Hallgarten & Company

Corporate Action Coverage

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Duluth Metals (DM.to) Strategy: Long
Wallbridge Mining (WM.to) Strategy: Long

Key Metrics - Duluth Metals			2008	2009e	2010e
Price (CAD)	$ 2.50	Consensus EPS		n/a	n/a
12-Month Target Price (CAD)	$ 3.30	Hallgarten EPS		n/a	n/a
Upside to Target	32%	Actual EPS	($0.25)		
High - Low (12 mth)	$0.14-3.99	P/E	n/a	n/a	n/a
Market Cap (CAD mn)	$ 239.4				
Shares Outstanding (millions)	95.8	Dividend	n/a	n/a	n/a
Diluted	111.4	Yield	0.0%	0.0%	0.0%

Key Metrics - Wallbridge Mining			2008	2009e	2010e
Price (CAD)	$ 0.29	Consensus EPS		n/a	n/a
12-Month Target Price (CAD)	$ 0.50	Hallgarten EPS		n/a	n/a
Upside to Target	72%	Actual EPS	($0.20)		
High - Low (12 mth)	$0.06-0.39	P/E	n/a	n/a	n/a
Market Cap (CAD mn)	$ 33.3				
Shares Outstanding (millions)	114.7	Dividend	n/a	n/a	n/a
Diluted	143.9	Yield	0.0%	0.0%	0.0%

Duluth Metals/Wallbridge

Bait for Antofagasta

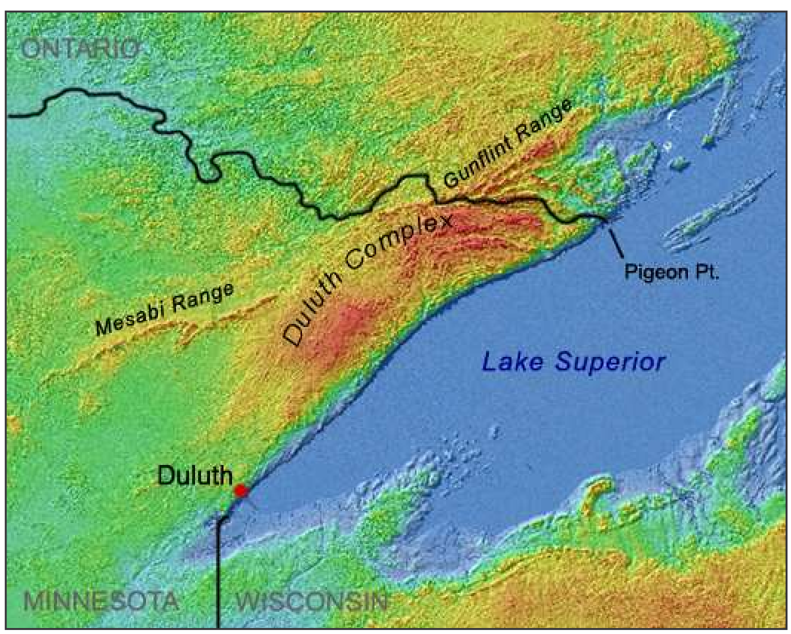
+ Duluth has been the recipient of a great vote of confidence in its Nokomis project when the base metal major Antofagasta signed a JV in January
+ The approval process for Polymet's neighbouring mine is now within sight of the finish line which should finally dispel whatever lingering doubts there may be about the "doability" of base metal mining in Minnesota
+ The Nokomis resource is sizeable, bordering on massive, which delivers substantial economies of scale and profitability at quite low metals prices.
+ The exposure to PGMs is relatively downplayed but could be a very profitable part of the project once producing
+ Duluth is vulnerable to takeover by Antofagasta… this a negative for management but not for shareholders

✘ The capex is very large at $1.3bn thus subject to conditions in the market place (unless Antofagasta which has access to such resources internally was full owner)

✘ It is being taken for granted that success for PolyMet in its environmental approvals will mean likewise for the other contenders, but this should not be taken for granted

✘ As a massive base metals project Nokomis is subject to the mood (and price) swings in the markets for those metals. While the project clearly works at copper sub-$2 per lb, this does not mean the market mood at those levels would favour funding projects no matter how profitable

