFS. In either option Chesapeake was responsible for the delivery of electric power at no cost to Air Products.

The Mine Plan

The final pit design is based on a floating cone run at $1200 per ounce gold and $19.20 per ounce silver, and no value for zinc. Five mining phases have been established to mine the pit from the initial starter pit to the final pit limits. The phase designs include haul roads and adequate working room for large mining equipment.



The revised PFS envisions a conventional truck and shovel open pit mining operation at a 90,000 tpd (down from 120,000 tpd) throughput. From the run of the mine, the ore is crushed and ground to 80% finer than 212 microns through two primary crushers, two SAG mills and four ball mills. Flotation is done with a single rougher stage to produce a bulk sulphide concentrate that contains on average about 94% of the gold, 78% of the silver, and 86% of the zinc. The projected mass pull into the concentrate is 15%. The concentrate is thickened and then pumped downhill (a 700m elevation change) to El Paso through a 103-km-long pipeline using only a single pump station.

The Slurry Line

Water is a prime consideration in most mining operations and has a particular relevance here due to water being needed to get the concentrate to a sufficient state of liquefaction for the journey downhill. The original slurry line to Ranchito was 126 kms, while the revised one to El Paso will be 103 kms.

The proposed flowsheet envisions a flotation concentrate that is thickened to about 57% solids and pumped through the pipeline. At its destination the concentrate is received in the POX plant feed storage tank. The pipeline is designed to transport 13,500 tpd of concentrate based on a 90,000 tpd

milling operation. The concentrate can be transported at between 55% and 61% concentration by mass. During startup of the Metates operation, the concentrate tonnage is reduced. Consequently, the pipeline will operate in batch mode.

Processing at El Paso

The El Paso site is situated beside a large high-grade limestone resource and close to key infrastructure including power, water, transportation and labour. At El Paso acid pressure oxidation (POX) will be performed in an autoclave. The autoclaves will use a Flash-Thicken-Recycle (FTR) configuration which will effectively double their capacity over a conventional autoclave. The final POX discharge is cooled by flashing, and then pumped to four stages of counter current decantation wash to rinse the slurry of as much free acid and dissolved iron as possible. The rinsed slurry will then undergo lime boil for two hours before leaching by cyanidation. Gold and silver in solution are then recovered by filtration and Merrill-Crowe zinc precipitation. The gold and silver precipitate is then smelted and cast into doré bars. Gold and silver recovery during POX and cyanidation is projected to be 98% and 87%, respectively. About 1% of the metals are expected to be lost during filtration and zinc cementation.

Acidic solutions from the pressure oxidation process will be neutralized with ground limestone and lime produced from an on-site quarry and related processing facilities. The neutralization product will be dry filtered as will cyanide leach tailings prior to mixing for co-disposal in an adjacent storage facility. Zinc will be recovered from the pressure oxidation solutions via SXEW methods to produce SHG grade (+99.9% purity) zinc ingots.

The use of the FTR technology allows for a higher pulp density in the autoclaves. In the updated PFS the lower initial ore throughput rate of 30,000 tonnes per day and the lower sulphur content of the ore in the early years (one through three) allows Chesapeake to get by with only one FTR-configured autoclave. At the planned full capacity for the updated PFS of 90,000 tonnes per day this will be boosted to a total of 4 autoclaves.

Addressing the Water Issue

The Mexican national water agency (Conagua) last year published the payment schedule for consumptive water use for both surface and ground water (retro-active) for the 2015 calendar year. The new cost schedule increased rates nearly 100% from those used in the original PFS. The updated PFS design of the Metates processing facilities envisages almost 60% of the water use being recycled.

The first PFS published some statistics on expected water consumption. With the new phasing in the updated PFS the quantity consumed is less in the first few years but are similar once the project is at full production. At full production (90,000 tpd) the Metates Process Plant is projected to require about 1,050 m^3/h of fresh water makeup, while the Ranchito Facilities (now transposed to El Paso) also requires 970 m^3/h of fresh water makeup to sustain the operation. In addition, an average of 200 m^3/h of fresh water is estimated for mine dust control and another 32 m^3/h for potable water. Hence, total fresh water requirement is about 2,250 m^3/h, or about 0.60 m^3 of fresh water per tonne of annual milling capacity. This would amount to about 20 million cubic meters of water annually.

Desalination

As is increasingly becoming the case in South America and elsewhere (California, dare we mention it) there is strong competition for water rights between local residents and agricultural/industrial/mining users. The challenge is ensuring a cost effective and reliable long term water source, especially given Metates long mine life. Whatever the tight supply situation might be today the company needs to ensure that supplies won't be restricted even further several years into production throwing all expectations and previous economics out the window. As an alternative to conventional water sources, Chesapeake has evaluated the use of desalinated sea water as an option. The concept is not novel as several desalination plants already operate in Mexico. Recent advances in desalination technology and low cost electricity from the proposed dedicated natural gas fired power plant provides an opportunity to realize savings in both capital and operating costs.

The close proximity to the coast and to existing infrastructure also enables Metates to capitalize on the desalination option. Chesapeake would outsource the construction and operation of a desalination plant and plans to integrate this option into the water supply network.

During the period in which the PFS has been under revision, Chesapeake has undertaken the following tasks to determine the viability of adopting the desalination option:

- Several large international companies were approached with experience in the construction and operation of large scale sea water reverse osmosis (SWRO) desalination plants
- A tender process was initiated for SWRO proposals to supply approximately 20 million cubic meters of desalinated water annually
- The use of desalinated water was reviewed with government authorities and other stakeholders in the region
- Evaluated the logistics and implications of integrating the SWRO water into the Metates distribution network as well as that of the existing surface water users

It has been decided that in light of Metates' long (about 37 years) mine life desalination might provide a cost effective, reliable and responsible water supply solution. SWRO water is projected to have operating costs comparable to conventionally sourced surface water given the new Mexican tariff. From a stakeholder and environmental perspective, desalination will not compete or conflict with the expanding demand from surface water users in the region during Metates' mine life. Chesapeake plans to outsource the construction and operation of a SWRO desalination plant and will integrate this option into the water supply network.

Chesapeake and its consultants have been working to integrate SWRO desalination into the overall project wide water supply and demand balance. The company significantly redesigned the reservoir component at the mine site and the El Paso site, significantly reducing the amount of earthworks for each facility. The SWRO water will be delivered to the local irrigation district approximately 15kms from the desalination plant. The desalinated water is being "swapped" for the in stream water rights farther up the basin and close to the Metates and El Paso sites.