Under the radar

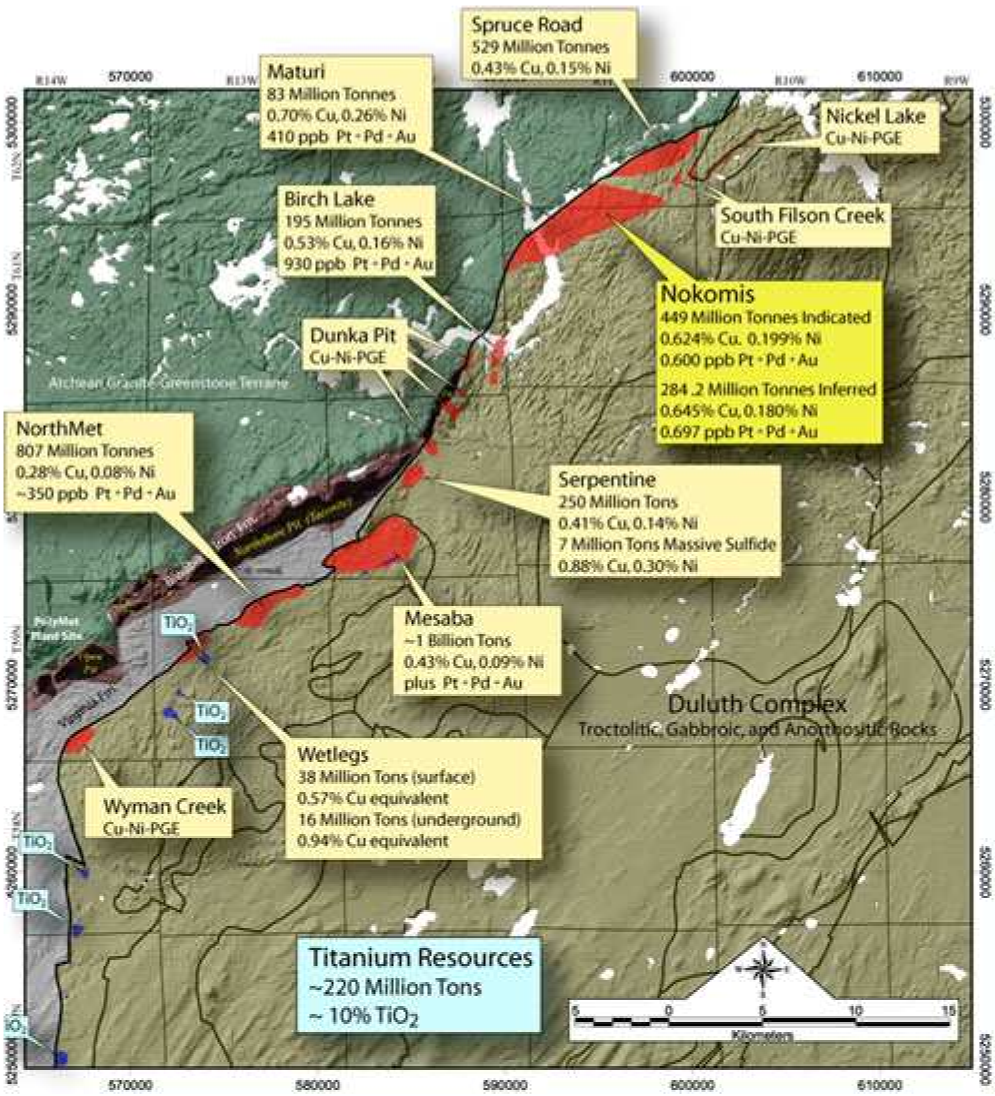


It is oft bemoaned that the world lacks major base metals projects to replace those that have peaked or are nearing exhaustion. While this is largely a truism, it is somewhat ironical that the US, a country in which large-scale base metals mining has been allowed to go to the dogs, excepting a few large legacy mines (such as Bingham Canyon), hosts not only a world-scale district but one that has scarcely been tapped. While Northern Minnesota is not new a s a mining zone, it has been the major source of US iron ore for nearly 100 years from the Mesabi Range mines, the base metals in the area's Duluth Metals Complex have scarcely been either recognized nor exploited.

The Duluth Complex hosts one of the world's largest undeveloped repositories of copper, nickel and PGMs. The Duluth Complex represents:

- the world's third largest accumulation of nickel sulphides
- the world's second largest accumulation of polymetallic copper and platinum group metals

The platinum holds a particular interest (even though it is one of the lesser highlighted items in the Duluth mix) because the Western World (and indeed China) are almost entirely dependent upon South Africa and Russia for PGMs.



Source: University of Minnesota, Duluth

The map above shows the principal deposits of the complex. Franconia Minerals (FRA.to) controls Spruce Road, Birch Lake and Maturi at the very north of the map, Nokomis (marked in yellow) is the property of Duluth Metals and NorthMet at the far left is the property of Polymet (PLM: Alternext). Teck (TCK: NYSE) owns the massive Mesaba open pit just to the north-east of NorthMet. Rio Tinto (RTP: NYSE) has a property, Tamarack, some 75 miles to the south west of Duluth, that is not covered by this map.

Duluth is not unknown to the cognoscenti of the base metals investing space. Indeed it has been a source of frustration for the glacial progress in recent years in the face of dogged environmental resistance by the forces of NIMBYism (largely Twin Cities-based) who have blanketed the whole region with a cloud on its future development.

We have had multiple interactions with the players in the space over recent months in various capacities. The key miners are Polymet, Franconia and Duluth Metals. We also had the broader overview and governmental input when Minnesota staged a mining day in NY several months ago.

Mining in Minnesota – or trying to..

Polymet has been the battering ram (and lightning rod) of the group. Its project, which is partially a brownfields' restoration and reactivation, is a massive open-pit base metals discovery. Polymet has come in for the greatest attacks by a group called The Friends of the Boundary Waters, who are essentially urbanites who take their leisure at the wilderness wetlands in the far north of the state. The projects of Duluth Metals and Franconia are likely to be underground so have not attracted the same negative vibes, though it is not clear whether dedicated NIMBYs can discriminate that well.

A torturous process of getting the environmental approvals for the Polymet mine has been going on for several years now. We suspect that having Glencore as a sugar daddy has saved Polymet from withering and dying during this process of attrition. However the end is now in sight. The government's initial report on the project came out in the last quarter of 2009 and an intensive process of public discussions began. The State government has shown itself to be strongly behind the project moving forward as unemployment is high and chronic in the regions where the new mines will be sited. We suspect that the foes of the development might have received more traction if it had not been for the current economic slump. Opposition to the projects now appears to the broader public like a battle between upper middle class urbanites and hardscrabble people who live in the zone where the mines are located. Not unsurprisingly those public meetings held in the mining district were strongly supportive of the developments. Even more surprisingly the massively attended Minneapolis meeting was overwhelmingly in support, with unions and urban supporters vastly outnumbering the naysayers. This has left the resistance in disarray and the Polymet project moves inexorably towards approval. Once that is out of the way, there can be little justification to quibble with the underground (and thus less intrusive) projects of Duluth and Franconia.