Limestone in the Mix

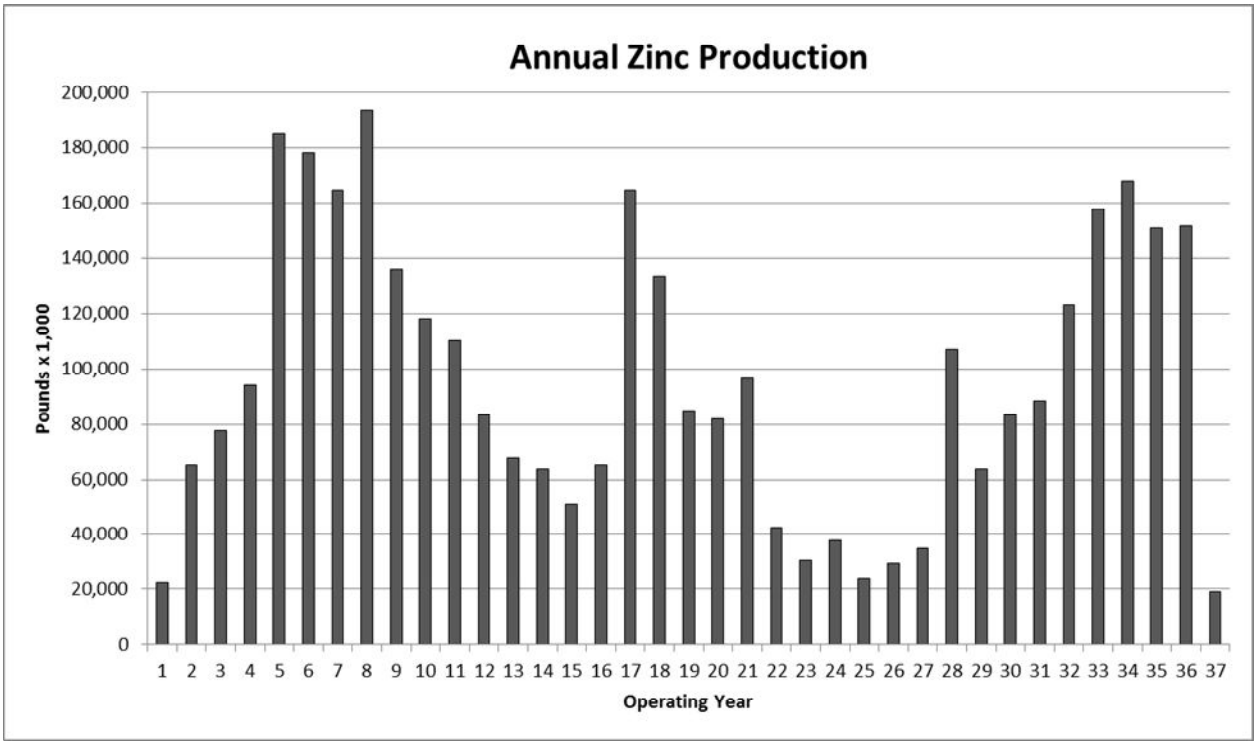
Acid pressure oxidation of high sulfide concentrate produces large quantities of acid that need to be neutralized. The solution also contains dissolved zinc and copper that may be recovered during the course of neutralization.

Neutralization would have been a significant cost for the operation and this drove the decision to locate the El Paso plant adjacent to a large, high quality limestone resource. The bulk of neutralization can be achieved with limestone slurry, to be finished off to the target pH with milk of lime (MOL). Much of the limestone and lime production is outsourced to a specialist third party operator in the updated PFS with anticipated operating costs of about $4.50/ton for limestone slurry and $28.00/ton for lime. Neutralizing most of the acid in the rinse solution will also have the benefit of significantly reduced gypsum scale formation in the slurry neutralization tanks.

Zinc Process

The recovery of zinc from the rinse solution of the autoclave discharge will provide additional revenue. Zinc is first beneficiated as a hydroxide precipitate. The precipitate is then re-dissolved with sulfuric acid with the zinc put into solution for subsequent recovery via a solvent extraction and electrowinning (SX/EW) plant, which produces special high-grade (SHG) zinc ingots.

The zinc plant has a zinc dust unit to produce zinc dust for the Merrill-Crowe plant. Life of mine average zinc production is 88 million pounds per year. Overall, zinc recovery is estimated at 81%.



Zinc – Potential to be a Major Contributor

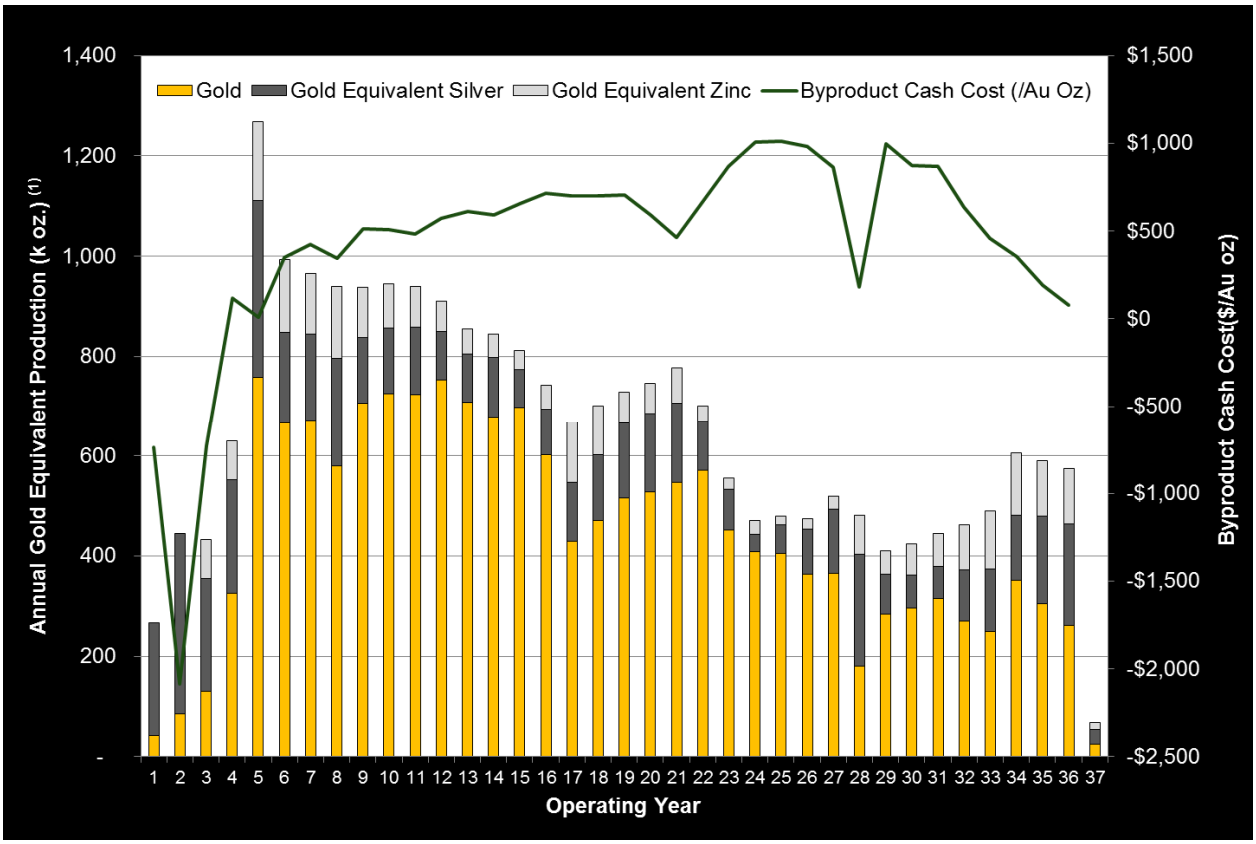
After years of false starts, the looming Zinc supply crisis is starting to focus minds on this formerly unloved base metal. Zinc was previously a light that Chesapeake hid under a bushel in its unfashionable days but now its benefit as a major revenue kicker for Metates is justifiably being played up.

The company estimates Zinc revenues of $3.2bn over the mine life (using prices of recently so we would predict significantly higher). Annual production is targeted at $88mn over 37 years with a production cost of only 25 cents per pound.

Clearly Zinc will enhance the project's economics if you subscribe to our view that the Silver price looks unlikely to match projections used in the revised PFS. Indeed Zinc by-product credits will reduce mine site opex by 30%.

The Zinc aspect could be an attraction to other players or offtakers, though not to the extent of the full capex required to build the project as it stands. We would note that many gold majors are base metal producers in some of their existing producing assets.

Life of Mine Gold & Gold Equivalent Silver/Zinc - Cash Cost



Economics

LOM average operating cost per tonne of ore mined including mining, processing and G&A are estimated at $9.37 per tonne or $628 per ounce net of by-product revenue from the sale of silver and zinc. Close proximity to a high quality limestone resource and low cost electric power contribute significantly to the project's operating financial performance.

Financial results have been developed with $1,250 per ounce gold, $20 per ounce silver and $1.00 per pound zinc as the base case.