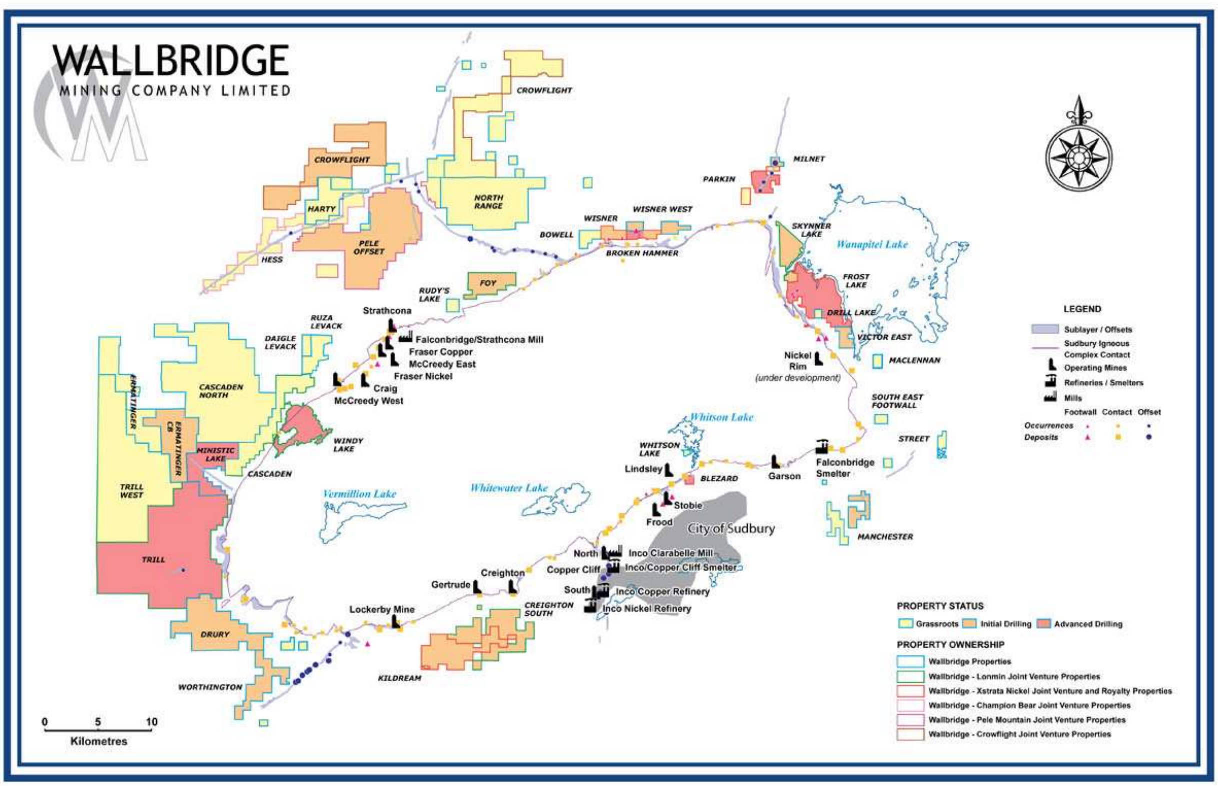
The Spin-out of Duluth

It might be useful though to begin with the origins of the two companies covered by this note. In October 2006, Duluth Metals began trading on the Toronto Stock Exchange as a result of a partial demerger from Wallbridge Mining. As a result, Wallbridge ended up owning 10 million shares of Duluth (around 22% of the then issued stock in DML). Existing Wallbridge shareholders received a dividend of one Special Warrant for every four shares of Wallbridge held. These Special Warrants converted to free trading shares of DML upon completion of its IPO. This resulted in Wallbridge shareholders owning a further 11,848,466 shares representing another 26% of DML.

The spin-out of Duluth Metals monetised Wallbridge's stake in the Maturi Extension (now renamed Nokomis) property from an embedded non-performing asset into a standalone company which initially had a market capitalization of around $50 million. Now the child outweighs the parent, but that is not to say that Wallbridge still does not hold the fate of Duluth Metals in its hands. The companies still have one common director in the form of Alar Soever who is the President & CEO of Wallbridge and a director of Duluth Metals.

Wallbridge Mining – in the shadow of Vale

So Duluth Metals was really the offspring of Wallbridge and is still in some ways connected to its erstwhile progenitor. Looking at the asset mix of this company we can see why it has flown under the radar of most investors. As a base metals explorer on the fringes of a massive base metals asset (Sudbury) that is no longer in Canadian hands the word that springs to mind is "overshadowed". This is not to belittle the assets that Wallbirdge holds but just to recognize that the current asset mix is "junior" in a number of ways. Indeed, the spin-off (Duluth) is far more advanced than the former parent. The company needs to raise serious amounts of money to move any of its Sudbury discoveries forward. The easiest way to do this would be exiting the Duluth position, instead it is increasing its holding via recent actions.



The company has a sizeable land position of approximately 71,000 hectares in the world's most productive nickel-copper complexes, the Sudbury Mining Camp. The complex has historic production of over 20 billion pounds of nickel and 20 billion pounds of copper. Wallbridge is focused on nickel, copper, gold and PGE exploration in Sudbury basin.

Wallbridge claims as its focus the under-explored footwall rocks of the Sudbury Mining Camp. It currently has 39 properties covering more than 705 square kilometers in the Sudbury Contact footwall rocks. These footwall rocks in the Sudbury Igneous Complex are deemed important as they contain the majority of nickel-copper-gold-PGE deposits found in this mining camp.

It points to its own Broken Hammer deposit, Trill Offset dyke and Amy Lake PGE zone, as well as FNX Mining's Levack Footwall and Rob's deposits, and Vale Inco-Lonmin's Capre 3000 discovery as evidence of the potential in these rocks.

Most of Wallbridge's Sudbury properties are being explored in joint venture with partners such as Vale Inco, Lonmin Plc and Xstrata Nickel. In addition, Wallbridge has acquired two additional North Range land packages from Pele Mountain Resources (a company we recently commented upon in our Rare Earths review) and Crowflight Minerals to increase its land position in the unexplored outer footwall rim of the Sudbury Basin.

Wallbridge also has four properties outside of the Sudbury Mining Camp. These properties are situated in the Swayze and Kirkland Lake greenstone belts within driving distance to Sudbury and include the Demorest, the Shipley, Hong Kong and Ben Nevis Properties. In addition, Wallbridge has acquired the Rogers Creek copper-molybdenum-gold porphyry property located about 40 kilometers south-east of Pemberton, in south-western British Columbia.