At the base case, the Updated PFS demonstrates that Metates will generate a pre-tax NPV of $1.78 billion at a 5% discount rate with an IRR of 10.9%. The LOM cash operating cost is $628 per ounce. The project is expected to generate $11.15 billion in pre-tax cumulative net operating income at base case metal prices.

Economic Cases

	Low Case	Base Case	High Case
Gold ($/oz.)	$1,100	$1,250	$1,400
Silver ($/oz.)	$17.60	$20.00	$22.40
Zinc ($/lb.)	$0.88	$1.00	$1.12
Pre-Tax Economic Indicators			
NPV @ 5% ($mns)	$375.46	$1,779.31	$3,183.16
IRR	6.40%	10.90%	14.70%
Payback (yrs)	11.2	8.7	7.2
After-Tax Economic Indicators			
NPV @ 5% ($mns)	-$395.01	$737.42	$1,842.63
IRR %	3.30%	7.70%	11.30%
Payback (yrs)	15.4	10.1	8.4

Conjuring with Potential Predators

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

With the project financing landscape so drastically altered in recent years there are less than a handful of gold projects of Metates' size that are not already in the hands of majors. Here we shall do a brief review looking at which companies might be predators:

Goldcorp – undoubtedly the most obvious suspect which we shall examine further on.

Barrick – this company is still in wound-licking mode after its Pascua Lama debacle. The problem the company has is that PL was destined to fill a gap in Barrick's future production and now cannot fulfill that task, therefore a replacement is needed. Barrick is at least in familiar territory as its Pueblo Viejo mine in the Dominican Republic is the closest comparative, geologically, to the Metates project.

Newmont – This company is much touted as a merger partner for Barrick, but in light of the troubled status of this mooted partner, such a merger would be negatively seen by the marketplace as a value-destroying. Newmont has, in recent times, sold out of its Mexican position to its partner there, Fresnillo. This company certainly has the resources, and the need to bring Metates to production. There are serious questions about the strength of its future production pipeline.

Freeport McMoran – this company is the most prominent gold/base-metal crossover stock. The company needs to balance further away from its Indonesian exposure and Mexico is a former playing field for Phelps Dodge, which was subsumed into Freeport during the last decade. The demands of being US-listed though mean investors have little tolerance for long development projects preferring plug-n-play.

Eldorado Gold – definitely in a lower size category than the other potential contenders. The company ran the La Trinidad mine in Sinaloa state until 1999. Returning to Mexico (and Sinaloa) would be the company coming full circle. Currently its stock price is battered, but a sale of its Chinese operations could free up capital for it to pursue Metates. As we have written elsewhere the company needs to focus down on its Latin American operations.

Agnico Eagle-Yamana – this pair are more likely to merge with each other than with anyone else at this point in time. Certainly if they did all merge together (consolidating the ownership of Osisko) then they would be a good cashflow machine and have the balance sheet to undertake a transaction like the undertaking of Metates.

Fresnillo PLC- this London-listed miner with a Mexican control group is the world's largest producer of silver from ore (primary silver) and Mexico's second-largest gold miner. The company is very cashed up and acquisitive. Metates is in the size category that Fresnillo is used to. As a "local group" it would also potentially be able to, tactfully put, arrange things more to its advantage than a foreign-controlled group might. The company has negligible financial debt on its books and had cash on hand of $154mn at the end of its last reported FY (as at Dec 2014).

Minera Frisco – a company that flies below the radar but has made waves in the past is Carlos Slim's mining venture. It paid US750mn to acquire some AuRico assets in 2012 and money is clearly not an object to one of the wealthiest men in the world.

Other possibilities may appear out of left-field but they are a lot less foreseeable than the companies just mentioned.

Goldcorp Still the Best Positioned

Any Venn diagram highlighting the connection between Chesapeake Gold and Goldcorp would show two

major points of intersection.

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.

It also bears mentioning that a major point in common is also the strengths in Mexico, a country that Goldcorp has as a key pillar of its production profile.

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

- ✓ Inexpensive to takeover in its entirety
- ✓ Familiarity with the story
- ✓ Confidence in the CEO
- ✓ Mexico being familiar territory
- ✓ Substantial size of gold reserve
- ✓ Greater than 25-year mine-life

Compared to any of the other potential buys out there, Chesapeake represents the best way of Goldcorp plugging a production gap 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.

In early March, Goldcorp announced a series of changes in senior leadership, with the company saying it is exiting an intensive project-development phase and focusing on optimizing performance of its mines and advancing an organic project pipeline. This was probably the reason for Chesapeake's stock price took such a beating, even though the revised PFS came bearing the promise of a more bite-sized capex.

Goldcorp claimed its new strategy was a decentralized management approach, with mine general managers empowered to act as business owners and be held accountable for maximizing returns on capital, while growing net asset value. The company's CEO, David Garofalo stated, "We will seek more efficiency in our operations and will reinvest into a robust pipeline of existing organic growth opportunities. We believe this strategic renewal offers the best potential returns with the lowest-risk profile". All "mom and apple pie" stuff.

The question here is as to which reading of tea leaves one believes. Russell Ball, executive vice president of corporate development and capital management, has become chief financial officer and shall carry out both roles.

Interestingly Charlie Ronkos, senior vice president for exploration, is also leaving to pursue other interests and the exploration office in Reno, Nev., will be closed. Primary responsibility for exploration activities will ostensibly rest with business unit leaders as part of Goldcorp's newly decentralized management approach. This implies the company won't do much of its own greenfields exploration, which by implication means it shall need to rely on outsiders to bring projects to fruition. Institutional investors always want to hear that majors have a pipeline and that is something that Goldcorp will need

to expand upon. Much depends on one's interpretation of the phrase "advancing an organic project pipeline". We have long regarded Chesapeake's Metates project as an extra-mural component of Goldcorp's organic project pipeline. Clearly others do not, so we shall beg to differ.

The company's management believes that a takeout price of over $400mn is fair value at current metals prices, particularly in light of the valuations on the more "challenged" projects of Seabridge and Novagold. However this would represent four times the current market valuation of Chesapeake, which is not a percentage premium over current 20-day VWAP that we can remember seeing before, even in the boom days. We also suspect that in line with trends in recent times whatever offer would be an all-stock offer in preference to cash. Goldcorp after all would only be paying for the part it did not already hold and then Metates would indisputably be part of Goldcorp's "organic project pipeline".

Randy Reifel – the Common Factor

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.

Risks

The prime risks we can envision at this stage are:

- A return to gold price weakness
- Ongoing caution by majors on large ticket projects they think may damage their market valuation in the short term
- Problems from the criminal cartels operating in the vicinity of the Metates project

The one risk this company does NOT face is financing as it is exceedingly well padded with funds. As for Goldcorp's actions, that factor is outside the control of the company.

As for the cartels they are "otherwise occupied" and the company has got on well with them thus far.

Conclusion

When the original PFS came out, naysayers 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 has rightly focused on "right-sizing" the project to suit the tenor of the times. The updated PFS is the result of that process and definitely more bite-sized, however still only for those in the top-tier of players.

While we can conjure with a variety of potential acquirers it is still apparent to us that Goldcorp remains

in the pole position to move on Chesapeake. The pace of takeovers should pick up now that gold is awoken from its slumbers. Big institutional shareholders will be pressuring majors on their pipelines and few of them have anything concrete they can offer over the next few years in way of added capacity.

In the size category where Goldcorp (and their ilk) shops, there is not much on offer. Chesapeake Gold looks like a key chess piece in the international gold asset game which, if bid for even at a multiple of its current market cap, would represent a significant and synergistic move by a major looking to plug a hole in future production goals.

We maintain a Long position in Chesapeake Gold in the Model Mining Portfolio with an unchanged 12-month target price of US$4.10.

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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