Active exploration work is ongoing on the following properties:

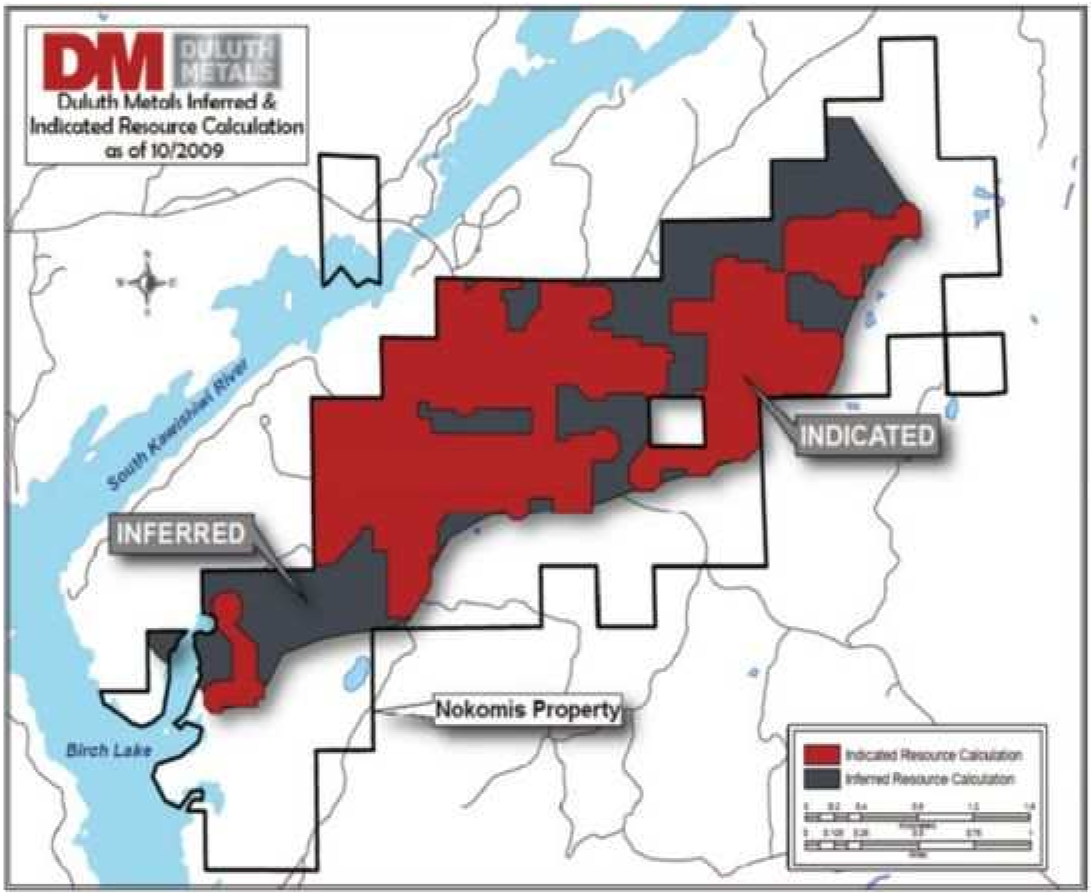
- Frost Lake (with Xstrata)
- Skynner Lake (with Lonmin)
- Wisner (with Xstrata)
- Trill (with Lonmin)
- Parkin (joint venture with Impala Platinum)
- Rogers Creek (100% Wallbridge)

The partnerships the company has put together are with international majors, showing the potential of these zones. As we note later on the totality of these non-Duluth assets are currently valued at a few millions of dollars by the markets.

Duluth Metals – worth the wait

The chief asset of Duluth Metals is the Nokomis copper-nickel sulphide deposit located in northeast Minnesota. In the company's opinion, sizewise, the total resource is comparable to the Sudbury Basin and Voisey's Bay, among the world's largest copper-nickel-PGM mining complexes. The property had seen historical drilling by Inco, Kennecott, Duval, Newmont and others on and adjacent to the property.

The Nokomis Deposit lies about 1,400 ft below surface and extending to depths of about 4,000 ft, and extends for approximately 2.1 miles along its known drilled-off extent. The deposit forms a tabular sheet of copper-nickel-PGM mineralization, hosted in troctolitic rocks resting on the lower contact between the South Kawishiwi Intrusion and the Giants Range Batholith granitic rocks. Typically, the highest copper-nickel grades are concentrated in the upper 100 ft of the main body.



	Metal	Indicated	Inferred
Base	Copper	7.75 Billion lbs.	3.82 Billion lbs.
	Nickel	2.43 Billion lbs.	1.25 Billion lbs.
	Cobalt	121.26 Million lbs.	60.37 Million lbs.
Precious	Platinum	3.11 Million ozs.	1.63 Million ozs.
	Palladium	6.93 Million ozs.	3.60 Million ozs.
	Gold	1.63 Million ozs.	0.80 Million ozs.
	TPM (Pt+Pd+Au)	11.67 Million ozs.	6.03 Million ozs.
	Silver	37.42 Million ozs.	18.10 Million ozs.

The most recent NI 43-101 compliant report on the Nokomis deposit states that it contains 550 million tonnes of Indicated Resources grading 0.639% copper, 0.200% nickel, 0.660 grams per tonne PGM (platinum-palladium-gold) for a copper equivalent (CuEq) grade of 1.51%, plus an additional 274 million tonnes of Inferred Resources grading 0.632% copper, 0.207% nickel, 0.685 grams per tonne TPM for a CuEq grade of 1.53%. The map above below shows the distribution of Indicated and Inferred resources .

Production metrics/expectations

Under the modeling done in the recent scoping study, prepared by Scott Wilson Roscoe Postle Associates, the Nokomis mine could produce up to 40,000 tonnes of ore per day, based on an initial 22-year mine life. This estimate is based on utilizing only approximately one-third of the currently identified resource, with 40% of the Nokomis property yet to be explored.

Thus the key new production metrics, going into the feasibility study stage, are:

- Ore production rate of 40,000 tonnes per day, or 14 million tonnes per year;
- Production of saleable copper and nickel metal via standard electrowinning, and production of cobalt and PGM-gold products to be shipped to refineries for final processing to metal
- 181.7 million pounds of copper per annum
- 42.3 million pounds of nickel per annum; and
- 251,000 ounces of platinum-palladium-gold per annum

Mining method:

- Underground mining by blasthole open stoping with partially recoverable pillars;
- Underground access by shaft and ramp;
- Underground ore handling by conveyor systems;
- Underground primary crushing, further crushing and grinding on surface;
- Transfer from mine to concentrator via 10 km slurry line;
- Agitated holding tanks at mill with a minimum capacity of 11,000 m3
- Flotation concentration, producing a bulk copper-nickel-cobalt-PGM-gold concentrate
- Hydrometallurgical processing using PLATSOL™ process
- A brownfields tailings disposal facility within three kilometers of the processing site.

CapEx is projected to be $1.332 bn. Clearly this is not a low-budget operation and we have seen no sign of scalability projections so presumably they are going for the full build-out the first time around.

Production costs are naturally advantaged by the economies of scale from the substantial daily throughput that is now being envisaged.

Operating Costs – Nokomis Mine	**40,000 tpd**
Mining	$12.02/tonne milled
Slurry Pipeline	$0.87/ tonne milled
Concentration Process	$3.92/tonne milled
2nd Stage Process	$5.04/tonne milled
GS&A	$0.87/t milled

The Nokomis project is located near international ports and good mining infrastructure such as power, well-developed roads, railway networks, supply-equipment centers and a local labor force.

In a move showing foresight, and extreme confidence, the company entered into an exclusive option agreement in early 2008 to purchase the 1,845-acre Dunka brownfields site (approximately four miles southwest from the Nokomis Deposit) from Cleveland Cliffs with a view to using the mined out iron ore pit (for tailings impoundment), water (for operational processing), access to rail, access to power, area for plant sites, and working active (treatment plant) and passive (wetlands) water treatment systems.

We expect copper prices to stay above $2.50 through most of the upcoming process of feasibility studies and financing of the mine while nickel we expect to maintain its current levels. PGMs should continue to improve in price while gold, in our opinion, should remain in the $950-1150 range. Silver we expect to retreat to the $14 level and largely stay below $16 per oz. All of these levels bode well for the advance of his project.

Eye to the North

In the company's documentation it states coyly: "The Cu-Ni-PGE mineralization in the Nokomis Deposit extends in part, onto property that adjoins the Company's properties on the northwest. As such, the Cu-Ni PGE mineralization was modeled using drilling and assay data from the Company's Nokomis Property as well as drill hole information from historic drill holes both on and off the property located along its northwest boundary. Resources have been estimated from the northwest boundary of the Nokomis Property at a minimum depth of approximately 130 m to a depth of approximately 1,300 m on the properties". This observation was elaborated upon more at the lunch we attended and in fact refers to the property of Franconia Minerals. Franconia (with a market capitalization of around $36mn), while still partnerless at the dance, is by no means destined to be a wallflower and probably represents the cheapest access point still available to the Duluth Complex. We were not surprised by DM's focus on what really appears to be the northern extension of their asset.

The Antofagasta Deal

In a bolt out of the blue that electrified the awakening trio of miners hoping to be the next big thing in Minnesota in mid January, Duluth Metals announced a Joint Venture with the Chilean copper mining major Antofagasta plc. This JV relates to the development of the large scale Nokomis Project in northeast Minnesota, USA. The joint venture provides the execution and financing capabilities required to move forward the project to production.

The terms of the agreement, in principal, are:

- Under the Joint Venture Duluth will contribute the Nokomis Project and approximately 5,000 acres in the Duluth Complex for a 60% interest in the joint venture, with Antofagasta to acquire an initial 40% interest
- Antofagasta holds the option to acquire an additional 25% of Nokomis from Duluth at an exercise price calculated on a pro rata share of 1.0x Net Asset Value, which will be determined by the Bankable Feasibility Study

- Antofagasta will provide US$130 million in direct funding to the project in consideration its 40% interest in the joint venture
- Thereafter, if Antofagasta elects to proceed with the further funding of the project and to maintain its 25% Option, Antofagasta will disproportionately fund 65% of the joint venture expenditures and Duluth will fund 35%
- Antofagasta has agreed to provide Duluth with up to US$30 million in additional funding to cover Duluth's share of subsequent project expenditures, which will ultimately be repayable in cash, Duluth shares or offset against the 25% Option exercise price
- Antofagasta is subscribing to a private placement of Duluth shares for approximately US$11.6 million
- The combination of the initial funding commitment, private placement and incremental funding from Antofagasta ensures that up to US$227 million of funding will be available to advance the project with Antofagasta involvement, before any additional funding would be required from Duluth
- Antofagasta has also committed to pursue project financing, on a common basis with Duluth in respect of the large development capital cost financing requirements of the project.

This joint venture provides three key benefits that will act as catalysts to the development and construction of Nokomis. First, it delivers near and longer-term project development financing that we expect will be sufficient to bring the project to production. Second, Antofagasta is providing a commitment to arrange project financing for the large capital cost requirements, which are projected to be US $1.3 billion by the latest Scott Wilson RPA 43-101 Preliminary Assessment. Third, it brings outstanding execution capability and mitigates execution risk."

Duluth expects development activities at Nokomis to proceed on an accelerated basis, and anticipates pre-feasibility and bankable feasibility studies to be completed within 36 months.

Antofagasta's funding and financing commitments are subject to certain terms and conditions, including the execution of a definitive participation and shareholder agreement. Duluth anticipates these conditions to be satisfied during the second quarter of 2010.

Duluth completed a private placement of 6 million shares of its common stock, or approximately 7% of (the then) outstanding shares, to Antofagasta plc at a price of CAD$2 per share, resulting in gross proceeds to the company of CAD$12 million (approximately US $11.6 million).

Antofagasta – memory lane

Maybe it dates us to say it, but we started covering Antofagasta in the mid-1980s. Back in those days the annual meetings of what was a railway company that connected Bolivia to Chile with side assets in mining and banking (Banco O'Higgins in Chile) were intimate affairs for a few hardy investors held at the Great Eastern Hotel above Liverpool Street Station, a stone's throw from the firm's offices on Finsbury Circus where the railway had been ensconced for nearly 100 years. Philip Adeane, scion of the family that had long run the company fronted the company in London was the host of the events but Andronico Luksic, *patron* of the Chilean family of Croatian extraction, that had taken control in the previous decade presided inscrutably over the events. Those were the days.

Antofagasta plc, now with a US$16bn market capitalization, still has its main listing on the London Stock Exchange and is a constituent of the FTSE-100 index, a far cry from its small-cap days when we first adopted it. The company these days has interests in mining, transport and water distribution. Antofagasta Minerals, the mining division, now overshadows all the other parts and is one of the world's largest copper producers. Its activities are mainly concentrated in Chile where it owns and operates three copper mines with a total production of more than 478 thousand tonnes of copper per annum. Its principal mining assets include the Los Pelambres, El Tesoro and Michilla mines and the Esperanza and Antucoya projects in Chile and the Reko Diq joint venture in Pakistan.

Looking forward the company' s Esperanza Project is expected to add around 200,000 tonnes of copper and 230,000 ounces of gold to production from 2011 onward. Reko (in partnership with Barrick) is in relative pioneer territory at the far end of the Tethyan Belt. Like many other pioneering efforts, its outlook is subject to discussion. Complications are not in short supply.

The company also has exploration programs in Chile (mainly in the Sierra Gorda district), Latin America, Europe and Africa. The Duluth deal is the first excursion, of note, into North America.

Keeping up with the Joneses

An interesting codicil to the Antofagasta transaction was an announcement on the January 28, 2010 that Duluth Metals has privately placed 7,456,420 common shares with Wallbridge at a price of CAD$2 per share, resulting in gross proceeds to Duluth of approximately CAD$14.9 million. The shares were issued to Wallbridge pursuant to a pre-emptive right previously granted by Duluth, which gives Wallbridge the pre-emptive right to participate under certain circumstances in future issuances (such as that to Antofagasta) of common shares of Duluth. The purchase was financed under a bridge financing and the subsequent sale of 5,172,500 of Wallbridge's existing Duluth shares to institutional investors, which generated sufficient funds to affect the purchase. This latter transaction(s) seemed to have taken place on the 25th of January when the price was around $2.85 per share, giving Wallbridge a tidy one-day cap gain.

As a result of these transactions, Wallbridge increased its holding in Duluth Metals from 10,000,001 shares to 12,283,921 shares, representing approximately 12.9% of the issued and outstanding shares of Duluth Metals.

In a curious round of catch-up, as a result of the issuance of shares to Wallbridge, Antofagasta consequently has the right to purchase up to 550,939 common shares of Duluth at a price of CAD$2 per share, pursuant to a similar pre-emptive right granted by Duluth to Antofagasta pursuant to the January 14, 2010 private placement, which gives Antofagasta the right to participate under certain circumstances in future issuances of common shares of Duluth.

By our calculations (in light of the September30 cash balance of $800K and the proceeds of a $1.6mn raise in January 2010) Wallbridge is still not particularly flush with cash, helping to explain why it is so dependent upon JVs to move its non-Duluth projects forward.

The Valuation Scenarios

The company has put forward three valuation scenarios that are worth repeating and expanding upon. These are:

- Low-Price Case - reflecting recent low metal prices of 1.55/lb Cu; $4.90/lb Ni; $10.00/lb Co; $795/oz Pt; $295/oz Pd; $600/oz Au.
- Base Case - same base case prices used in the previous Technical Report (January 2008 PEA), based on long-term average price forecasts of the past several years. ($1.75/lb Cu; $7.00/lb Ni; $10.00/lb Co; $1,100/oz Pt; $350/oz Pd; $600/oz Au)
- Market-Price Case - prices as of January 13, 2008 (the date of the previous Scott Postle model namely $3.31/lb Cu; $12.70/lb Ni; $47.00/lb Co; $1,559/oz Pt; $376/oz Pd; $895/oz Au))

The CapEx and output parameters were the same for all cases:

- CapEx of US$1.332bn
- 40,000 tpd throughput
- 181.7 million pounds of copper per annum
- 42.3 million pounds of nickel per annum; and
- 251,000 ounces of platinum-palladium-gold per annum

These scenarios produced the following financial outcomes…

	Low Metal Price Case	Base Price Case	Market Price Case (as of Jan. 13, 2008)
Undiscounted NPV	$4.901 Billion	$8.214 Billion	$20.983 Billion
Net Present Value @ 10%	$672 Million	$1.598 Billion	$5.144 Billion
Average Annual Cash Flow	$283 Million	$434 Million	$1.014 Billion
Internal Rate of Return (IRR)	16.20%	23.00%	41.40%
Payback Period	6 years	4 years	2 years

At the low metal price scenario we doubt the mine would be built. This is not due to the economics, as they are obviously robust, but due to the inevitable funk into which investors and financiers would be thrown should prices retreat to these levels. This is the type of thinking that made for the tight copper market of recent years due to underinvestment (and lack of capital) during the low price years.

Looking at the base price case the copper assumption is the type of thing that would give investors nightmares also. Thus if the project works at $1.75 per lb copper (and work so handsomely) then Duluth's project is attractive indeed. Though there would be a struggle to finance if copper was back under $2 because most players, spoiled by seeing $4 per lb copper in 2008, are now not content with the outsized gains that low cost producers can still make below $2 per lb.

We are not sure why the company resuscitated the “market price” model when it is so patently out of date. The only realistic expectations one can have, in our view, for the components are in the “lesser” output items e.g. PGMs and Au. The current gold price is also significantly above all the model levels and almost certain to stay there. We would not be surprised to see the PGMs near their past highs if the global auto industry ever gets off its back again. Copper though recently passed the $3.31 per lb level both going up and coming down. This was largely China buying. However, a good number to use might be some midpoint between the base model’s $1.75 and the current price around $3.20 per lb.

In any case the valuation one might put on the project would be somewhere between the base price scenario and the 2008 model. The payback, at some midpoint therein would be a stunningly short three years for such a substantial investment. That might give financing bankers comfort at night.

A rather simple arbitrage equation

At the current price around $2.51 per share, Duluth has a market capitalization of CAD$240mn. Wallbridge currently has a market capitalization of CAD$34.4mn. Wallbridge owns 12.9% of DM, which is thus worth CAD$31mn. Thus all the other assets of Wallbridge and its cash are worth around CAD$3.5mn in the market’s current estimation of the worth of Wallbridge. By any estimation WM represents a cheap access point to Duluth Metals.

The way Duluth hopes it will play out

We recently met with Duluth Metals in the days following the Antofagasta deal. The stock was riding high (having briefly touched $3.99) and the mood was bullish indeed. A long process of negotiation had finally born fruit and lifted Duluth into a position where it could conceivably launch itself on the back of Nokomis into the league of medium sized base metals miners.

For its initial 40%, Antofagasta will be putting in $130mn, which gives a grossed up value of $325mn to the project in its current state and values the Duluth portion at $195mn. After the BFS is in then Antofagasta has to step up to the plate and buy an extra 25% (to get up to 65%) or else it has to fund the project as if it owns 65% while still owning only 40%. However acquiring the 25% thereby financially enables Duluth to move forward with its 35% of the costs. However, by holding off from exercising the option on the 25%, Antofagasta ends up investing the same amount either way in the project but puts a financial strain upon Duluth.

The big issue here is how much of the project will be debt and how much will be equity. Obviously Antofagasta throwing its weight behind any loan arrangement (by guaranteeing it) gives Duluth a payday with little dilution and little risk carried by the smaller partner. Antofagasta pushing to have more equity and less debt in the funding mix (and remember the amount in question is over $1.3bn, of which Duluth’s share is 35% at least) would put severe pressure on Duluth. Assuming that the project has its initial $227mn in funding that still leaves $1.1bn to fund. If half of this is debt, then Duluth’s share of the equity portion would be over $150mn. Duluth has cut itself a hard bargain with the Chileans. Maybe too hard…

The Latin way

The first thing we thought of when seeing the Antofagasta transaction with Duluth was, unfortunately, Hochschild. This was clearly not the thought that ran through Duluth's mind when it did the transaction. However long experience in LatAm leads one to consider the historical experience of outsiders with large cap miners owned by Latin American families. There are not many examples to draw upon but a few names come to mind, Grupo Mexico, Peñoles, Hochschild and Antofagasta. Of these the one with the best, indeed unblemished, reputation is Antofagasta. Ask shareholders of Southern Peru Copper (or the liquidators of Asarco) for comments on Grupo Mexico, ask MAG Silver for comments on the Peñoles spinout Fresnillo, ask Minera Andes and International Minerals for comments on Hochschild. Don't ask Rob McEwen for comments on Hochschild for he will tell you in no uncertain terms that they are "the worst nightmare of a joint venture partner". Indeed "partner" is not a good word for Hochschild, maybe "dominatrix" would be more apt. Finding a junior partner to comment on Antofagasta is a thankless task because the company has always had big partners and thus companies that are harder to push around. BHP and Barrick are not partners one tries to strong-arm.

Reality intercedes at this point. In one corner of the ring we have Antofagasta with a $16bn market cap and in the other we have Duluth with $240mn and a smallish amount of cash. Much as we like the prospects for Duluth's project we wonder how long Antofagasta will hold back from making a move upon the smaller party particularly as the project starts to move forward. The temptation for the Chileans to make a move will be great indeed. Duluth reassured us that there is a clause that limits Antofagasta from building up a larger position in Duluth without the company's approval.

We somehow suspect that the aforementioned clause does not stop the Chileans from acquiring Wallbridge and thus checkmating any other suitors, in the short- or long-term, for Duluth Metals. How much to pay for Wallbridge? Being Australian, English, South African or Chilean the answer is "as little as possible". Being Canadian the answer is "whatever the target wants"… Alas for the target Canadians are not involved on the buy-side of this deal. An offer of 50 cents for WM shares would give Antofagasta nearly 20% of Duluth (when including its existing holding) for an expenditure of a tad over CAD$50mn. Would Wallbridge shareholders baulk? Why should they? Its 66% more than the current market price and WM basically represents an option on Duluth anyway. If they like DM that much they can now redirect their newly-gotten gains to buying Duluth shares directly. The only party disgruntled by all this would be Duluth as its "standstill" agreement would not be worth the paper it was written on. Antofagasta would have a larger participation than management and could conceivably take some, or all, of the director's seats at Duluth. And, even worse, without even firing a shot… Who is to stop them?

Would Antofagasta do this? Well, why not? Latin American *empresarios*, in our experience (and this goes beyond the mining sector – having played the role of lamprey to a Mexican billionaire shark in the 1990s) are not prone to regarding $240mn companies as their equals when they are worth north of $10bn themselves. In Latin America ownership accrues from holding 51% or more of one's enterprise. There is method in the Luksic's "madness" in owning 63% of the equity of Antofagasta. It has made them very wealthy indeed. Thus managements who only own a mere few percentage points are not only regarded as insignificant but uncommitted. Be afraid… be very afraid..

That is not to say that Duluth's management will experience any rough justice at the Chileans' hands. However, if they are pining for the day that their own stock has a $2bn market capitalization, they are not thinking clearly and definitely not thinking like a Latin high net worth. They will be taken out well before that day. Thus our feeling is that investors positioning themselves in Wallbridge will get “first bite of the apple” when Antofagasta moves on that vehicle and can then get a second payday by switching to Duluth and waiting for the inevitable takeout by the Chileans.

Risks

The prime risks here are metals prices and non-performance by the JV partner. Firstly, The project is highly dependent on the copper and nickel prices. A collapse in either would potentially put the property back in a holding pattern. It is clear that the project can fire on one cylinder but whether the financiers would be so sanguine when the budget and borrowing need is so high is hard to imagine. The models show the project viable and profitable at copper prices below $2 but a slide back to this territory would signal global economic problems that would transcend the attractions of any individual project anywhere and lead to its mothballing.

The potential for non-performance by the partner is two-fold. The main one being linked to a perception of near- and mid-term base metal pricing. Being a major player in copper, Antofagasta has probably better intelligence than most on that space and would thus be expected to have a better grasp of potential supply and demand beyond the radio noise that comes from pundits in the space. Thus if Antofagasta took a negative mid-term outlook on copper the project could be slowed to a near halt. Duluth would have little remedy if its partner just maintained the minimum level of contribution to maintain within the JV’s conditions.

The second reason that the partner could go slow is to put a squeeze on Duluth. This might ultimately good for shareholders but not if it were to degenerate into something like the standoff currently seen at Minera Andes in its struggles with Hochschild.

We would not regard a move by Antofagasta upon Wallbridge as a negative for Duluth shareholders, even though it may not be the outcome Duluth’s management would hope for.

Conclusion

The Duluth/Wallbridge combo is essentially an arbritrage play. It is not even worth us speculating upon potential earnings for Duluth as the project, with the best will in the world, will not be producing within any useful earnings horizon such as two or three years. Moreover we doubt Duluth will be around, or the owner of Nokomis, when the first metal is trucked out.

What goes on inside the mind of the Luksic family? This must be a key question. At our meeting with Duluth the hard question of relations going forward was brushed aside with a lot of consequence being given to their success at the lengthy negotiations on the JV. Duluth had better hope that Antofagasta play nice and believe in a fair deal for all. Then again opinions may differ on what is a fair deal. We are confident that the upside for Duluth is substantial but 35% of the equity in a project worth around $3bn (a mid-point between the second and third scenarios) would make Duluth’s share worth over $1bn or four times its current market cap. We suspect they think their part is worth even more than that. Antofagasta may also think so and want to bring that potential asset appreciation in house. We would note that from our initial contacts with Antofagasta back in the mists of time the appreciation from

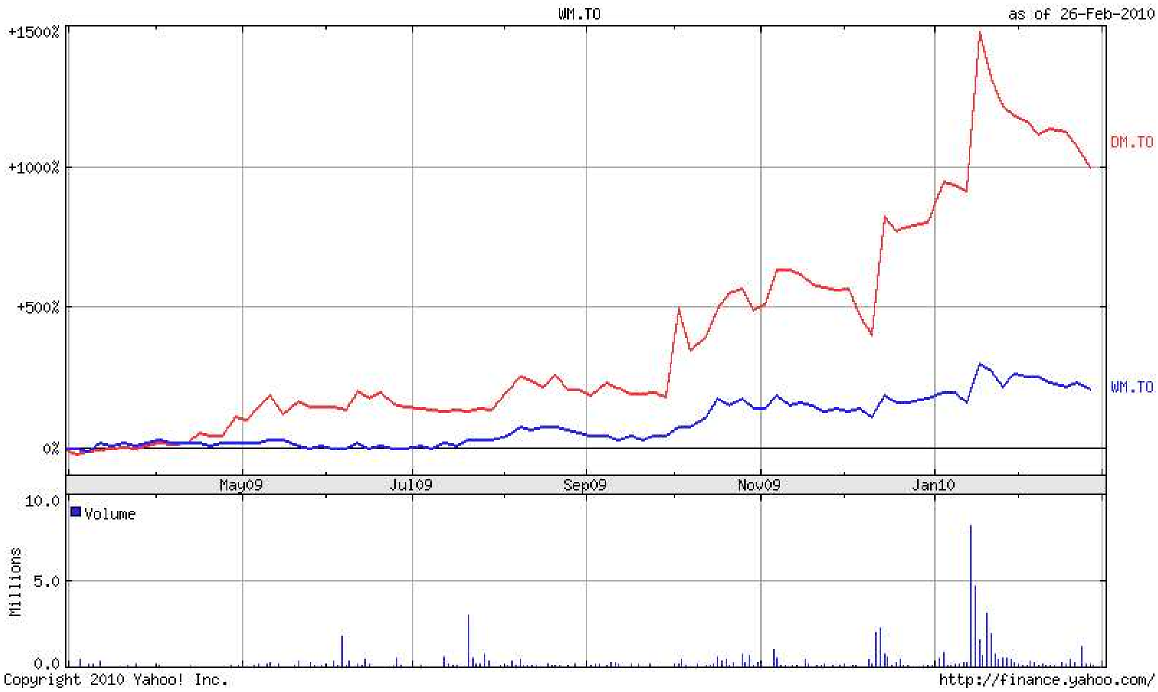
GBP100mn market cap to its current levels was largely achieved organically and its is stunning that the company should have achieved so much with essentially the same assets it held over 20 years ago.

The Nokomis project has broken away from the pack of the endless stream of Canadian owned projects that never move forward and are just meal-tickets for their managements. With Antofagasta on board there will be no fooling around at Nokomis. This means that the stream of announcements should accelerate once the feasibility study gets underway. Beyond these internal stimuli, there is any progress that PolyMet makes which should reflect well onto Duluth (and Franconia). Duluth is currently in a denouement phase after the quantum leap that the JV represented. This represents a good moment to position in both Wallbridge and Duluth for the eventual news build-up.

At current levels both Duluth and Wallbridge look like they are attractively priced (though everyone would have preferred to have entered the former at its 12 month low of 14 cents). Looking forward we would frankly prefer to hold Walbridge shares given a choice between the two. Both companies though are rated as **Buy** calls by us with a twelve-month target price of 50 cts for Wallbridge and $3.30 for Duluth Metals.

The chart above shows the “denouement” of the Duluth share price after its initial flurry of excitement (and the selling pressure from Wallbridge selling its “old” position to fund buying its “new” position.

The chart below shows that the recovery in Wallbridge has not been proportional to the evolving good fortune of Duluth. This implies that the market is not fully grasping the strategic value of its Duluth stake.



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